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Additional Information

Level 1 Regulation
Regulation 648/2012 - OTC derivatives, central counterparties and trade repositories (EMIR) - CCPs

Level 2 Regulation
COMMISSION DELEGATED REGULATION (EU) No 153/2013 Regulatory technical standards on requirements for central counterparties

Topic
EU-CCPs

Additional Legal Reference
Art 41 of EMIR 648/2012 and Art 24 of RTS 153/2013

Subject Matter

Calibration of confidence interval for CCP margin requirements

Question

We would appreciate to clarify the two issues referred below in the context of the calibration of the confidence interval for CCP margin requirements.

Q1. Article 24(1) of Commission Delegated Regulation (EU) No 153/2013 (RTS on CCP requirements) sets out the minimum confidence intervals for the calculation of the initial margins of a CCP to 99,5% for OTC derivatives and 99% for financial instruments other than OTC derivatives. Can a CCP rely on the back testing performance of its margin model as sole proof of compliance with Article 41 of EMIR and Article 24 of the RTS on CCP requirements?

Q2. If a margin model has several components, does each component need to be calibrated to the confidence interval set out under Article 24 of the RTS on CCP requirements?

ESMA Answer

03-01-2025

Original language

A1. No. Article 41 of EMIR, and the related Article 24 of the RTS on CCP requirements, contain several requirements on CCPs, including to impose, call and collect margins, to specify what the margin requirements shall cover, as well as to list what the adopted models and parameters shall capture.
Pursuant to Article 41 of EMIR and Article 24 of the RTS on CCP requirements, the CCP must calculate forward-looking initial margin requirements using a margin model designed to anticipate potential future exposure ex-ante to meet at least the required confidence interval. To note that Article 41 and the related Article 24 of the RTS on CCP requirements establish that a CCP shall calculate the initial margins to cover the potential exposures arising from market movements for each financial instrument that is collateralised on a product basis, over the time period defined in Article 25 of the RTS on CCP requirements and assuming a time

horizon for the liquidation of the position as defined in Article 26, respecting at least the confidence intervals of 99,5% for OTC derivatives and 99 % for other financial instruments.

Furthermore, according to Article 47(1) of the RTS on CCP requirements, a CCP shall conduct a comprehensive validation of its models, methodologies and liquidity risk management framework. In the context of such comprehensive validation and in accordance with Article 47(3) of the RTS on CCP requirements, a CCP must ensure (inter alia) the conceptual soundness of its models. To do so, the CCP must ensure that the method applied for calibration is consistent with the model to which it is applied.

Hence, relying solely on back testing as sole proof of compliance with Article 41 of EMIR, and the related Articles of the RTS on CCP requirements (including in particular Article 24) would not be sufficient as the requirements are wider in scope and cover several aspects as noted above. In addition, and more importantly, the results/outcome of applying the back-testing model(s) is limited and does not provide assurance of the model's future performance. Therefore, it would not be sufficient to comply with Article 41 and the related Articles under the RTS of CCP requirements. In other words, there needs to be an overall sound and detailed explanation as to what the expected results/outcome of the application of the model would be and evidence how the model is envisaged to meet the requirements, including the required confidence interval in the future.

Example: Where a CCP relies on the computation of initial margins on a parametric distribution with very fat tails, calibrated to a 98% confidence interval, the model may generate initial margins levels higher than the 98% quantile of the empirical distribution of observed returns, and may result in a 99% back test performance. However, such model could not be considered as sound where the outcome of the model is not consistent with the input parameters. In addition, such a model provides no indication of how future margin requirements will continue to meet the requirements under Article 41, including confidence intervals.

A2. Where the initial margin model consists of a number of components that need to be used together to capture the price movements of a cleared product, and where the results of the risks covered by these components of tradable risk factors cannot be isolated, then such individual components should not be calibrated separately to meet a confidence interval according to Article 24 of the RTS on CCP requirements. For the avoidance of doubt, the total assessed margin requirements shall meet the required confidence interval set out in Article 24 of the RTS of Requirements, as explained under Question 1.

However, where a margin model decomposes the computation of the initial margin in a way that isolates tradable risk factors using trading strategies, each tradable risk factor needs to

be calibrated at the appropriate confidence interval.
Example: If a CCP decomposes interest rate risk in risk factors such as level and curve, and since such risk factors can be isolated respectively by an outright 5Y swap and a unit portfolio with long 5Y and short 10Y swaps, each of level and curve risk factor must be calibrated at 99.5%.

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