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| 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.

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**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 | European Federation of Energy Traders (EFET) |
| Activity | Other Financial service providers |
| Are you representing an association? |  |
| Country/Region | Europe |

**Introduction**

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

<ESMA\_COMMENT\_APC\_00>

EFET welcomes this consultative paper as it addresses the margin models and tools to be used and applied by Central Counterparties (CCPs) in times of stressed market conditions, including high price volatility.

Since the beginning of 2020 the worldwide energy market has been suffering from several negative implications, particularly the coronavirus pandemic. The situation has worsened now with the current Russia/Ukraine crisis. Energy markets are experiencing unprecedented price levels and price volatility.

Non-financial firms participate in the energy markets to cover their supply and demand and to execute transactions to mitigate the market risk of their commercial activities (hedging). For example, the operator of a gas fired power plant must hedge its commercial risk (market risk), which consists of the constant change in value of the gas procurement and of the produced power. For these purposes, energy market participants trade on wholesale energy markets and in particular in centrally cleared, regulated markets.

The higher the level of prices and the greater the volatility in price, the higher will be the size of the collateral collected to cover that risk. As the collateral provided by market participants to clearing members is predominately cash, this can create a significant liquidity management challenge for market participants (and for energy corporate firms in particular). In high volatile periods margin calls may be issued several times within a day to cover the risk caused by extreme intraday market price movements.

Therefore, EFET would welcome improvements in the margin processes of centrally cleared markets, amongst others regarding APC tools, as following:

* **Transparency of risk models to enable market participants to better replicate resulting margin requirements:** Increase transparency and accessibility of initial margin models and calculation tools: EFET recommends that CCPs should make margin models and calculation tools more transparent and accessible to the clients of the clearing members, in order to increase at all levels the ability to predict and plan for market stress scenarios and resulting impacts on margin requirements.
* **Predictability of market scenarios:** helps to better prepare for upcoming margin requirements in normal and stressed market conditions: Market participants need real-time “as-is” margin calculation tools that help to verify short term liquidity demand. In addition, they need to be able to run “what-if” scenarios to be prepared for further extreme markets conditions (high volatility) and their impact on liquidity planning.
* **Higher responsiveness to market conditions should allow to mitigate the impact of volatility on liquidity demand:** CCPs have specific rules to update margin parameters depending on market conditions. The frame is given by the EMIR regulation and subsequent acts. There is no doubt that margin requirements need to follow daily price changes, but CCPs should have more flexibility to adjust models regarding projection on volatility especially during stressed market conditions to mitigate impact on margin requirements and liquidity demand.
* **A wider choice of eligible non-cash collateral** will help to reduce impact on liquidity risk. This requires a change in EMIR, as EMIR defines the list of eligible collateral that CCPs may accept to be posted as Initial Margin. The clearing members (usually banks) widely use cash and securities (e.g., bonds) to cover CCP margin requirements, which have to be subsequently collected from their clients. In stressed market scenarios which increase the demand towards liquidity, clearing members would need to offer additional alternatives to cash to cover at least a partial amount of the margin requirement, for example non-cash backed bank guarantees issued by investment grade banks or EU Allowances (EUAs).

Regarding the timing of this consultation, EFET wonders whether this is the right moment to consult on APC at European level, given the work at international level and the ongoing market volatility resulting from the geopolitical events in Europe are still ongoing.

<ESMA\_COMMENT\_APC\_00>

**Questions**

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

<ESMA\_QUESTION\_APC\_01>

EFET agrees that CCPs should be able to explain and justify their APC tool choices.

More generally, EFET recommends that CCPs make margin models and calculation tools more transparent and accessible to the market participants respective clients of the clearing members, in order to increase their ability to predict and plan for market stress scenarios and resulting margin requirements. This covers APC tools but also the following points:

* Improvement of transparency via better accessibility (contemporary IT platform, API connection) to well explained risk models and margin calculation tools of CCPs;
* More educational efforts by CCPs on margin practices, both in normal and stressed market conditions, highlighting on specific means used to respond to extremely stressed markets, e.g. stress test scenarios, addition of concentration and/or supplementary margins;
* Consultation of market participants on risk model design and review, as their deep expertise on commodity risk management models could be better exploited;
* To increase visibility on which APC tools have been used, in which situations by CCPs and which effects or benefits they had.
* Standard term sheets about CCPs rules and conditions would help to increase readability of the main characteristics of CCP models. This would also ease the comparison between CCPs when it comes to identical products.
* CCP risk model design and review: this requires very specific knowledge, e.g. financial quantitative experts. One idea could be to introduce the need of having a sort of independent control for CCPs, potentially in a defined frequency by an independent institute. This would support the discovery of weaknesses and areas that are not covered well, e.g. the level of overcollateralisation applied.

Regarding the details of APC tools, EFET recommends that CCPs should provide information to their clearing members and market participants whether current margin rates are driven by the model or by APC tools, and to which extent. This information will normally differ for each CCP, depending on their APC tool, or mix thereof.

CCPs using floors should disclose whether the margin rates are driven by the floor or the shorter-term-model.

* If a CCP is using a margin buffer, the CCP should disclose the current size of the buffer.
* If a CCP uses stressed scenarios in the lookback period, the CCP should disclose the percentage of losses driven by recent (non-stressed) scenarios outside the confidence interval.
* If a CCP uses filtered historical simulations, the CCP should disclose the current volatility in order to scale the value at risk (VaR) output.

<ESMA\_QUESTION\_APC\_01>

1. : 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>

EFET agrees that CCPs should be able to define their own APC thresholds for margin changes based on their risk appetite/tolerance. This would allow to apply models which are suitable to the specifics of the product classes to which the APC tools are applied too. EFET subscribes to the opinion that APC tools should help reflect the real risk related to changes in prices and volatility more than simply following strict and conservative risk models.

The choice made by CCPs should be regularly reviewed and explained via clear description and documentation, including the benefits achieved by using (or not) specific APC tools. For example, if a CCP decides to apply a certain level of over-collateralisation on own discretion, the calculation behind it needs to be explainable.

CCPs have to follow specific strict but reasonable rules to ensure the stability of the risk managed clearing system especially with regards to the update of margin parameters under any market conditions, normal or with high price volatility. The framework of risk models and APC tools is indeed ruled by EMIR regulations and, whereas there is no doubt that margin requirements need to follow daily price changes, CCPs should have more flexibility to adjust their models and APC methods. CCPs should be able to choose thresholds on own discretion, for example regarding the forecasting on volatility, especially during stressed market conditions. This would considerably mitigate the impact on margin requirements without increasing credit risk, as CCPs’ adjustment would rely on high expertise on related markets and products.

This means giving CCPs higher flexibility regarding the adjustment of the volatility component of the IM parameters (forward looking scenario). For example, CCPs could adjust projection on volatility from models based purely on changes in percentages to a combination of percentages and cap amounts.

CCPs could still calibrate parameters used according to product specifics, market, volatility, seasonal effects or concentrations. This will ease the replication and forecasting of margin calculations, also for simulations in case of planned changes in the various positions. Previously, all CCPs were using SPAN, but now each CCP is developing its own methodology in order to create competitive advantages, which stresses the need to receive access to risk models and the calculation of what-if scenarios even more..

To sum up, EFET would welcome a change in regulations that would allow CCPs to exercise their independent risk management ability, given the increasingly limited scope for CCPs to tailor the risk management approach to the products and markets within the discretion provided for in EMIR.

Additionally, ESMA has announced its intention to further harmonise CCP risk management development with international institutions. The consequence of this work is to tighten a framework potentially further around European CCPs, which will not apply to those in third countries, thereby potentially creating a competitive disadvantage for CCPs clearing in Europe. This flexibility is currently legislatively blocked in Europe.

<ESMA\_QUESTION\_APC\_02>

1. : 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>

EFET agrees to the new draft of Article 28a, as it would give CCPs more flexibility to review and adjust APC tools. EFET also recognises the necessity to have the policy and procedure documented and easily accessible. not only for clearing members. but also for market participants. Furthermore, EFET would welcome that CCPs get incentivised to apply APC tools which reflect the real level of actual risk in stressed market scenarios and not only very conservative models which may result in an unnecessary exponential increase in margin due to the application of tools which are exclusively linear.

In general, increased predictability of market scenarios would also help to better plan and prepare for upcoming margin requirements in normal and stressed market conditions.

Markets participants who are indirect users of CCPs need access to real-time “as-is” margin calculation tools that help to verify short term liquidity demand. In addition, they need to be able to run “what-if” scenarios to be prepared for further extreme market conditions (high volatility) and their impact on liquidity planning.

User friendly and standardized simulations tools should be offered by CCPs not only to clearing members, but also more extensively to market participants.

Margin simulators are important tools for the preparedness of market participants. Clearing members and their clients need access to real-time calculations of initial and variation margin that would deliver:

* Planning, including liquidity planning;
* Historical Analysis;
* Capabilities to respond timely to margin calls;
* What-If-Analysis, in order to allow better mid-term liquidity planning not only on current market levels but also for stressed market conditions.
* These contemporary and user-friendly margin calculators should provide application program interfaces (APIs) to avoid high cost for accessing margin calculators that could be prohibitive for medium sized and smaller clients.
* To Increase the ability to install simulation tools and therefore for clients to replicate margin calculations
* Intraday margin call projections could be added to these margin simulators.

<ESMA\_QUESTION\_APC\_03>

1. : 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>

EFET would appreciate better transparency and accessibility on which and how quantitative metrics are applied in the context of procyclicality.

Whereas EFET understands the utility of quantitative metrics, they may not help if:

* they are not comparable between CCPs (issue of standardization) and
* if there is a sufficient level of competition between CCPs.

<ESMA\_QUESTION\_APC\_04>

1. : 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>

EFET understands the reasons for introducing these three dimensions, but there is not enough clarity on how these dimensions will be used by CCPs:

With regards to conservativeness and over collateralisation, EFET would welcome more transparency and guidance from CCPs about the reasonable level of over collateralisation which would mitigate the impact of procyclicality on margin calculations. As such, the impact on short term liquidity risk for market participants will not be based only on the extrapolation of extreme historic market events.

<ESMA\_QUESTION\_APC\_05>

1. : 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>

In principle, EFET agrees to this proposal, if the right level of adjustment is found between frequency and over-collateralisation.

<ESMA\_QUESTION\_APC\_06>

1. : 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>

EFET generally agrees to this proposal.

<ESMA\_QUESTION\_APC\_07>

1. : 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>

N/A

<ESMA\_QUESTION\_APC\_08>

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

<ESMA\_QUESTION\_APC\_09>

EFET proposes that per total Initial Margin bucket only one APC option should be applied, in order to make the APC calculation more comprehensible for market participants.

<ESMA\_QUESTION\_APC\_09>

1. : 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>

EFET underlines that transparency and accessibility to information is granted by CCPs in order to better understand the APC tools:

* Which tools have been used by a CCP and by when in order to respond to which market conditions and under which considerations buffers are also used or not;
* How buffers have been used and/or replenished;
* Which incentives exist for CCPs using buffers.

<ESMA\_QUESTION\_APC\_10>

1. : 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>

As indicated as an answer to Question 2, EFET agrees that CCPs should be given more flexibility and discretion regarding the APC tools choice and application.

In this case, documentation and transparency are key. If disclosed as aggregated data, the communication on current overall amount of IM, contribution to default funds or concentration margin, or level of margin buffer would give an indication to clearing members and the market participants about the CCP’s and the clearing member’s preparedness on stressed market situations and potential increase in intraday calls or ad-hoc margins. As this data is not related to specific client data, we do not see any reasons for keeping it confidential. CCPs should also provide clearing members and clients regular reports on historical adjustments of IM parameters and margin amounts posted with the CCP.

<ESMA\_QUESTION\_APC\_11>

1. : 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>

This is really specific to products and markets and therefore a certain level of discretion should be defined by CCP. EFET proposes for consultations to take place with Clearing Members and market participants, for example in the framework of the existing risk committees. Decision making on minimum buffer needs to be properly documented. The question may also be raised whether buffers should not also be capped.

<ESMA\_QUESTION\_APC\_12>

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

<ESMA\_QUESTION\_APC\_13>

N/A

<ESMA\_QUESTION\_APC\_13>

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

<ESMA\_QUESTION\_APC\_14>

EFET notes the need for documented and easy accessible procedures, so that market participants are in best place to replicate these models and include them into self-developed simulations or delivered by CCPs.

<ESMA\_QUESTION\_APC\_14>

1. : 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>

EFET generally agrees with this proposal and would welcome that CCP calculation includes all historic market events, including extreme scenarios. The inclusion of events that may even be older than 10 years will help to understand and calibrate what is the bandwidth of extreme scenarios from a quantitative aspect (price and volatility) as well as the time period involved. This is to be linked to an increased flexibility to be given to CCP on their expert analysis of market events, if this especially allow to deploy margin models and parameters that follow the true risk of a market event, instead of using a simple and conservative view or model.

<ESMA\_QUESTION\_APC\_15>

1. : 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>

As indicated in response to question 15, independently from lookback periods, the market situation that has affected the price and volatility of specific product classes should be considered in historical views. The historical analysis will help to define the size of actual risk (size of the volatility of a defined time period).

<ESMA\_QUESTION\_APC\_16>

1. : 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>

EFET agrees that CCPs should be able to include ongoing and recent stress observations in the set of extreme market movements with due care to avoid any procyclical reinforcing effect. EFET therefore agrees with ESMA’s proposal.

<ESMA\_QUESTION\_APC\_17>

1. : 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>

N/A

<ESMA\_QUESTION\_APC\_18>

1. : 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>

EFET agrees that a daily calculation would help to capture better market changes in a timely manner. The resulting impact on the margin parameters would then define the necessary point in time to update margin parameters.

Regarding the margin parameter update, there may be room for improvement regarding pre-warning communication processes between CCPs, clearing members and market participants to help to prepare better on margin requirements. Such examples include:

* Longer lead time (prior notices) for IM parameter updates to help market participants to plan the impact on margin demands across different CCPs and markets.
* Immediate integration of updated parameters in simulation tools to help clearing members and market participants to predict in real time impact on margin requirements.

<ESMA\_QUESTION\_APC\_19>

1. : 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>

N/A

<ESMA\_QUESTION\_APC\_20>

1. : 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>

N/A

<ESMA\_QUESTION\_APC\_21>

1. : 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>

EFET understands the reasoning for a proposal to extend backward the lookback periods to longer than 10 years. Extending this period has a dilution effect on the stress events. The best solution may be to append the stress observations to the 10-year lookback period. EFET would however want to better understand why the 10-year period is applying.

<ESMA\_QUESTION\_APC\_22>

1. : 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>

N/A

<ESMA\_QUESTION\_APC\_23>

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

<ESMA\_QUESTION\_APC\_24>

N/A

<ESMA\_QUESTION\_APC\_24>

1. : 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>

N/A

<ESMA\_QUESTION\_APC\_25>

1. : 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>

N/A

<ESMA\_QUESTION\_APC\_26>