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ESRB Secretariat's response to ESMA's
consultation on APC measures for
CCPs
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ESRB
European Systemic Risk Board
European System of Financial Supervision

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Although this response is sent on behalf of the ESRB Secretariat, it largely builds on established ESRB positions. Where the response opines on areas where there is no established ESRB position, this is highlighted. Input for the response was collected from members of the CCP Taskforce and the Expert Group on Margins and Haircuts, and feedback from members of the ESRB's Advisory Technical Committee (ATC) was also considered. The response has not been submitted for approval by the General Board and therefore constitutes a response by the ESRB Secretariat.

The ESRB Secretariat welcomes the possibility to respond to the proposed changes to regulatory technical standards (RTS) No 153/2013 with respect to the procyclicality of margins. These changes are aimed at amending the requirements applicable to CCPs when addressing the procyclicality of margins. Although the ESRB Secretariat acknowledges that within the EU the regulatory framework addressing pro-cyclicality is among the most advanced globally, the coronavirus (COVID-19) crisis has highlighted areas where the framework could be improved.

ESRB Secretariat overarching view

The ESRB welcomes the proposals put forward by ESMA, although the ESRB Secretariat's response to ESMA suggests some improvements. The ESRB has repeatedly indicated the need to address procyclicality in initial margining (and collateral) practices, most recently in its June 2020 Recommendation (ESRB/2020/6), and for this reason it supports ESMA's initiative. In its response, the ESRB Secretariat provides ESMA with some topical considerations for the revision of the anti-cyclicality framework in EMIR and in the appendix answers the questions ESMA raised in its consultation that are most relevant from a financial stability perspective.

A definition of procyclicality

In its 2017 report on the EMIR Review¹, and in its earlier report in 2015, the ESRB proposed including a definition of procyclicality in Article 2 of EMIR. Although this option is not considered in ESMA's consultation paper, the ESRB Secretariat wishes to reiterate this proposal. In its view, a definition of procyclicality in the legal text would provide stakeholders and supervisors with a commonly shared description and understanding of this

¹ [Revision of the European Market Infrastructure Regulation](#), ESRB, April 2017.

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multifaceted phenomenon. This would be beneficial in terms of the transparency and predictability of margin requirements. It could also help to close the gap in supervisory convergence on procyclicality identified by ESMA.

The ESRB underlined that such a legal definition of procyclicality should encompass both centrally and bilaterally cleared transactions, to avoid fragmentation. In this respect, it notes that the EMIR Level 1 text refers to procyclicality with regard to margins and haircuts applied by CCPs, whereas international principles for bilaterally cleared transactions consider procyclicality for both centrally cleared and non-centrally cleared trades. From a macroprudential perspective, the concept of procyclicality goes beyond risk management practices for bilateral and central clearing. In a broader sense, procyclicality refers to changes in the risk profile of market actors that are interlinked with business, financial or credit cycle fluctuations and thus may affect financial stability. These changes may be the direct or indirect result of shifts in asset market prices but may also result from automatically triggered or behavioural changes in risk management. The ESRB report on the macroprudential use of margins and haircuts² discusses concepts of procyclicality and further sets out systemic risks stemming from procyclicality in collateral requirements.

More broadly, in its Recommendation 2020/06 and accompanying report³, the ESRB recommended engagement in international discussions aimed at mitigating procyclicality in margin and haircut practices. These practices could include making liquidity planning as predictable and manageable as possible by reducing unexpected and large initial margin calls and providing enforceable notice periods for any changes in the initial margin and haircut protocols to ensure that market participants have sufficient time to adapt. Discussions within the relevant standard-setting bodies should lead to the design and set-up of global, harmonised standards in this regard.

The ESRB Secretariat would like to emphasise that in order to achieve harmonisation, a shared concept of procyclicality is paramount. The lack of a common definition will most likely hamper the process of convergence and coherence.

Procyclicality of haircuts

The ESRB Secretariat believes that, in parallel to the amendments being considered regarding the procyclicality of margins, the procyclicality of haircuts needs to be considered as well, and provisions in EMIR regarding procyclicality should be clarified. During the COVID-19 crisis the procyclicality of haircuts did not result in any (liquidity) problems, whereas during the 2011 crisis this procyclicality led to some challenges for market participants. In its response to the EMIR Review, the ESRB made some suggestions for addressing this.

² **The macroprudential use of margins and haircuts**, ESRB, February 2017.

³ **Liquidity risks arising from margin calls**, ESRB, June 2020.

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For instance, more granular guidance on the determination of collateral haircuts could be provided, with the aim of preventing procyclicality resulting from haircut changes. The wording in EMIR uses qualitative terms and phrases such as “prudent” and “as far as possible”, which does not sufficiently limit procyclicality. For example, more guidance could be given on how to take into account look-back periods or how to estimate pre-defined minimum haircuts. The relevant Level 1 provisions could be revisited accordingly.

Proportionality

The ESRB Secretariat appreciates the fact that ESMA's proposal to amend the anti-cyclicality requirements for CCPs leaves some room for proportionality. CCPs will no longer be obliged to test each of the three APC tools set out in EMIR⁴ to determine which anti-cyclicality tool is best suited. CCPs will be allowed to choose any of the three tools, provided they are able to justify this decision. However, the wording of the draft RTS is not sufficiently explicit on further proportionality measures. For example, the largest four CCPs, which control 90% of the market share, will need to carefully analyse the impact of all three options on a quantitative basis to support the justification of their choice. On the other hand, for the smallest CCPs, which pose much less risk and have fewer resources available, a simplified justification based on qualitative arguments could suffice. Being more explicit on the principle of proportionality will ensure that the largest CCPs carry out this kind of quantitative analysis when justifying their choice of APC tools.

The ESRB Secretariat suggests clarifying the minimum requirements of the thresholds included in the RTS. In this respect, the percentages referred to in paragraph 5.2.3 of the proposed text for the RTS should be qualified as maximum or minimum thresholds. Furthermore, no EU CCP seems to apply APC parameters higher than the minimum requirements. CCPs should therefore be asked to provide a fully reasoned explanation, with the pros and cons of adopting higher parameters, to be endorsed by the CCP Board and submitted to the NCA, in order to discourage CCPs from making mechanistic choices.

Client clearing

ESMA's proposal to amend procyclicality requirements only targets anti-cyclicality measures at the level of CCPs and their clearing members. In the view of the ESRB Secretariat, the transmission of procyclical inputs via the relationship between client and clearing member should also be avoided or limited to protect financial stability. It notes that EMIR already includes some requirements targeting the provision of services by clearing

⁴ Article 28 of Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties (OJ L 52, 23.2.2013, p. 41).

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members to clients. However, these provisions mostly, if not exclusively, concern the level of segregation of assets and positions offered by clearing members to clients and do not address any procyclicality concerns.

In the ESRB Secretariat's view, the provisions to limit the procyclicality of margin and haircut requirements of CCPs could be broadened to include client clearing as well. Counterparties, including CCP clearing members and their clients, should ensure that they maintain sufficient liquidity to meet margin calls in a timely fashion. It is, however, also beneficial, from a financial stability perspective, to ensure that CCPs' decisions in terms of risk management do not unnecessarily burden clearing members, clearing members' clients and other counterparties because of excessive procyclical features, thus unintentionally creating liquidity strains that could develop into solvency issues.

Against this background, the ESRB Secretariat reiterates its suggestion to consider broadening the procyclicality-limiting provisions in EMIR to also include the "client" level, while bearing in mind that smoothing potential procyclical effects could entail more conservative, and therefore more costly, margin and collateral requirements.

Coordination with other international workstreams

In parallel with ESMA's work, there are other (global) initiatives to enhance the anti-cyclicality framework. The ESRB Secretariat would like to caution ESMA not to adopt any measures that might be contradictory to what is being developed globally. Especially concerning public disclosure there is a risk of divergence, and the ESRB Secretariat urges ESMA to ensure that the initiatives stay aligned as much as possible.

In addition, the ESRB Secretariat notes that the underlying proposals leave CCPs with too much discretion to define metrics and parameters. The ESRB Secretariat understands that ESMA has opted for this solution because it would like to await the outcome of the current BCBS-CPMI-IOSCO work in the same area. The ESRB Secretariat acknowledges the flexibility that this choice brings, but at the same time believes that more guidance for CCPs is needed, at least in the medium-term. The ESRB stands ready to contribute to providing more guidance this, based on the outcome of the BCBS-CPMI-IOSCO work.

In that regard, it is also worth mentioning the related international regulatory initiatives, although they do not specifically target the central clearing "domain". These include the FSB framework on qualitative standards and numerical haircut floors on non-centrally cleared SFTs. The framework is part of a set of policy recommendations issued by the FSB to address financial stability risks related to SFTs⁵; it includes recommendations on (i)

⁵ In August 2013 and November 2015, the FSB published reports that set out recommendations for addressing financial stability risks in relation to SFTs. See Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos, FSB, 2013 and Regulatory framework for haircuts on non-centrally cleared securities financing transactions, FSB, 2015.

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qualitative standards for methodologies used by market participants to calculate collateral haircuts⁶; and (ii) numerical haircut floors on non-centrally cleared SFTs. The scope of this recommendation is broad; it complements the existing entity-based regulation of leverage (for credit institutions and investment firms) and specifically addresses pro-cyclicality. While recognising that currently no such standards apply to all market participants in the EU⁷, an assessment of the need for and the scope of potential regulatory action in this field may become increasingly worthwhile and feasible now that more comprehensive and detailed data on these markets are available in the EU.

Finally, the ESRB Secretariat understands that the current Guidelines on anti-cyclicality measures will continue to exist and that (temporarily) both the Guidelines and the RTS will address the anti-cyclicality measures taken by CCPs. Each will have a different scope and different addressees, and while the ESRB Secretariat understands the need to provide proposals for improvement in the short term, it is nevertheless of the opinion that this development adds complexity to the supervisory framework, and would prefer a simultaneous review of the Guidelines and the RTS.

ESRB Recommendation 2020/06 on liquidity risks arising from margin calls⁸

The Recommendation published by the ESRB in 2020 on liquidity risks arising from margin calls (ESRB/2020/6) makes four recommendations to further limit the financial stability risks arising from the collection of margins. These recommendations cover: (i) limiting any cliff effects in relation to the demand for collateral; (ii) stress scenario for the assessment of future liquidity needs; (iii) limiting liquidity constraints related to margin collection; and (iv) mitigation of procyclicality in the provision of client clearing services and in securities financing transactions. The compliance assessment of Recommendation 2020/6 made it clear that in some areas significant progress has been made and anti-cyclicality measures are increasingly part of the holistic risk management framework of market participants. However, not all the recommendations have been addressed sufficiently and the ESRB Secretariat sees room and need for further improvement.

6 For example, it is mentioned that haircut methodologies should be designed to limit potential procyclical fluctuations in haircuts, specifically by moderating the extent to which they decline in benign market environments (for example characterised by low market volatility and rising asset prices) and thus mitigate the magnitude of the potential increase in volatile markets.

7 See [Report from the Commission to the European Parliament and the Council](#) under Article 29(3) of Regulation (EU) 2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012.

8 [Recommendation of the European Systemic Risk Board of 25 May 2020 on liquidity risks arising from margin calls \(ESRB/2020/6\)](#).

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Use of buffers (please note this topic has not previously been discussed at GB level but only at a technical level)

To increase the effectiveness of the APC buffer, ESMA could investigate the exhaustion strategy of margin buffers and whether this could be applied at clearing member level as well as at CCP level.

Determining in advance the best moment for using the APC buffer is challenging, as a CCP cannot foresee exactly what the depth and length of a crisis will be. To address this risk, the buffer exhaustion strategy could be applied not only at CCP level and/or for all clearing members simultaneously, but also partially for only those clearing members that are experiencing difficulty in paying the additional (buffer) margin, ensuring that the other clearing members are still protected by the buffer. This could pose several advantages compared with addressing margin buffer exhaustion at CCP level.

The main purpose of the APC buffer is to protect clearing members against liquidity shocks following sharp increases in margin requirements. However, if a clearing member can default on the additional margin required for the APC buffer, then this measure no longer serves as protection to the clearing member. The risk for the CCP would not increase, because margin requirements, leaving aside the additional buffer required, should already be calibrated to a level that allows the CCP to liquidate the positions without remaining losses. When applying the buffer exhaustion at individual clearing member level, the other clearing members are still protected by the buffer. This creates a natural diversification of the buffer exhaustion strategy.

However, if ESMA were to allow for buffer exhaustion strategies at clearing member level, the ESRB Secretariat would consider it important for them to be accompanied by other risk mitigating measures that prevent future sudden increases in margin requirements, such as imposing hedging strategies and preventing those clearing members from increasing their exposures.

On a more technical level, Article 28 (b) poses the risk that CCPs may not use a sufficient number of stress scenarios. This could lead to stressed margins not being calibrated to stress level if, for instance, a CCP used a 99% confidence interval, but only 0.5% of the scenarios were actually stress scenarios (the stressed margin would then contain stress scenarios but would not be calibrated at stress level). The ESRB Secretariat proposes adding the following: "A CCP should make sure that the stressed margin is calibrated on stressed scenarios. Therefore, ..." The CCP should ensure that this set of stress scenarios includes an adequate number of extreme market movements for all margined products, including the ones that could expose it to the greatest financial risks.

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Appendix

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

The ESRB Secretariat agrees with this change, which leaves CCPs with more flexibility to choose the most appropriate tool and decreases the burden of having to test all three tools.

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?

The ESRB Secretariat is of the view that a prerequisite for more harmonisation is a common definition of procyclicality and convergence in the use of APC metrics. The current proposal leaves too much room for the CCPs to diverge and the ESRB Secretariat doubts whether consulting the risk committees would sufficiently remedy this. If NCAs were involved and these parameters were to be discussed within EMIR colleges, this scrutiny by several NCAs could facilitate more convergence and harmonisation.

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?

Please refer to our suggestions made in the body of the response.

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?

Yes, but the requirement is not sufficiently specific and is open to interpretation.

Question 5: 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?

Yes, although feedback from the market seems to suggest that clearing members have a preference for structural overcollateralisation rather than sharp increases.

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?

Yes.

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?

Yes.

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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?

Yes.

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

Yes.

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?

Yes, we welcome this addition as it would provide more guidance for and insight into the use of the buffers, and would increase the effectiveness of this tool.

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?

We refer to our previous comment on the level of discretion: proportionality and discretion are valuable to a certain extent. They provide CCPs with more flexibility in choosing the most appropriate actions to take, but will not lead to a more harmonised and coordinated playing field. Some guidance on the exhaustion strategy could support the latter. At the same time, the ESRB Secretariat is aware that having all CCPs adopt the same methodologies and parameters would have a pro-cyclical effect in itself.

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?

Yes.

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.

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)?

Yes.

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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?

Yes, and there should be no limit on the maximum number of observations used.

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?

Yes, although revisions should take place infrequently as frequent revision could lead to more pro-cyclical outcomes.

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?

Yes.

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?

Yes.

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?

Yes.

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

Yes.

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

Yes.

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

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Yes.

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?

Yes.