



**Response: ESMA Consultation Paper on Review of RTS No
153/2013 with respect to procyclicality of margin – March 31st,
2022**

Background

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent over 250 market-infrastructures, spread across the Asia-Pacific region (~37%), EMEA (~43%) and the Americas (~20%). with everything from local entities in emerging markets to groups based in major financial centres. Collectively, member exchanges are home to nearly 53,000 listed companies, and the market capitalisation of these entities is over \$95 trillion, while the 50 distinct CCP clearing services (both vertically integrated and stand-alone) collectively ensure that traders put up \$1 trillion of resources to back their risk positions.

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise financial stability, consumer confidence and economic growth. And we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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General Comments

The WFE appreciates the opportunity to respond to the Consultation and to share perspectives and feedback on behalf of our members. We are supportive of the efforts and initiatives to assess and further understand how recent market volatility has impacted the financial markets including how CCPs, together with their members, managed through such events. In January 2022, the WFE responded to the 'Review of Margin Practices' Consultative Report issued by the Basel Committee on Banking Supervision (BCBS), the Committee on Payments and Market Infrastructures (CPMI) and the International Organisation of Securities Commissions (IOSCO) in October 2021 (BCBS-CPMI-IOSCO report)¹ which also provides meaningful analysis from the perspective of CCPs on topics that are also analysed by ESMA in this Consultation.

We would like to highlight that this review comes at an inopportune time as an analysis of margining practices is currently being undertaken at an international level as acknowledged by ESMA in this Consultation as well. We would welcome, if ESMA prioritized coordination and cooperation with global standard-setters with a view to ensure global consistency, rather than pressing ahead with the adoption of even more prescriptive approach to APC in the EU.

CCP Risk Management during Market Volatility

We disagree with ESMA's suggestion in recital 4 of the amended RTS that "some increases may have acted in a procyclical manner, potentially diffusing or even amplifying liquidity stress to other parts of the financial system". Responses will vary across CCPs, for legitimate reasons and outcomes are key. We would therefore argue that EU CCPs' risk management practices, in particular, their margin models appropriately addressed the prevailing market conditions during March 2020. Thus, whilst CCPs monitor and manage the appropriateness of their margin models on an ongoing basis, the overall performance of these models during March 2020 should not be cause for broad overhauls of the models. CCPs successfully managed the extreme market changes in early 2020 and were able to dampen the impact of those changes on market stakeholders, a result that we believe is consistent with the stated objectives in this Consultation. Moreover, data contained in the BCBS-CPMI-IOSCO report supports this view and demonstrates that CCP margin models were sufficiently anti-procyclical.

The WFE has also published a paper² on procyclicality, where we argue that rather than placing an emphasis on IM models, the issue of mitigation of future liquidity crises should be approached from a systemic perspective for the following reasons:

- IM models are inherently risk sensitive, which is a necessary characteristic of these models, which provides for appropriate collateralization of the exposures of a CCP's participants. Thus, there must be a limit to how much procyclicality can be reduced through model recalibration, so as to not compromise the CCP's safety or the economic viability of central clearing.

¹ WFE, Response: BCBS-CPMI-IOSCO Review of Margining Practices <https://www.world-exchanges.org/storage/app/media/regulatory-affairs/Recent%20publications%202021/WFE%20Response%20to%20BCBS-CPMI-IOSCO%20Review%20of%20Margining%20Practices.pdf>

² WFE, Procyclicality of CCP margin models: systemic problems need systemic approaches, January 2021 (https://www.world-exchanges.org/storage/app/media/Procyclicality_cut7.pdf)

- It is well-known that financial systems are complex. Complexity is characterised, among other features, by feedback loops. The propensity to feedback loops is a property of the interactions in the system and not of its individual elements. Since concerns around procyclicality are fundamentally about the generation of adverse feedback loops that could amplify a stress, then the focus should be directed to understand and control the system interactions and not solely to change the behaviour of one single node or agent.

Potential Impact to CCP Risk Policy

WFE continues to caution against an overly prescriptive approach to achieve the stated APC objectives and that doing so may result in unintended consequences that are inconsistent with the stated objectives and could undermine, rather than support, financial stability, particularly where a CCP is required to implement practices that are not consistent with the nature of its clearing service(s).

We stress that the observed variability in margin model responses to market stress noted in recital 5 does not justify the need for a review of the APC framework. It is the case that different CCPs justifiably require flexibility to adapt their margins to their respective situations and characteristics of their clearing service(s). A “one-size-fits-all” approach imposed by regulation may prevent a CCP from adopting ex-ante approaches and ex-post actions to manage APC that are most suitable for its market.

As described in our response to Q14, we are concerned that the proposed more prescriptive approach stands to have a material impact on the margin framework for CCPs whereby such policy changes should be subject to Level 1 procedures. Moreover, we also consider that the proposed requirements may impact the nature of and characteristics of loss bearing financial resources of a CCP which stands to impact the incentive structure of central clearing.

Considering this, we would advocate that for any policy changes that stand to have a material impact on CCPs (and market participants alike) should be subject to Level 1 procedures.

Response to Questions

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

WFE believes that it is important to recognize that CCPs did perform well during the recent significant market events (as noted in Paragraph 10 and Paragraph 12 and also in other publications), therefore we query why more prescriptive guidance is being promoted where the stated objectives have been demonstrably achieved.

For example, the BCBS-CPMI-IOSCO report on 'Review of Margin Practices' evidences that CCPs successfully managed the extreme market changes in early 2020 and were able to dampen the impact of those changes on market stakeholders. Data contained in the report also supports that CCP margin models were sufficiently anti-procyclical and states that “[g]enerally, margin rate and IM increases were lower than the corresponding increases in price volatility of key risk factors for CCPs.”.

WFE agrees that the CCP is best suited to determine which APC tool is most suitable for the characteristics of its product offering, its membership and its risk management practices and further that any requirement to model (and/or quantitatively justify) each tool would create significant and unnecessary burdens (as referenced in Paragraph 35 and 36).

We agree that it is appropriate for EU CCPs to describe and document their approach to APC, including tool choices, within a policy (or equivalent document such as risk documentation related to the margin methodology) that includes, as appropriate, APC targets (as it is described in Section 4.1.3).

However, WFE continues to caution against an overly prescriptive approach to achieve the stated APC objectives and that doing so may result in unintended consequences that are inconsistent with the stated objectives and could undermine, rather than support, financial stability, particularly where a CCP is required to implement practices that are not consistent with the nature of its clearing service(s). We maintain that the existing Guidelines currently strike an appropriate balance by also fostering a more outcomes-based and results oriented approach to APC. As described in Paragraph 15, we concur that approaches to APC will vary among CCPs, further evidencing that a “one-size-fits-all” approach may prevent a CCP from adopting ex-ante approaches and ex-post actions to manage APC that are most suitable for its market (not least for reasons noted in Paragraph 40).

We also believe that an overly prescriptive approach (with specified measures and metrics) lacks an element of flexibility needed for CCPs to enhance their approaches to APC over time and be reactive to market changes as market characteristics and market events develop and evolve.

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?

WFE agrees that to the extent EU CCPs are required to adopt such thresholds for margin changes, they should be able to define, and adjust as necessary, such thresholds based on their risk appetite/tolerance and with consideration to the characteristics of (each of) its clearing services.

The margin framework for EU CCPs already includes extensive requirements for routine review and assessment as well as risk governance requirements (both internal and external); therefore, we query the need for any additional requirements where such mechanisms are demonstrably already in place.

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?

WFE queries whether new text is required to achieve the stated objectives when considered together with the existing Guidelines for approaches to APC. Please also refer to our response to Q1. However, where new text is contemplated, we believe that it should reinforce the importance of an outcomes-based and non-prescriptive approach (as described in our responses to Q1 and Q2).

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

WFE believes that CCPs need to be reactive to changes in markets and other circumstances, not all of which are able to be predicted through prescribed quantitative metrics (e.g., hard thresholds). However, we agree that to the extent EU CCPs are required to consider quantitative metrics when establishing approaches to address procyclicality, it is appropriate that they retain the flexibility to define the metrics that are best suited for the characteristics of (each of) its clearing services (as described in Paragraph 40).

The margin framework for EU CCPs already includes extensive requirements for routine review and assessment as well as risk governance requirements (both internal and external); therefore, we query the need for any additional requirements where such mechanisms are demonstrably already in place. Where this is demonstrated to be the case, we would not support additional analysis/requirements on the basis that the objective is already satisfied through existing practices of the margin framework.

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?

WFE notes that many EU CCPs already consider these dimensions, among others that the risk practitioners of the CCP may deem suitable for the characteristics of (each of) its clearing services. Therefore, while we agree that these dimensions may be reasonably common among CCPs, any proposed text should not be written in such a way that they are prescriptive or restrictive such that a CCP would lose necessary flexibility to make such determinations.

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?

WFE does not agree and generally notes that there can be no ‘one-size-fits-all’ method to approaching mechanisms to address procyclicality. As noted in our response to Q4, we believe that to the extent

EU CCPs are required to consider quantitative metrics when establishing approaches to address procyclicality, it is appropriate that CCPs retain the responsibility to define the metrics that are best suited for the characteristics of (each of) its clearing services (as described in Paragraph 40).

It would be inappropriate to require an analysis of effects of changes in price/yield levels as part of any such assessment as it stands to create a significant burden to CCPs that may not create any valuable data or insights on the behaviour of the margin model.

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?

WFE agrees that CCPs should assess measures to address procyclicality for **material** risk factors (i.e., not **all** risk factors). However, we note that even such material risk factors could be numerous, therefore it could be impractical to attempt to calculate and test all of them (some of which will be unknown).

Due to the varied nature and numerous characteristics of a given clearing service, the proposed approach will likely create an overly prescriptive and burdensome requirement that may not be suited for (or may create undue burdens against) different types of risk methodologies (e.g., margin models) and the approaches to meet such objectives is best left with the CCP’s risk management function. Therefore, we caution against creating over-prescriptive requirements within the RTS as it may not best achieve the objectives. As described in our response to Q1, rather than focus on metrics for risk factors that may not be relevant, it is important to maintain and foster an outcomes-based approach.

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?

Please refer to our response to Q7.

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

Please refer to our response to Q7.

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?

WFE agrees that EU CCPs should be able to describe and document their APC tool choices within a policy (or equivalent document such as risk documentation related to the margin methodology). We agree that it would be inappropriate to set prescriptive regulatory requirements on the timing and methodology to exhaust/replenish the margin buffer as it would be challenging to establish a buffer exhaustion strategy that would be “optimal for all products, market events and stress scenarios” (as

described in Paragraph 64). Moreover, as noted in our response to Q9, it is not feasible to anticipate all potential market events or stress scenarios.

It is important that this APC tool not be overly prescriptive, rather it should allow for the CCP to employ practices that allow it to appropriately react based on prevailing market conditions in order support financial stability. It should allow for scenarios where a range or measures of relativity are more appropriate than hard-coded thresholds that may prohibit (among other things) measured assessment and/or specific actions to address current market dynamics and/or scenarios (as described in Paragraph 65).

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?

WFE agrees that, to the extent an EU CCP is required to establish predefined thresholds, there should be a degree of discretion subject to appropriate governance arrangements. Please also refer to our response to Q4 and Q10.

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?

WFE agrees with the summary conclusions that the size of the margin buffer constitutes a complex trade-off to the CCP that is informed by the type of asset class cleared by the CCP as well as the market events that it may experience (as described in Paragraphs 66 and 69). Therefore, the appropriateness of any selected margin buffer percentage may also need to consider such factors and enable the CCP to determine the appropriate size of the buffer.

However, we do not object in principle to the currently established 25% unless, for example, the nature of the product would make a different percentage or methodology more appropriate (e.g., for non-linear products).

The margin framework for EU CCPs already includes extensive requirements for routine review and assessment as well as risk governance requirements (both internal and external); therefore, we query the need for any additional requirements where such mechanisms are demonstrably already in place. However, where current market dynamics and/or scenarios would require more frequent review the CCP would do so (in accordance with provisions that already existing within the margin framework).

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

Please refer to our response to Q12.

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

WFE agrees that the effectiveness of this tool relies heavily on the identification of the appropriate stressed observations (as referenced in Paragraph 73). While we agree that certain extreme historical and/or potential market movements (applied to stress scenarios identified under Article 30) **may be suitable** for consideration for purposes of this APC tool, it **should not be the default assumption** as it may result in an overly prescriptive approach that prohibits reasonable discretion to the risk practitioners of a CCP (particularly where any such regulatory requirement may lead to an inconsistent overall approach to a CCP's risk management framework that is calibrated to the characteristics of its clearing service(s)).

The proposed requirements to consider extreme market movements from historical and/or hypothetical stress scenarios (in Q14, Q15 and Q16) may lead to a material effect on the margin framework for CCPs whereby such policy changes should be subject to Level 1 procedures. While the proposed amendments appear technical in nature, we are concerned that the proposed text (specifically in that it states "consider") establishes a prescriptive approach and would effectively require CCPs to include historical stress scenarios. Because margining and stress-testing serve different purposes, we challenge an approach that would effectively apply methodological guidance for stress-testing in the context of margin models (e.g., for APC measures). We consider that the inclusion of stress-testing observations (currently used for the purpose of the default fund) coupled with the prohibition of scaling techniques will lead to a regulatory prescribed permanent rise of minimum confidence levels above the values set out in either EMIR Art. 41 or Art. 24 of the RTS (percentage). Considering this, together with our procedural concerns, we would advocate that its more appropriate that for any policy changes that stand to have a material impact on CCPs (and market participants alike), such as directly or indirectly adjusting the minimum confidence interval under EMIR, be subject to Level 1 procedures.

We also consider that the proposed requirements may impact the nature of and characteristics of loss bearing financial resources of a CCP which stands to impact the incentive structure of central clearing.

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)?

Please refer to our response to Q14.

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?

WFE agrees with the summary conclusions that it would be difficult, onerous, and operationally intensive for a CCP to define stress observations and/or hard thresholds particularly where a CCP has a diverse set of margined products (including what could be hundreds of different products), models, and calibrations (as referenced in Paragraph 85). Therefore, we do not agree with the proposed text as currently drafted. Rather it should clarify that the scope of any such requirement is strictly limited

to products that may expose the CCP to the greatest financial risk (i.e., covering **all** margined products stands to create a significant burden to CCPs that may not create any valuable data or insights on the effectiveness of the tool). Please also refer to our response to Q14.

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?

WFE agrees with the summary conclusions that it may be challenging to uniformly determine an appropriate time restriction (as referenced in Paragraph 88), particularly where an EU CCP provides clearing services for a diverse set of margined products, models, and calibrations. Therefore, we agree that it would be imprudent to include a specific time restriction.

The margin framework for EU CCPs already includes extensive requirements for routine review and assessment as well as risk governance requirements (both internal and external); therefore, we query the need for any additional requirements where such mechanisms are demonstrably already in place. However, where current market dynamics and/or scenarios would require more frequent review the CCP would do so (in accordance with provisions that already existing within the margin framework).

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?

WFE believes that the revised text should provide for scenarios where applying the “same model and parameters” may not be appropriate or may not achieve the intended objectives. Please also refer to our response at Q14.

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?

WFE agrees that stress margin should be calculated together with routine margin calculations.

However, we disagree with the premise that this (or any) APC tool would explicitly disallow techniques that may already be part to a CCP’s approach to the margin framework (including risk methodologies employed). Therefore, we believe that the risk practitioners of the CCP should maintain the ability to determine if scaling techniques are also appropriate and/or better suited to achieve the stated objectives (i.e., outcomes-based approach), which can be particularly relevant where a CCP is using longer lookback periods (as would be the case in using the stress margin APC tool).

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?

WFE agrees with the summary conclusions that EU CCPs should be able to describe and document approaches to weight increase(s) and reduction(s) and the time period that they may apply and that it should be documented within a policy (or equivalent document such as risk documentation related to the margin methodology). Please also refer to our response to Q10.

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

Please refer to our response to Q14.

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?

WFE agrees that the methodology shall consider stress market movements and that it should recognise the varied nature and characteristics of a given clearing service, for example, the different types of risk methodologies (e.g., margin models) employed by EU CCPs. Please also refer to our response to Q1 (which equally applies to proposals regarding this APC tool).

However, we believe that extending the lookback period beyond a minimum period and/or adding extreme market moves beyond such period should be decided by the risk practitioners of a CCP (subject to internal governance arrangements as necessary). Therefore, we believe it would be inappropriate to include prescriptive regulatory requirements for the sole purpose of capturing more and larger market movements and that such an approach may not meet the stated objectives in a common, uniform, or consistent manner.

As described in our response to Q14, we would advocate that its more appropriate that for any policy changes that stand to have a material impact on CCPs (and market participants alike), such as directly or indirectly adjusting the minimum confidence interval under EMIR, be subject to Level 1 procedures.

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

WFE generally agrees with the premise that this APC tool shall consider the requirements established in the referenced articles. However, it should be acknowledged that due to the varied nature and characteristics of a given clearing service, for example, the different types of risk methodologies (e.g., margin models) employed by CCPs, the proposed approach may not meet the objectives in a common, uniform, or consistent manner. Therefore, any revised text should provide for such scenarios which can be further described within supporting guidelines and described by the CCP within a policy (or equivalent document such as risk documentation related to the margin methodology).

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

WFE disagrees that the analysis and calculation of the margin floor for purposes of the APC tool should be directly aligned to that of the margin methodology. For example, where a CCP performs margin analysis frequently (e.g., at/near real time, hourly), directly aligning the frequency of the margin floor calculation stands to create a significant burden to CCPs (e.g., operational effort, computational power, compliance checks) that may not create any material benefits as it relates reducing procyclicality or improving CCP risk management.

We believe however that the text within the existing Guidelines (Paragraph 21) provides the necessary guidance on this topic and therefore would advise that any revised text align to the existing Guidelines and to be described by the CCP within a policy (or equivalent document).

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?

WFE disagrees with the premise that this (or any) APC tool would explicitly disallow techniques that may already be part to a CCP's approach to the margin framework (including the risk methodologies employed). Please also refer to our response to Q19.

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

WFE notes that any EU CCPs in scope for this option are likely to need to spend a substantial amount of time and resources to implement the changes proposed (e.g., model development, model validation, internal approval, request for regulatory approval via EMIR Article 49 procedure). Please also refer to our response to Q22.