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**EBA-2022-D-4073**

John Berrigan
Director General
Directorate-General for Financial Stability,
Financial Services and Capital Markets Union (FISMA)
European Commission
Rue de Spa 2
1049 Brussels
Belgium

29 September 2022

**Subject: Response to the current level of margins and of excessive volatility in energy derivatives markets**

Dear ~~Mr Berrigan,~~ Dear Seán

It is my pleasure to submit to you today our response, endorsed by the EBA Board of Supervisors, to your letter dated 13 September 2022 on the current developments in energy derivative markets. We appreciate being involved in this important and urgent issue and welcome the opportunity to assist with technical input.

The EBA has co-operated closely and constructively with the European Securities and Market Authority in the drafting of our response. In addition, we have actively engaged with several key industry stakeholders to complement our understanding of the key role of banks in energy derivatives markets, and the potential impediments faced by market participants in the provision of collateral by non-financial corporates and related liquidity challenges. Finally, as always, the national competent authorities and the ECB have been closely involved during the development of the response.

While the full reply can be found in the document enclosed, please allow me to briefly outline our initial assessment on the specific matters highlighted in your letter.

- Banks are already providing significant levels of support to energy firms by facilitating the posting of collateral towards CCPs. This includes the provision of so-called collateral transformation services to their clients. Support from banks to energy firms has grown rapidly, with banks reaching a point where internal risk limits are beginning to bind. Banks will likely continue to do so, but given the support already provided, additional bank capacity will likely be more limited should the levels of market stress in energy derivatives exceed those observed in August.

- In terms of the forms of support, market-based solutions are already in place, typically in the form of higher usage of existing credit lines and expansion of various forms of collateral transformation. Banks have generally indicated that they are highly mindful of their role.

- The role that bank guarantees can have for posting as collateral has been given particular emphasis from our side. Bank guarantees are already used, albeit as collateral for clearing members, rather than as collateral for CCPs. Banks can take these guarantees from other banks as collateral in their own support efforts towards energy firms and some limited usage already exists today. Bank guarantees are subject to similar capital requirements as outright loans. Toward CCPs, for practical and administrative reasons, bank guarantees however have not been the preferred solution by market participants and rather the use of credit lines is the norm. We also note that ESMA may consider to exceptionally expand eligible collateral in CCPs to uncollateralized bank guarantees subject to certain restrictions.

- In terms of banks liquidity management, sudden significant requests can easily exacerbate the liquidity shortage experienced in a crisis. Banks are however facing significant liquidity draws – including in USD – when there are significant market movements. Efforts to provide more transparency around margin calls would therefore be welcomed.

Finally, the reply explores further whether any adjustment to the existing regulatory elements may somewhat alleviate the current situation. Particular consideration is given to the eligibility of bank guarantees' credit risk mitigation, together with supervisory relief to market risk and prudent valuation requirements. The current assessment is that changes to the prudential framework for banks are not likely to significantly help alleviate the current situation without also raising the vulnerability of the banking sector. This reflects that the majority of identified binding constraints stem from existing internal risk management limits and constraints decided upon by banks and/or CCPs as a result of their risk appetites and sustained flows of business with customers and counterparties.

Undoubtedly, the current situation in energy markets is exceptionally challenging and tensions arise in some financial markets closely linked to this sector. The EBA view is that the prudential framework is built for normal, as well as more challenging times such as the current situation and overall is working as designed. The soundness and risk-sensitiveness of the regulation should not be eroded, as it may put overall financial stability at risk. There is however broad agreement that the current difficult situation merits continued careful monitoring and assessment, which the EBA will continue to exercise in close co-operation with ESMA and competent authorities.

I trust that our reply meets your request for technical input. As always, we remain at your disposal for any further elaboration on our initial assessment and stand ready to further engage and complement as needed to assist you in addressing this complex issue. The response will be published on the EBA website.

Yours sincerely,

José Manuel Campa

CC: Verena Ross, Chair of the European Securities and Market Authority
Encl: EBA response to the European Commission on the current level of margins and of excessive volatility in energy derivatives markets