Svensk Värdepappersmarknad
Swedish Securities Markets Association

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Response to EBAs consultation on draft technical standards on Initial Margin Model Validation (IMMV)

The Swedish Securities Markers Association (SSMA) welcomes the opportunity to respond to EBAs consultation on draft technical standards on Initial Margin Model Validation (IMMV).

General comments

- The SSMA agrees that it is important with a proportional approach and supports the introduction of a dual regime consisting of a "standard" and "simplified" validation procedure. However, in addition to such dual regime, there should be an exemption for smaller firms (e.g. those in phase 4-6 regarding the implementation of IM) using existing models (e.g., ISDA SIMM) that have already been assessed by NCAs in the EU or approved by authorities in other BCBS-IOSCO non-cleared margin commitments-compliant jurisdictions.[1]

- The governance process for "simplified" validation refers to a large extent to the rules applicable to the "standardized" validation and is therefore quite complex. The SSMA considers that it should be further analysed if there are additional ways to make the "simplified" regime more proportional as regards the requirements for documentation.

- The SSMA notes that the RTS includes many references to actions to be taken by the management body. As the management body of a credit institution is not typically involved in the day-to-day business, we question if this the right organisational level to assign tasks of such a technical nature.

- The SSMA questions whether it is appropriate to use a draft RTS[2] which, to our knowledge has not been adopted by the Commission, as a legal basis when drafting proposals for technical standards.

Specific questions

Q1: What are the stakeholders' views regarding the split between standard and simplified validation processes?

As noted under General Comments, the SSMA takes the view that the validation process should not include smaller firms (e.g. those in phase 4-6 regarding the implementation of IM) using existing models (e.g., ISDA SIMM) that have already been assessed by NCAs in the EU or approved by authorities in other BCBS-IOSCO non-cleared margin commitments-compliant jurisdictions.[3] Thus, the SSMA considers that it should be clarified in the technical standards that smaller firms usage of such existing models are out of scope of the regulation.

[1] https://www.isda.org/a/Y3tME/2019.05.17_EU-Letter_IM-Models_FINAL.pdf
[2] RTS on the specification of the assessment methodology to use internal models for market risk
[3] https://www.isda.org/a/Y3tME/2019.05.17_EU-Letter_IM-Models_FINAL.pdf

The SSMA agrees that the regulatory, compliance and operational burdens shall be reduced for small and medium-sized counterparties with respect to the initial margin calculation model validation, including internal back-testing and model governance processes. Thus (for models that have not already been reviewed, cf. above) we support EBAs proposal to distinguish between a split between a standard and simplified validation processes. A threshold of Euro 750 bn seems appropriate (see Q 2).

However, if the additional threshold of AANA of EUR 50bn is added as a factor that can trigger the application of the standard validation model based on the decision of the national competent authority in accordance with Article 2(2) of the RTS, clear criteria for taking such decision by the national competent authority shall be established. The reference to *"complexity and interlinkages of the counterparty activity in OTC derivatives"* can be broadly interpreted. The preparations for compliance with the implementation of initial margin for phase 5 firms showed that there are many market participants with an AANA of 50bn on the market. Without specifying the criteria which the national competent authority should base its decision to apply the standard validation process on, the risk that small and medium sized counterparties might be obliged to go through the standard validation process instead of the simplified process cannot be fully avoided. Thus, the aim stated in Section 3 of the Consultation Paper, to ensure the application of the simplified validation model for small and medium sized market participants (mostly Phase 5 and 6) and to reduce the operational and documentational burdens and the number of market participants that apply for the validation of the model at the same time, cannot be achieved to the fullest extent.

Q2: What are the stakeholders' views regarding the Euro 750 bn threshold selected?
We support this approach since it will oblige larger market participants (Phase 1-4) to perform standard validation, provided that all market participants are required to report in case of shortfalls to the ISDA SIMM model. Thus, it will ensure general compliance with the risk-management procedures required under EMIR, simplify the procedure for small and medium sized market participants and reduce the scope of work for competent national authorities (that would be much larger if all market participants would be required to apply the standard validation procedure) at the same time.

Q3: What are the stakeholders' views regarding Article 2, Par 2, and the 50 Euro bn. threshold selected to allow the switch from simplified to standardised validation processes?
Please see response to Q1 above. There are many counterparties on the market with an AANA which is at least EUR 50bn. There is a risk that they might be required to apply the standard validation procedure as decided by the national competent authorities. We therefore suggest that the phrase *"complexity and interlinkages of the counterparty activity in OTC derivatives"* is elaborated on to establish clear criteria for national competent authorities to apply the standard validation procedure or to delete the reference to the AANA EUR 50bn threshold in Article 2(2). Another alternative would be to increase the threshold materially.

Q4: What are the stakeholders' views regarding Article 2, Par 3, that would allow a temporary implementation of the model to subject in the simplified validation process?
We consider that it is a practicable approach and a way forward to give an opportunity to use the initial margin model for some time (one year as mentioned in Article 2(3)) after the application in respect of the simplified procedure is received by the competent authority.

Q5: What are the stakeholders' views regarding section 1? Please specify the issue by article where possible.
In general, the approach taken in Section 1 by establishing two types of procedures and a threshold of AANA EUR 750bn is beneficial. However, some clarifying amendments should be considered with respect to Article 2(2) and the threshold of AANE 50bn. Please see responses to Q1 and Q3 above.

Q6: What are stakeholders' views regarding the methodology applied to identify material changes and extensions in the IM model?

Q7: What are the stakeholders' views regarding the threshold selected (5% and 10%) in order to trigger the process?

Q8: What are the stakeholders' views regarding the selected extensions and changes in the Annex I Part I and II?

Q9: What are the stakeholders' views regarding the documentation to be provided for the application under the Standardised supervisory process.
With respect to the scope of the documentation that needs to be submitted according to Article 6, we suggest that points (c) and (f) of Article 6 are clarified as the current wording of those provisions is very broad. It would be practical to limit the scope of these provisions to what is necessary from an objective standpoint. It should be clear to market participants as to what documentation they are expected to make accessible to the competent authority.

Moreover, we consider that it is unclear what is meant by the term "relevant competent bodies" in point (d) of Article 6. Please clarify in the final report.

Q10: What are the stakeholders' views regarding the section 2 subsection 1 in general? Please specify the issue by article where possible.

The SSMA notes that the RTS includes many references to actions to be taken by the management body. As the management body of a credit institution is not typically involved in the day-to-day business, we question if this the right organisational level to assign tasks of a technical nature.

Q11: What are the stakeholders' views regarding the outsourcing provisions proposed by Article 7 in the RTS?

See comment in Q 10 regarding the day-to-day involvement of the management body.

The SSMA considers that it should be clarified what it means that the management body or the committee designed by it is "actively involved"?

Please also confirm in the final report that the requirements regarding outsourcing in the technical standards are aligned with and not broader than EBAs guidelines on outsourcing.

In addition to internal and external auditors, it could be considered to allow credit institutions to decide which control function is most suitable to perform the audit of the models e.g. the risk control function.

Q12: What are the stakeholders' views regarding the use of validation results proposed by Article 8 in the RTS?
It would be beneficial to be able to rely on the assessment made by another competent authority in the EU or in a third country as it would decrease the amount of work for market participant as well as for competent authorities.

Q13: What are the stakeholders' views regarding the possibility to rely on the assessment of a third country competent authority and the treatment proposed by Article 8 in the RTS?
Please see response to Q12 above.

Q14: What are the stakeholders' general views regarding the senior management requirements as stated in article 10? Also, please highlight specific issues.

Q15: What are the stakeholders' general views regarding the model implementation unit requirements as stated in article 11? Also, please highlight specific issues.

Q16: What are the stakeholders' general views regarding the audit requirements as stated in article 12? Also, please highlight specific issues.

Q17: What are the stakeholders' general views regarding the internal validation requirements as stated in article 13? Also, please highlight specific issues.

Q18: What are the stakeholders' views regarding the split between the general structure of the model and the actual implementation of the model for the validation as stated in article 13(2)?

Q19: What are the stakeholders' views regarding the thresholds suggested to trigger for the CAs notification, as described in paragraph 5 of article 14?

Q20: What would be the stakeholders' choice on the value of Ks, as described in paragraph 7 of article 14?

Q21: What would be the stakeholders' choice on the distribution of Xi applied? Could you please specify the first four moments (mean, standard deviation, standardized skewness and standardized excess kurtosis)? Additionally, could you please describe the distribution Xi, e.g., by means of an analytical approximation or a plot of the empirical distribution density, with the normal distribution included as comparison?

Q22: What would be the stakeholders' choice on the values of Ng,s and Nr,s. Would you please provide a concise description of the methodology to obtain Ng,s and Nr,s?

Q23: What are the stakeholders' methods applied to transactions maturing in less days than the MPoR?

Q24: What are the stakeholders' views on the static backtesting proposal as stated in article 14?

Q25: What are the stakeholders' views regarding the thresholds suggested to trigger for the CAs notification, as described in paragraph 5 of article 17?

Q26: What would be the stakeholders' choice on the value of Kd, as described in paragraph 7 of article 17?

Q27: What are the stakeholders' views regarding the dynamic backtesting as set in article 17?

Q28: What are the stakeholders' views regarding the treatment of the Valuations Adjustments within the requirement of the backtesting programme as set in article 14 and the monitoring programme of article 17?

Q29: What are the stakeholders' views regarding the requirement in the backtesting programmes as set in Articles 14 and 17? Should the requirements be specified in terms of IM collected only?

Q30: What are the stakeholders' views regarding Articles 18 through 23? Please specify the issue by article where possible.

Q31: What are the stakeholders' views regarding the section 2 subsection 2 in general? Please specify the specific issue by article where possible.

Q32: What are the stakeholders' views regarding section 3 in general? Please specify the issue by article where possible.

Q33: What are the stakeholders' views regarding the thresholds selected (10% and 20%) to trigger the process for model changes and extensions in Article 25 for the simplified assessment?

Q34: What are the stakeholders' views regarding the scope of the documentation requirements in Articles 27 and 28 for the simplified assessment?

With regards to Article 27 please see the response to Q9 above.

Additional guidance would be welcome as regards the meaning of "self-assessment of the compliance with this Regulation". To our understanding, the requirement of a self-assessment would be satisfied by a statement that the credit institution complies with the Regulation together with a brief description and, where relevant, supporting document? Please confirm.

Article 28 specifies documentational requirements to prove the involvement of the senior management and management body in supervision and management of the initial margin calculation model. In practice, initial margin calculation model is a very technical area which the relevant operational unit of the organization is responsible for. We consider that it is not practicable to submit the documents mentioned in Article 28 to the competent authority. A formal approval of the internal procedures related to the initial margin model could serve as sufficient evidence of understanding and involvement of the senior management and management body.

Q35: What are the stakeholders' views regarding the transitional provision in Article 30? Are the two years of transition suggested sufficient to have a first validation of the models in place?
It is mentioned that the competent authority can object to the use of the model within two years, but it is not clear if the competent authority shall confirm that market participants can use the model further. It would be good if this is clarified.

The timeframe during which market participants shall submit additional documents in case the competent authority decides to apply Article 2(2) (standard procedure) is not clear. It would be beneficial to have sufficient time to enable market participants to prepare and submit the required additional documentation.

Q36: What are the stakeholders' views regarding the final provision in Article 31? Is the phase-in of 1, 2 and 3 years appropriate, considering the population of counterparties in the scope of the validation requirement?
The phase-in set out in Article 31 seems to be appropriate and give market participants sufficient time to implement these requirements.

Q37: What are the stakeholders' views regarding the transitional and final provisions in general? Are there aspects that should further be considered?

Please see responses to Q35 and 36 above.

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