EAPB Comments on the EBA Consultation Paper on

Draft Regulatory Technical Standards on Initial Margin Model Validation (IMMV) under article Art. 11 – Paragraph 15 – point (aa) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties, and trade repositories (EMIR)

I. General Comments

N/A

II. Responses to individual questions

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

While we welcome that the draft proposal intends to address the diversity in the counterparties by adopting a proportionate approach, we believe that the proposed split is not the right way and not sufficient to address the very specific circumstances under which the models for the calculation of the initial margin (IM models) are used by the market participants.

The proposed approach does not reflect the central characteristics of IM models and fundamental differences between the use of an IM model to calculate the amount of initial margin to be provided in connection with (bilateral) derivative transactions and the application of internal models in the context of the CRR.

The central characteristics of IM models and key differences in comparison to other internal models can be summarized as follows:

- The overwhelming majority of market participants will apply the SIMM methodology developed by ISDA. The application on such a standardised methodology is – for most market participants – a factual necessity as each counterparty receiving a demand for the provision of IM must be able to monitor, verify or even replicate the underlying calculations based on IM models on a continuous basis. For most market participants, even large/model-experienced institutions, this is only practically feasible, if the core aspects of the IM models used by the counterparties they face are standardised and comparable to the ones used by the relevant counterparty or other market participants. Consequently, the level of standardisation of the IM models in use or the key building blocks they are built on needs to be significantly higher than in other forms of internal models. Largely independent/individual IM model will thus also be very much the exception.
- Reliance on the SIMM methodology is also a vital prerequisite to allow cross-border/ cross IM-regime transactions.
- The application and implementation of the SIMM model (or any other form of standardised methodology) of course allows for discretion and requires individual adjustments. However, many market participants will rely on service providers for the implementation so that even individual/discretionary elements of the model application will in many instances by standardised where implemented in the same manner/ by the same service provider.
- The widespread use of a standardised methodology, specifically SIMM, but also the standardisation of other individual/discretionary elements of the

implementation/application of such a standardised model makes it necessary that these widely used standardised elements are treated uniformly, to avoid conflicting validation results.

The draft proposal addresses some of these specifics and characteristics, but they already must be reflected in the basic approach and on all levels and especially call for an approach which - for the purposes of the validation of the IM models - at least distinguishes between

- basic core elements/features underlying a widely used standardised methodology, in particular SIMM
- other (partially) standardised elements/features of the implementation of a standardised methodology, and
- and actual individual/institute specific aspects.

Only the individual /institute-specific aspects mentioned last actually lend themselves to an individual/in depth validation process, which then, of course, should be proportionate.

The first two should generally be subject to a simplified and uniform validation process. This would not only avoid conflicts and inconsistencies but also significantly reduce complexity and increase the efficiency of the validation process for all involved parties, including the competent authorities.

Q2: What are the stakeholders' views regarding the Euro 750 bn threshold selected?

As to concerns/comments on fundamental aspects of the approach, see our response to Q1.

The 750 bn threshold could be a workable/appropriate indicator for establishing a proportionate approach. However, in view of our general/fundamental concerns set out in our response to Q1 we see limited room for the application of the threshold.

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?

We point to our general/fundamental concerns as set out in our response to Q1. In view of these concerns, we see no practical need for such possibility to deviate.

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?

As to our general concerns, see above. We welcome and support the possibility to permit an immediate/preliminary use of IM models. In order to ensure continuity and prevent disruptions, it is vital to provide the competent authorities with the ability to validate IM models at least temporarily/conditionally.

Q5: What are the stakeholders' views regarding section 1? Please specify the issue by article where possible.

We refer to our response to Q1.

We refer to Article 2(5) providing that "*A competent authority may exclude types of OTC derivative contracts from the scope of the validation requested.*". It would be helpful to have further explanatory text on this sub-paragraph. Does this, for example, mean that there is a market participant that only trades in the subsequently excluded type of OTC derivative contracts would be relieved from the validation requirements in general following the effective date of such exclusion?

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

We believe that changes in the initial margin value resulting from the annual recalibration of the ISDA SIMM model should not be considered to constitute a material change for each individual user and should therefore – as such - not trigger the need for a new/additional validation by the competent authority for each market participant.

Many market participants will rely on ISDA to decide on SIMM methodology and/or parameter changes and the effective date thereof and will rely on third-party outsourcing service providers for the implementation of annual recalibration, as well as any ad hoc intra-year methodology and/or parameter changes. Article 25, regarding change materiality, focusses on approving changes *before* they are applied. This approach works well for models maintained internally, but less so for outsourced models, particularly where these models are updated by a single independent organization (ISDA).

We ask for additional clarity on the application of Article 25 to updated of outsourced IM models. We ask to specify which party is expected to do a pre- or post-validation in this respect:

1) ISDA as the deciding body for methodology and for parameter values
2) Model implementers (outsourcing partners) as the model owners
3) Financial Institutions as the parties under supervision.

If this is expected from financial institutions, it is foreseeable that in practice it will not be feasible for financial institutions to comply with this requirement.

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

As stated in our response to Q6, changes in the initial margin value resulting from the annual recalibration of the ISDA SIMM model should – as such – not be considered to constitute a material change. Consequently, we believe that thresholds are not a useful indicator.

Many market participants would not have all the means and time to check whether an annual/ad hoc change to SIMM methodology would fall within these thresholds, and then make an application to the regulators for validation before starting to use it.

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

N.A.

Q9: What are the stakeholders' views regarding the documentation to be provided for the application under the Standardised supervisory process.

In general, the requirements appear to be unnecessary formalistic and detailed.

As regards the possibility to allow for the involvement of third parties, which we support and which is addressed in by Art. 6 (1) item (i), it could be considered to review or clarify the provision: Art. 6 (1) first sentence implies that (only) a "counterparty" is required (and able?) to submit the documentation. This appears to conflict with item (i) which sets out a special requirement for a third party (namely to submit proof of the right to act on behalf of a counterparty).

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

N.A.

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

The provisions on outsourcing and delegation are of considerable practical relevance since – as we already indicated in our response to Q1 - many institutions are likely to rely on external service providers on various levels of the implementation of the IM model.

This means that many aspects of the model implementation will effectively be standardised and include the involvement of service providers. Consequently, the reliance on these standardised elements as well as the involvement of third parties in this context should be subject to a uniform/ simplified/ streamlined validation and connected requirements. This will need to be reflected in all provisions concerning the delegation/outsourcing of elements of the IM model implementation and use, and the requirements should not be to detailed and inflexible.

As a matter of clarification: our reading is that the key aspect for use of outsourcing models is validations by a competent authority from either the EU or an equivalent regulatory regime. The authority providing the validation would need to be EU or equivalent, but the outsourcing partner to be validated need not be. E.g., it would be possible for the German competent authority to validate a model supplied by an outsourcing partner residing in the UK, which is not an equivalent regime at this time, and this validation would be 'valid' across the EU. Can you please confirm this reading, or elaborate on where the 'equivalent regime' applies?

Q12: What are the stakeholders' views regarding the use of validation results proposed by Article 8 in the RTS?

Subject to our general concerns set out in our response to Q1, we fully support the approach to allow reliance on validation results in other validation processes and/or by other authorities: Such reliance will be indispensable to streamline the validation processes and ensure uniformity within the EU and compatibility with third-country regimes.

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?

See our response to Q12.

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

We note that the requirements are modelled after the governance requirements applicable in the CRR context.

In view of the significant differences and specifics of IM models we already addressed in our response to Q1, we do however believe that a much simpler/reduced/proportionate approach is merited, considering that these requirements will not only apply to credit institutions but also other market participants and that it is likely that significant elements of the IM model will be standardised.

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

See our response to Q14.

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

See our response to Q14.

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

See our response to Q14.

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)?

See our response to Q14.

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

We believe that the backtesting requirements are too closely modelled on parallel CRR market risk requirements and are overly complex and not suited to IM models. We again refer to our general concerns set out in our response to Q1.

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

See our response to Q19.

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?

See our response to Q19.

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?

See our response to Q19.

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

See our response to Q19.

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

See our response to Q19.

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

See our response to Q19.

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

See our response to Q19.

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

See our response to Q19.

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?

See our response to Q19.

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?

See our response to Q19.

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

Our response to the backtesting requirements applies correspondingly.

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

Our response to the backtesting requirements applies correspondingly.

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

We refer to our response to Q1.

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?

We refer to our response to Q1, Q6 and Q7.

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

We refer to our response to Q1.

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?

We welcome transition provisions. They are needed to ensure continuity and prevent disruptions. However, in view of our general concerns regarding the approach set out in the draft proposal, and if the current approach is not reviewed, we believe that the transition provisions will not be sufficient to avoid significant disruption and challenges.

It would also be helpful to include clarification on the objection procedure in this article.

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?

See our response to Q35.

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

See our response to Q35.