FINANCE FINLAND

2.2.2022

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EBA - European Banking Authority

EBACP/2021/334/November 2021

Consultation Paper: 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 counterparts and trade repositories (EMIR)

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

Finance Finland welcomes the split between standard and simplified validation. From our point of view, as banks use Standard Initial Margin Model (SIMM) to calculate IM requirement, it is in our expectations that the core model (SIMM) will be validated via standard validation before validating the same model using simplified approach. For the first time, the industry has itself developed a Standard Initial Margin Model, which guarantees a level playing field for highly sophisticated banks as well as smaller regional banks, since 99% of model users use the same model. The validation requirements of the draft RTS derive their structure from the final draft RTS on internal model assessment methodology for market risk; smaller banks do not use internal models in the market risk area and hence have no experience of the internal validation process. Some banks do not have capabilities or the will to invest in validation process – thus, the validation requirement (either simplified or standard) would create a gap between banks. Is this the intention of the EBA?

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

Whatever threshold is chosen, the Standard Initial Margin Model will be validated first by counterparties with larger portfolios.

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

As stated in our answer to question 1, counterparties with AANA above 750 bn will validate their Standard Initial Margin Model using standardized approach. In our understanding, most or all banks that use a model to calculate IM-requirement, use SIMM and others use standard calculation known as grid. To require validation of an industry standard model for every bank would seem very excessive and would create unnecessary burden for banks and competent authorities and that costs/the burden would outweigh any benefits. In our opinion, it would be justified to include the Standard Initial Margin Model (SIMM) as a standard method and to postpone the entry into force of the RTS.

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

Subparagraphs 1 and 4d both refer solely to Article 13 ("Internal validation",under Section 2, Standardised Supervisory Procedures) and not to Section 2 and the relevant parts concerning supervisory validation, nor to Section 3 (Simplified Supervisory Procedures);

Article 8 should refer to both sections and the validation procedures laid down therein, or a corresponding article should be included in Section 3.

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

The requirement in the proposed Article 25(1) for counterparties to apply for validation by the competent authorities in cases of material changes and extensions to their initial margin model would create unnecessary burden for both banks as well as for competent authorities, and even more so than initial validation, since in the case of the changes to the industry standard, all banks would change their model as soon as possible and thus all submit their application to their competent authorities at the same time.

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?

The thresholds seem unjustified. The industry standard model (ISDA SIMM) is constantly evolving in order to capture changes in bilateral derivatives and market conditions. When new versions are rolled out, banks will change their model as soon as possible, and if thresholds are triggered, banks with similar positions will thus submit their applications to their competent authorities at the same time. Changes in the industry standard model might create larger changes for banks with smaller or concentrated positions, triggering an application to change the model, while banks with bigger or non-concentrated positions might not experience a similar change in their position. Competent authorities would need to have enough resources to validate multiple applications at the same time.

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

Requiring application for initial validation, material and non-material extensions and changes would create unnecessary burden for banks as well as for competent authorities. In our understanding, validating (either standard or simplified) an industry standard model multiple times would not create any added value - nor would it increase the robustness of the model.

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?

The proposed timeline (requirement of initial validation within one month at the latest from the date of application) would be acceptable if smaller banks were to be given enough time to prepare for the application (Article 31:"3 years from the date of entry into force of this Regulation"). The validation requirements derive their structure from the final draft RTS on internal model assessment methodology for market risk; smaller banks do not use internal models in the market risk area and hence have no experience of the internal validation process. There is an issue with the given timeline; transitional supervisory procedures give two years for competent authorities to object the initial application – it is likely that there will changes in the industry standard model between initial validation and initial approval, which will then require at least a notification of changes in industry standard model. Given the formal nature of the process, it could prove difficult for competent authorities to separate the initial application, notifications and the possible application to change the model in cases where the initial application is still under process.

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?

We welcome the transitional provision for smaller banks.

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