

ISDA RESPONSE TO EBA DISCUSSION PAPER ON FEES FOR PRO FORMA MODELS

The **International Swaps and Derivatives Association, Inc.** (ISDA) appreciates the opportunity to respond to the Discussion Paper issued by the **European Banking Authority** (EBA) intended to inform its technical advice to the European Commission (EC) on a possible Delegated Act specifying the method for the determination of the amount of the fees, and the modalities of the payment of such fees, to be paid by financial and non-financial counterparties requiring the validation of pro forma models under the European Market Infrastructure Regulation (EMIR) (the Discussion Paper).

The response by ISDA to the Discussion Paper is structured as follows:

- (1) Proposal to address the concerns raised by ISDA SIMM® users
- (2) Formal responses to the individual questions

Proposal to address the Concerns raised by ISDA SIMM® users in the Discussion Paper

In the subsequent paragraphs, we provide a background for context, summarize the concerns raised by SIMM users and propose a solution for consideration by EBA.

- **Background:** In coordination with and for the benefit of derivatives market participants, ISDA developed and maintains the **ISDA Standard Initial Margin Model** (ISDA SIMM® or SIMM) to calculate regulatory initial margin (IM) for global regulatory margin requirements for non-cleared derivatives. Market participants who calculate or have their regulatory IM calculated on their behalf using SIMM are required to be licensed with ISDA. Many of these SIMM users have one or more legal entities that are counterparties in the EU and may be subject to the initial margin model authorization and validation requirements (IMMV) as required pursuant to EMIR for which the EBA will act as the central validator.

As ISDA SIMM is currently the only IM calculation methodology that meets the definition of a “pro forma model” under EMIR, SIMM users would be responsible for paying the fees which the EBA will collect to recover their costs for establishing a model validation function and the initial authorization of ISDA SIMM. SIMM users will be responsible for collecting, calculating and submitting the data required by the EBA to determine the relevant fee for their application for authorization to use ISDA SIMM.

- **Concerns:** For the reasons explained in this response, we believe that **the proposed approach to assign fees based on an exact Euro notional amount is unnecessarily difficult, costly and burdensome.** In the case of smaller counterparties, **the cost** of determining the “monthly average outstanding notional amount over the past 12 months

of non-centrally cleared OTC derivatives, for which initial margin is calculated using IM model(s) based on a given pro forma model” (ANAPF) **might be multiple times the fee itself**. This could have an **unintended deterrent effect** on the decision of smaller firms to exchange (or continue to exchange) IM amounts based **on SIMM**, shifting more IM calculation to the regulatory schedule which is not subject to bi-annual recalibration. ISDA SIMM is a more accurate, risk sensitive and cost-effective method for determining IM amounts.

We appreciate that the EBA is confined by certain parameters specified in EMIR as regards the proposed fee structure, including the use of an average aggregate notional amount (AANA) based on twelve-months’ worth of data. This is unfortunate, as notional is neither an accurate indication of the risk of the portfolio nor straightforward to determine in many cases. An approach based on the IM amount calculated using the pro forma model would be much more suitable, since these amounts are proportionate, available and form part of the data requested in the initial application.

If the method for assessing fees will be based on notionals despite their limited relevance to the pro forma IM calculations, then we strongly encourage the EBA to adopt a method that limits the burden of new data production by prioritizing simplicity and efficiency.

- **Proposal to address Concerns:** The EBA should leverage the notional amounts and other data already reported by or on behalf of EU Counterparties to EU Trade Repositories (TRs) under Article 9 of EMIR. Requiring additional new data to be created and reported is duplicative and burdensome, contradicting the EC’s Simplification and Implementation initiative¹ and the EU objective to build a Savings and Investments Union².

Other alternatives are discussed below as part of our formal response to Q3 in the Discussion Paper.

¹ [Simplification and Implementation - European Commission](#)

² [Commission unveils savings and investments union strategy to enhance financial opportunities for EU citizens and businesses - European Commission](#)

Formal responses to the individual questions in the Discussion Paper

ISDA has solicited input from SIMM users through its working groups to inform our feedback to the Discussion Paper. We authorize the EBA to make our response public and are available to discuss our response or provide additional information that may help the EBA determine technical advice which **balances the requirement to recover their costs** for authorizing the use of SIMM in a proportionate manner **while ensuring that the cost and burden of counterparties to provide data to determine the fees is not disproportionate to the fees themselves.**

Our responses to the individual questions in the Discussion Paper provide our rationale for the conclusions above and details on alternatives for the EBA to consider.

Q1. Do you have any comments on the scope of the new tasks expected from the new role of EBA as central validator of pro forma models? Please elaborate.

We appreciate the explanation from the EBA on the scope of its new tasks and recognize the intended value and efficiency of conducting a central validation of a pro forma model, like ISDA SIMM. We have no further comments at this time.

Q2. Could you confirm that 3 months is appropriate to compute ANAPF for the purposes of submitting the information for fee calculation by the reporting deadline?

This question assumes that computation of the ANAPF as proposed is feasible and necessary. See our detailed response to Q3 as to why this is not the case.

Assuming the significant obstacles to calculate the ANAPF as proposed were overcome, and an aggregate notional amount was capable of being computed in an automated fashion following the conclusion of each month-end, then the proposed 3 months between the Reference Date and the Reporting Date would be sufficient to aggregate and submit the data. However, reliance on automation and the need to aggregate data from multiple sources, for instance in the case of a managed fund gathering data from each of its asset managers, may necessitate a longer period.

SIMM users are concerned by the expectation in section 39 of the Discussion Paper that counterparties should act now to retroactively gather the data for the proposed ANAPF from January 2025 in case the EBA announces its model validation function is ready in 2026. The proposed data collection and calculations are not automated and efforts to build automated processes could not be defined, budgeted and implemented until the EC finalizes the requirements. In the meantime, this would require an arduous manual effort which may not gain authorization from internal control functions for accuracy and certainty.

Q3. Do you have any comment with respect to the calculation of ANAPF? Please highlight any expected issue linked with the estimation of ANAPF (including accuracy of such estimation).

Market participants faced **substantial challenges determining the three-month group-level AANA** required to ascertain whether and when they would first become subject to regulatory IM requirements during the phase-in periods recommended in the BCBS and IOSCO *Guidelines for the margining of non-centrally cleared derivatives* (the Margin Framework) and the corresponding phase-in schedule adopted in the EU and other jurisdictions (IM Phase-In).

There are **two main challenges to AANA calculation**. The first is **determination of the appropriate amount to use for the “notional”** and the second is the need to **source and aggregate the notional data from multiple, separate resources**.

The currency denominated figure that corresponds to the term **“notional” is ambiguous for some products and may be expressed via different values**. There is not a global regulatory standard for how notional should be defined when a single currency amount is required. As a result, parties may report imprecise or inconsistent figures.

In the run-up to the September 1, 2021 (Phase 5) and September 1, 2022 (Phase 6) compliance dates for IM, ISDA received many queries from members on how to determine the notional amount for various products for their AANA calculation. At the same time, firms already subject to regulatory IM requirements were experiencing discrepancies with their counterparties on IM amounts calculated using the regulatory schedule due to different notional and duration inputs. At the request of members, ISDA conducted a **survey**³ in 2021 of SIMM users **on their method for determining notional** and duration values for various products. As the survey results demonstrate, **in many cases there is no consensus**, and various methods are applied. For instance, for cross-currency swaps, 7 different methods were reported for determining notional with the main methods specified as follows:

- (1) Notional amount and currency of the receive leg of the cross-currency swap transaction
- (2) Notional amount and currency of the primary (first-booked) leg of the cross-currency swap transaction
- (3) Maximum of the notionals across the two legs when the notionals are expressed in the same currency, and the currency of the maximum notional of the cross-currency swap transaction

³ [Grid Notional-and-Tenor Survey Results 20210603_clean.pdf](#)

As firms often use multiple trading platforms, aggregation of notional amounts for a portfolio is not straightforward. **Aggregation of notionals is particularly difficult for funds whose derivatives activity is managed in part or full through multiple asset managers.** It is quite common for large buy-side firms that use external asset managers to appoint more than one manager in order to receive different types of expertise or to encourage competition. And even firms that don't appoint multiple managers may well trade derivatives themselves in addition to using an external manager. To provide a precise AANA amount, such firms must obtain data from each manager, then aggregate it with their own trade data, a relatively complex step.

Due to the associated effort, most counterparties did not continue to calculate AANA once they came into scope of the IM requirements, and therefore they do not have automated processes available to produce an AANA. The only groups that would have reason to repeat their AANA calculations are:

- (i) Groups which did not breach the EUR 8 billion threshold at their last annual AANA calculation and need to affirm whether they may come into scope as of the next annual compliance date; or
- (ii) Groups which have materially altered their approach to trading derivatives (e.g. by shifting more trades to clearing) and therefore might have fallen below the EUR 8 billion threshold, allowing them to discontinue IM application entirely or to some extent.

Although AANA for IM Phase-In was difficult to calculate, it was not essential to determine a precise figure to a high degree of certainty because the established thresholds were banded, giving leeway of billions of derivatives notional averages. A group needed only sufficient certainty that it exceeded the lower bound threshold for the next phase-in period (i.e., €3.0 trillion, €2.25 trillion, €1.5 trillion, €0.75 trillion, €50 billion or €8 billion) to prompt disclosure to its counterparties and plan preparation for IM exchange.

The same challenges which apply to the calculation of AANA would extend to the calculation of ANAPF as proposed. Although figures would not need to be collected, aggregated and averaged for all entities that are part of the consolidated group, the effort to determine and report each month-end notional amount for the transactions included in the SIMM calculation for each applying legal entity is significant. As SIMM is risk-based, notional is not an input to the calculation and cannot be sourced from the Common Risk Interchange Format (CRIF). Instead, firms will need to build a process to determine, map and extract the values they will treat as the notional solely for the purpose of reporting the ANAPF data. Assuming continued long-term use of SIMM, this process would need to be conducted every month in perpetuity, rather than for an isolated three-month period that was suitable to determine initial application of IM requirements within a broad band.

The burden for smaller counterparties would be even more profound, with the cost to produce the ANAPF figure likely be multiples of the pro forma fee. This is a significant concern for managed funds for which an outsized effort will be required to gather, collate and submit the data at the level of the fund. In either case, it would deter the use of a pro forma model.

Regardless of the size of the counterparty, the effort and risk of establishing mechanisms to produce the proposed recurring ANAPF value would not meet the test of a sound cost-benefit analysis.

Strategic approach to calculating ANAPF

In theory, firms could cross-reference their workflows for reporting derivatives transactions under the Article 9 of EMIR to extract one of the values being reported as a “notional” for the purpose of determining ANAPF. But the implementation may be complex, firms may extract different values (e.g. for multi-legged transactions), and they may use different conversion rates for those not denominated in Euros, creating discrepancies that translate to fee differences under the ANAPF formula. They may also face difficulty getting internal authorization to report an imprecise value due to the risk of regulatory enforcement.

Moreover, it is **not reasonable to justify the cost, effort and risk for each firm to establish a foolproof method to determine ANAPF when data is already available** to EU supervisory authorities and national competent authorities **that could be used by the EBA to centrally and consistently calculate the ANAPF of each applying entity**. Since all EU Counterparties have an obligation to report their derivatives transactions by T+1 (either directly or via delegated reporting) to a TR, the **EBA could independently determine month-end notionals for uncleared transactions** using reported Legal Entity Identifiers (LEIs), Unique Transaction Identifiers (UTIs), clearing indicators, Unique Product Identifiers (UPIs) or ISINs, the fields for initial margin posted/received and notionals.

For each month end, the EBA would automate collation of the relevant data from the TRs for a legal entity which has applied for use of the pro forma model as follows:

1. Identify derivatives transactions via the applying entity’s LEI
2. Remove duplicate reports from dual-sided reporting using the UTI
3. Remove cleared transactions using the clearing indicator
4. Remove transactions on products exempted from IM requirements using the UPI or ISIN (e.g. equity options and physically settled FX swaps and forwards)
5. Remove transactions for which the initial margin posted+received is 0

We recognize that the TR data does not specify the relevant IM calculation method, but using the data proposed above, the **EBA would be able to cull transactions not subject to an IM exchange requirement**. For the remaining transactions subject to IM exchange, we believe the **differences for the proportional attribution of fees delineated by IM calculation**

method (i.e. pro forma vs. regulatory schedule) would be insignificant, and by no means meaningful enough to justify the considerable effort for each applying entity to produce separate figures solely to carve out the transactions calculated by means other than the pro forma model. A precedent for this broader inclusion is found in the Margin Framework and global regulations which include transactions exempted from IM exchange in the AANA calculation.

Alternative approaches to providing ANAPF

If, despite the compelling rationale for centralized determination of ANAPF by the EBA using TR data, the EBA recommends the EC require counterparties to report ANAPF amounts, the approach should be a method which is as simple and efficient as possible.

To that end, we recommend an approach by which the applying entity can choose whether their ANAPF amount is derived from the calculated pro forma IM amount (Equivalent Portfolio Notional) or based on a representation against a banded level.

For the Equivalent Portfolio Notional, firms would implement an automatic method of converting the total pro forma model calculated IM amount for the relevant portfolios of the applying entity into an equivalent portfolio notional amount using the highest weighted “% of notional exposure” in the standardized regulatory margin schedule in the Margin Framework and Regulation (EU) No. 648/2012 (i.e., 10% for Credit, 6% for FX, 4% for Interest Rates and 15% for Commodity and Equity).

So, the equivalent portfolio notional for a portfolio with initial margin across the product classes of IM(RatesFX), IM(Credit), IM(Equity), IM(Commodity) would be:

$$\text{EquivalentPortfolioNotional} = \text{IM(RatesFX)} / 6\% + \text{IM(Credit)} / 10\% + \text{IM(Equity)} / 15\% + \text{IM(Commodity)} / 15\%.$$

The notional of a legal entity would be defined as the sum of the equivalent portfolio notionals over all the CSAs in the entity.

For example, the table below shows a portfolio that has a total pro forma model calculated IM amount of EUR 24 million, its breakdown by product class, the applicable margin rate for each product class and the Equivalent Portfolio Notional amount

	RatesFX (EUR)	Credit (EUR)	Equity (EUR)	Commodity (EUR)	Total (EUR)
SIMM amount	10,968,000	816,000	11,184,000	1,032,000	24,000,000
Margin Rate	6%	10%	15%	15%	
EquivalentPortfolioNotional	182,800,000	8,160,000	74,560,000	6,880,000	272,400,000

If the total IM for the portfolio comprises the sum of a pro forma model IM and the schedule IM, under this proposal, a firm would only need to use the pro forma model IM in the calculation for Equivalent Portfolio Notional. If there are operational challenges with extracting the pro forma model IM from the total IM of the portfolio, we propose that a firm may use Total IM in the determination of the Equivalent Portfolio Notional and this would lead to a more conservative estimate of the Equivalent Portfolio Notional.

Pro forma IM amount derived notional is a simple method which would be:

- tied directly to the use of the pro forma model;
- consistent across users of a pro forma model; and
- substantially easier to implement and maintain than a variation on an AANA calculation.

CRIF for SIMM already represents the precise transactions to the portfolio which are included in the IM calculation for each product class. Deriving notionals from the SIMM amount eliminates the need to cull out the relevant population and source and determine notional values which are irrelevant to the IM calculation.

An applying legal entity should also have the option to instead make a representation regarding the banded amount of its ANAPF as further discussed in response to Q4.

Q4. Do you have any comments/relevant input to the proposed calculation methods for the fees? Please elaborate. Please elaborate, in particular if you raised issues linked with the estimation of ANAPF as part of Question 3, on how the calculation methods for the fee could be adjusted to address those issues (e.g. bucketing of counterparties according to ANAPF levels).

The proposed **Method 1** for attributing a variable fee based on the legal entity's proportion of ANAPF **would be feasible and appropriate only if the EBA calculates the ANAPF using TR data.**

We do not find sufficient value in Method 2 to warrant the separate attribution of a fixed fee to cover invoicing costs.

If the EBA calculates the ANAPF centrally, then it could use the precise method proposed for calculating the fees based on an applying entity's share of the total ANAPF.

But if the ANAPF component of the fee computation is sourced from the applicant then the fee should be determined based on banding, as was done with the original IM Phase-In schedule which bucketed groups at up to €750 billion and a minimum of €42 billion increments. This would allow for proportional application of fees whilst mitigating the challenges raised in response to Q3 to produce a precise figure.

The EBA could leverage the IM Phase-In bands, since these are well-known to market participants, or establish new bands using TR data for a graduated distribution of entity-level ANAPF amounts. The bands should be sufficiently wide to mitigate the ANAPF calculation challenges describe above while recognizing the substantive gradation in derivatives notional exposures among applying entities. The center point of each band could be used for the ANAPF input to the pro forma fee calculation. If we consider the EBA cost estimate of €1.5-2 million, the difference between use of an ANAPF to a single integer versus the mid-point for a band would be minimal.

SIMM users are certain that the cost of developing the mechanisms to determine a precise ANAPF figure would outweigh the pro forma fee itself. They would like to have the option to self-declare for a particular band rather than attempt to produce a precise figure (even if that precise figure might result in a lower fee). There is a precedent for this in the clearing mandate, for which some counterparties have exercised the option to declare themselves above the clearing threshold rather than run the required complex calculation.

Q5. Do you have any comments on the proposed timing of invoicing? Please elaborate.

We have not concerns at this time with the EBA's proposal to issue invoice by each June 30th each year with payment due within 30 days.

Q6. List of information to be communicated to the EBA for calculation of fees? Reporting timeline?

It is unnecessary and duplicative for counterparties to communicate the ANAPF and the end-months amounts of non-centrally cleared derivatives used to compute the ANAPF. These figures should be determined by the EBA using TR data.

An applying entity should only need to communicate the pro forma model used during the reference period and the financial details required for the billing process.

If firms are required to report monthly and/or annual ANAPF, then these figures should be derived in a less onerous manner, as suggested in response to questions 3 and 4.

For the reasons discussed in Q3, it will be complex and onerous for managed funds to gather and aggregate ANAPF amounts for electronic communication to the EBA. As a mitigant, managed funds should be allowed to submit the disaggregated ANAPF figures provided by their asset managers.

Q7. Do you have any other comment on the proposals made in this discussion paper?

The EBA's role as central validator is intended to enable an efficient and less burdensome approach to authorization and validation of pro forma models. **It stands in contrast then that the method to determine the associated fees would be decentralized, inefficient and burdensome, potentially deterring firms from using ISDA SIMM**, a robust, risk-sensitive calculation method which has been used globally for more than eight and a half years to comply with regulatory IM requirements.

Instead, a feasible method that would use the available dataset for derivatives transactions for surveillance of derivatives markets has not been considered, even though the data is (or should be) readily available to EU authorities and is subject to oversight for completeness and accuracy. **By extracting the relevant TR data, the EBA could apply a consistent, proportionate approach to determining ANAPF that could be automated centrally** using the proposed Method 1 formula for any pro forma model. This is significantly more efficient than requiring the estimated 300+ entities which might apply for SIMM approval to do this individually. Furthermore, it would align with current EU initiatives to promote efficiency and reduce regulatory burden.