

Cost effective solutions to the challenge of ISDA SIMM™ Backtesting & Benchmarking – Webinar Q&A

AcadiaSoft hosted a webinar on 30th January that reviewed some of the challenges and requirements for in-scope firms that may be subject to regulatory IM Backtesting & Benchmarking. We received several questions from attendees, which we would like to share together with the answers from our panel of experts.

We hope that you find this resource valuable and that it answers some of your pressing questions. If you have any feedback, or have any additional questions for our experts, or would like to join our Phase 4 or Phase 5 working group, please contact us on info@acadiasoft.com or visit our dedicated website for Uncleared Margin Rules: www.acadiasoft.com/umr_compass

1. What is the lookback period or window for the frequent (dynamic) actual P&L backtesting?

A: Dynamic monitoring is a process of comparing daily PNL with 1 Day SIMM. A lookback is affected through static backtesting. The idea is to catch new trades, cash flow events or edits which could potentially be a cause of a shortfall when looking back over a 10-year period.

2. SIMM™ excludes notional principal flows of deliverable cross currency swaps but actual P&L includes it. Is a dynamic backtesting exception caused by this an issue?

A: When calculating actual P&L (for dynamic monitoring purpose), it is required to exclude the notional exchange from cross currency swap, otherwise it will cause issues.

In order to compare to the SIMM methodology, most Phase 1 and 2 firms had to make changes in their valuation routine to accommodate this.

3. Does AANA currently include FX forwards?

A: Yes. For now, you should continue to calculate AANA including FX forwards. ISDA's advocacy to the regulators about removing FX forwards from the AANA calculation has not yet been approved by the regulators.

4. Can you clarify if there is any materiality limitation on what should be reported as part of the quarterly monitoring? If not, is there a plan to introduce something of the sort?

A: ISDA have outlined a materiality threshold for monitoring.

Please refer to page 6 and 7 of the following

document: <https://www.isda.org/a/3wEDE/isda-simm-governance-framework-25-july-2016-public.pdf>

- 5. Regulators require that when testing SIMM™ against alternative benchmarks, these are either external (DCO) or validated in the case of VaR etc. If VaR is calculated by an external service, how can the firm convince regulators the VaR is validated?**
- A:** The service AcadiaSoft provides an independent backtest of the SIMM™ model, on a full revaluation basis, over an extended period with DCO and alternative VaR benchmarks. Those benchmarks differ from the SIMM™ model. Our service also covers risks not included in the SIMM™ model.
- 6. The exposure calculation between buy and sell side is never spot on due to the risk perspective from both sides. How is the calculation for initial margin going to be addressed since there will be a difference on exposure calculation between buy and sell side?**
- A:** The post side of the IM calculation is always calculated from the other counterparty perspective, not your own.
- 7. If you are out of scope for CFTC but your derivative counterparties are in-scope for EMIR, do you indirectly qualify or does the firm just go with CFTC?**
- A:** Until both regimes recognize some concept of equivalency, you would calculate your IM collect and post requirement based on both EMIR and CFTC. You would then choose the maximum of the two calculations as the winning regulation which you would use in the margin call. Regulators will never object if you post more than the regulatory minimum. AcadiaSoft's IM Exposure Manager services supports this functionality today and this is how all Phase 1, 2 and 3 firms comply in this situation.
- 8. What is the expectation of the buy-side that are utilizing SIMM™ through a vendor product?**
- A:** The expectation is of a high quality, comprehensive, cost effective end-to-end service that satisfies both operational and regulatory needs.
- 9. We are a phase 4 firm that is prudentially regulated by US regulators. In seeking model approval from the PR, we understand that we need to evidence that SIMM is appropriate to our portfolios. However, it is not clear if the portfolio in question should be the whole legacy portfolio or if it is better to take trades over a more recent period only (e.g. the last year or 2 years). Please provide clarity and best practice.**
- A:** It is best to look at the trades from the last two years as a test case. Pick up a COB date and include all trades done in the last two years. Two years is a fair representation of trade volume.
- 10. When are we expected to hear from regulators around ISDA's advocacy points?**
- A:** There is a meeting of the Basel Committee on Banking Supervision in late February. ISDA and other trade groups are hoping for some guidance to be issued shortly.

11. Is back-testing necessary for regulatory approval, or it is only done after regulatory approval is done and by taking IM calculation service from AcadiaSoft will do away with regulatory approval?

A: Depending on the jurisdiction, there may be a requirement to do backtesting as part of the regulatory pre-approval which is not related to back testing requirement on an ongoing basis (annual/quarterly).

12. What is the likelihood that regulators will raise the AANA threshold to 100BN for Phase 5? Will FX be taken out of the AANA calc as they are not required to be margined?

A: To be perfectly frank, not likely. The only advocacy point that regulators seem likely to consider at this point is the request to delay the negotiation and implementation of your IM CSA and your custodian documentation until your firm would approach the 50MM IM threshold. This is the only advocacy point which doesn't require a rule change and is therefore judged to be somewhat more likely. This also means that you need to calculate SIMM or schedule so that you can monitor how close you are coming to the 50mm threshold.

13. If a small buy side firm Licences SIMM from ISDA will they need to provide annual data to ISDA as well or is it only the largest dealers that are required to do this?

A: The data that ISDA collects on an annual basis from firms is for the annual re-calibration and annual industry back test. At the moment, a small buy side firm is not expected to participate in either of these exercises (Although, this may change for backtesting pending future conversations with the regulators and/or the outcome of the industry relief efforts).

For the annual re-calibration, phase 1 firms are expected to participate. But anyone that trades the instruments used in calibration is welcome to submit data (if they have it). For the annual industry backtest, phase 1 and 2 firms (the largest dealers) are the expected participants.

This document is for informational purpose only.

About AcadiaSoft, Inc.

AcadiaSoft, Inc. is the leading industry provider of risk and collateral management services for the non-cleared derivatives community. The AcadiaSoft Hub encompasses a suite of applications and analytics that enable and measure the complete STP workflow from CSA agreement management, risk services, margin and collateral management through to settlement. Backed by 17 major industry participants and market infrastructures, AcadiaSoft is used by a community of more than 650 firms exchanging approximately \$400B of collateral on daily basis via its margin automation services. AcadiaSoft is headquartered in Norwell, MA and has offices in London, New York and Tokyo.

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