EXPLORING THE IMPACT OF UMR AND SA-CCR

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THE FUTURE IS YOU — SOCIETE GENERALE
UMR: OVERVIEW

UNCLEARED MARGIN RULES: WHAT ARE THEY AND WHAT DERIVATIVES ARE IN SCOPE?

• The UMR rules aim to reduce systematic risk, promote central clearing and cover losses in the event of default
• Swap dealers and their counterparties are now required to post initial margin (IM) on non-cleared, over-the-counter (OTC) derivatives
• The implementation of UMR poses a material and resource intensive challenge for clients

WHICH NON-CLEARED DERIVATIVES ARE IN-SCOPE

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Rates</td>
<td>All interest rate derivatives (e.g. swaps, cap, floors, swaptions, etc.)</td>
</tr>
<tr>
<td>Credit</td>
<td>All credit derivatives (e.g. credit default swaps, swaps on bonds, credit options, etc.)</td>
</tr>
<tr>
<td>FX</td>
<td>All FX derivatives <strong>except</strong> FX spot, <strong>physically</strong> settled FX swaps/forwards, principal payments on cross currency swaps (CCS)</td>
</tr>
<tr>
<td>Commodity</td>
<td>All commodity derivatives <strong>except physically</strong> settled swaps/forwards/options</td>
</tr>
<tr>
<td>Equity</td>
<td><strong>Equity swaps, dividend swaps, equity forwards</strong> while <strong>equity options</strong> are permanently exempt under US regulation and temporarily exempt under EU regulation until January 2024</td>
</tr>
</tbody>
</table>
BANK PERSPECTIVE

WHAT IS AANA?
• AANA is based on the open gross notional value of all non-centrally cleared derivatives positions during the designated calculation observation period for the phase

<table>
<thead>
<tr>
<th>UMR Phase</th>
<th>AANA</th>
<th>IM Compliance Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phase 5</td>
<td>&gt; 50 billion</td>
<td>1-Sep-21</td>
</tr>
<tr>
<td>Phase 6</td>
<td>&gt; 8 billion</td>
<td>1-Sep-22</td>
</tr>
</tbody>
</table>

• There is a regulatory maximum allowed IM threshold of EUR/USD 50mm in aggregate across all IM CSA between 2 counterparty Groups under which counterparties may decide not to exchange IM

IM EVOLUTION

Source: Societe Generale
LIQUIDITY & VENUES

PRODUCTS

Comprehensive central clearing offering with memberships of all major CCP venues

One of the largest execution & clearing brokers of ETDs in the world (9.7% global market share) with 2.5 billion contracts cleared & executed in 2020

Interest Rates
Credit
FX
Commodities
Equities

CHANNELS

OTC CLEARED
Comprehensive central clearing offering with memberships of all major CCP venues

LISTED
One of the largest execution & clearing brokers of ETDs in the world (9.7% global market share) with 2.5 billion contracts cleared & executed in 2020

Sources: Risk.net: UMR and the growth of client clearing & BIS

IMPROVING INITIAL MARGIN & COST EFFICIENCY
SACCR / EUROPEAN BANK

\[ \text{COST} = \text{Market B/O spread} + \text{CVA charges} + \text{Regulatory Charges} \]

- Market B/O spreads are observable
- CVA charges are increasingly standardised
- Regulatory charges depend on various constraints

\[ \text{Regulatory Charge} = \text{Function of (NSFR, LR, SACCR,…)} \]

Year End Turn

Sources: Societe Generale & Bloomberg
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Effects of SA-CCR and UMR on FX trading and liquidity conditions
Buy-side perspective
Elke Wenzler | 07. Dezember 2022
UMR Impact observation
Buy-side perspective

Phase 6 – more buy-side firms in scope, but impact remains to be seen

In-scope versus impact

- UMR Phase 6 was and is expected to have the biggest impact on the buy-side. Approximately 1,100 firms have been affected by this final chapter of the regulation.
- However, AANA* is based on the size of derivative portfolio including FX Swaps and Forwards, which have no direct impact on margin requirements.
- FX is a global market, not all market participants are affected.

New operational processing and contractual readiness

Legal considerations

- Determination of all legal entities in scope, based on AANA*
- Clarification of affected contractual relationships, incl. cross-border scenarios
- Waiver-Agreements allow trading up until an allowable IM threshold of 50 Million EUR
- Prioritization and optimization of contract negotiations based on historical trade pattern and projection as part of the analysis

Operational changes

- New set-up, includes using Tri-Party Agents. Increased importance and complexity in collateral management (asset-/ cash-pool optimization)
- Internal allocation and ongoing monitoring of thresholds

Strategies

- Optimized utilization of deductible thresholds
- Increase of the central clearing rates of traded credit default and interest rate swaps
- Get ready for further CCP instruments or ETD, with variety of factors drive the decision:
  - Access to more liquidity and additional liquidity providers
  - Risk reduction and ease of contractual and operational processes
  - Optimization in collateral management and potential netting effects

*AANA Average Aggregate Notional Amount

Source: MEAG
Observation on the Impact
Buy-side perspective on SA-CCR

Diverging and uneven impact between counterparts and instruments

Counterparts

- Diverging impact for the EU and the US, due to the harsher impact of the lower limit for RWA, set by the standardized approach
- Counterparts exposed to high directional derivative transactions, are penalized for one-side directional exposures
- SA-CCR is a risk sensitive model – focus on net risk, instead using gross amount of notional at a point in time

Instruments

- Influence is particularly pronounced for short dated FX swaps and forward
- SA-CCR provides better recognition of risk offsets (netting) and collateralized trades, therefore cleared derivatives benefit under SA-CCR, as they face a single counterpart (the CCP)
- Under SA-CCR, volatility is factored in – that's especially significant for FX forwards, which uses a factor of 4%

Divergence of quoted forward spreads

- Overall cost of trading FX forwards increased in 2022 for various reasons
- Noticeable are wider spreads for most US banks in G10 and EM countries, and an additional spread divergence for swaps with different maturities.

![Graph showing divergence of quoted forward spreads](source: BestX)

- Additionally, a significant change in the hit ratios and leaderboard of counterparties can be observed, especially in G10

Strategies

- Ensure transparency with the respective counterparties to understanding the effects
- Importance of netting agreements in place with all FX counterpart
- Addressing potential concentration risk, by adjusting the counterparty list
- Focus on cleared derivatives, as these benefit by SA-CCR
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