Initial Margin for non-cleared derivatives

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Passion to Perform
Agenda

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2) Margin Requirements
3) Covered Entities
4) Covered Transactions
5) IM Calculations
6) IM Requirements Overview
7) IM Segregation – Third Party Custodian
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9) IM Documentation under German Law
Based on a mandate from G20, BCBS and IOSCO developed global “minimum standards” on margin requirements.

**Objective**
- Reduce Systemic Risk
- Promote Central Clearing

At EU – Level implemented by European Market Infrastructure Regulation (EMIR)* and Delegated Regulation**

* Regulation (EU) 648/2012 on OTC-derivatives, central counterparties and trade repositories

** Commission delegated regulation (EU) 2016/2251 supplementing EMIR with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty
## Margin Requirements

**Variation Margin**
- Objective: Protects against counterparty credit risk arising out of fluctuations in market value.

**Initial Margin**
- Objective: Protects against potential losses between the last exchange of VM and liquidation or hedging of positions following a counterparty default.
### Covered Entities ➔ FC and NFC+

<table>
<thead>
<tr>
<th>Phase 1</th>
<th>Phase 2</th>
<th>Phase 3</th>
<th>Phase 4</th>
<th>Phase 5</th>
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</thead>
<tbody>
<tr>
<td>Feb 04, 2017</td>
<td>Sept 01, 2017</td>
<td>Sept 01, 2018</td>
<td>Sept 01, 2019</td>
<td>Sept 01, 2020</td>
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<tr>
<td>€ 3.0 + trillion (AANA)</td>
<td>€ 2.25 + Trillion (AANA)</td>
<td>€ 1.5 + Trillion (AANA)</td>
<td>€ 0.75 + Trillion (AANA)</td>
<td>€ 8 + Billion (AANA)</td>
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- **Aggregate Average Notional Amount (AANA)** of outstanding non-cleared derivatives during observation period (March – May) on group level (including intra-group transactions but counting them once)

- **After Phase-In periods:** AANA for months March – May of preceding year of € 8 billion or more (Art. 28 Delegated Regulation)
Covered Transactions

Art 2 (5) EMIR: “derivative” or “derivative contract” means a financial instrument as set out in points (4) to (10) of Section C of Annex I to Directive 2004/39/EC (MIFID) as implemented by Article 38 and 39 of Regulation (EC) No 1287/2006

- Physically settled FX forwards
- Physically settled FX swaps
- Exchange of principals of currency swaps

No IM

- Single – stock equity options or index options
- Art. 36(1) and 37 apply from 4.1.2020

Date of application
### IM Calculation

**EMIR allows for Standard and Internal Model approaches**

<table>
<thead>
<tr>
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<th>Standard Model</th>
<th>Internal Model</th>
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<tbody>
<tr>
<td><strong>pros</strong></td>
<td>Simple implementation</td>
<td>Smaller IM</td>
</tr>
<tr>
<td><strong>cons</strong></td>
<td>Potentially larger IM</td>
<td>Regulatory approval requirement and difficult to harmonize between counterparties</td>
</tr>
</tbody>
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**ISDA SIMM**
IM Requirements Overview

- Permitted threshold of EUR 50 million shared across consolidated group
- Reduction of threshold to EUR 10 million where both counterparties belong to same group
- Minimum Transfer Amount of EUR 500,000 (for both IM and VM)
- No Netting → Two way IM
- Segregation
- No re-hypothecation, re-pledge or re-use
- Documentation
IM Segregation – Third Party Custodian

Objective: protection of default or insolvency of collecting counterparty
Documentation Architecture - Example

- Party A
  - Custody Agreement / ACA
  - Custodian T&Cs
  - Service Agreement
  - Operating Procedures
  - Master Agreement
  - VM-CSA
  - IM-CSA
  - Security Agreement

- Party B
  - Custody Agreement / ACA
  - Custodian T&Cs
  - Service Agreement
  - Operating Procedures

- Party A Custodian
- Party B Custodian
IM Documentation under German Law

Party A

- Master Agreement for Financial Transactions
- VM-Collateral Addendum
- IM-Collateral Addendum
  - IM-Security Agreement Belgium Law (Euroclear)
  - or
  - IM-Security Agreement Luxembourg Law (Clearstream)

Party B