Bilateral Initial Margining

Initial Margin Reqirements

The exchange of variation margin (VM) was widely practiced in the past and is mandatory since the beginning of 2017 for non-centrally cleared derivatives. Initial Margin (IM), on the other hand, was rarely used in the OTC market in the past and will lead to additional efforts for affected entities.

Scope

Initial margin requirements will be phased-in over the years 2016-2020. Covered entities have to meet the requirements as of September of each year, depending on regulatory prescribed thresholds. After 2020, all institutions with a non-centrally cleared derivative volume (gross notional) greater than € 8 billion are required to exchange intital margin for OTC derivatives.

Threshold	2019				2020				2021			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
€ 750 bn	1. Sept 2019											
€ 50 bn					1. Sept 2020							
€ 8 bn									1. Sept 2021			

Adoption Bilateral Margining 2019 – 2021 (BCBS-ISOCO Update July 2019)

Calculation

Covered entities are able to choose between a standard method and a non-specified internal model for the calculation of initial margin amounts. The International Swaps and Derivatives Association (ISDA) has developed an internal model that is expected to become the market standard (ISDA SIMM™). Overall, the calculation of IM amounts involves high efforts especially when it comes to reconciliation with counterparties. It is possible to conduct this reconciliation and the IM calculation itself via a third-party provider (AcadiaSoft).

Background

Ever since the financial crisis, supervisory authorities around the world have been working to reduce risks in the financial industry and, in particular, the OTC derivatives market. Various initiatives have been launched aiming to protect market participants from negative consequences of a counterparty's default. As a result, a large number of new regulatory requirements have been introduced, including the obligation to clear certain products as well as new rules with respect to the collateralization of OTC derivatives.

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Implementation

The obligation to exchange IM imposes new challenges for entities involved in OTC derivatives trading. In particular, additional efforts will be required in the following areas:

Collateral Management

Adapting the collateral management processes to the new regulations and implementing the requirements for the selection and composition of collateral.

Risk

Frequent calculation of initial margin and generation of the required input data (positions, sensitivities, etc.).

Legal

Setup of regulatory compliant initial margin CSAs.

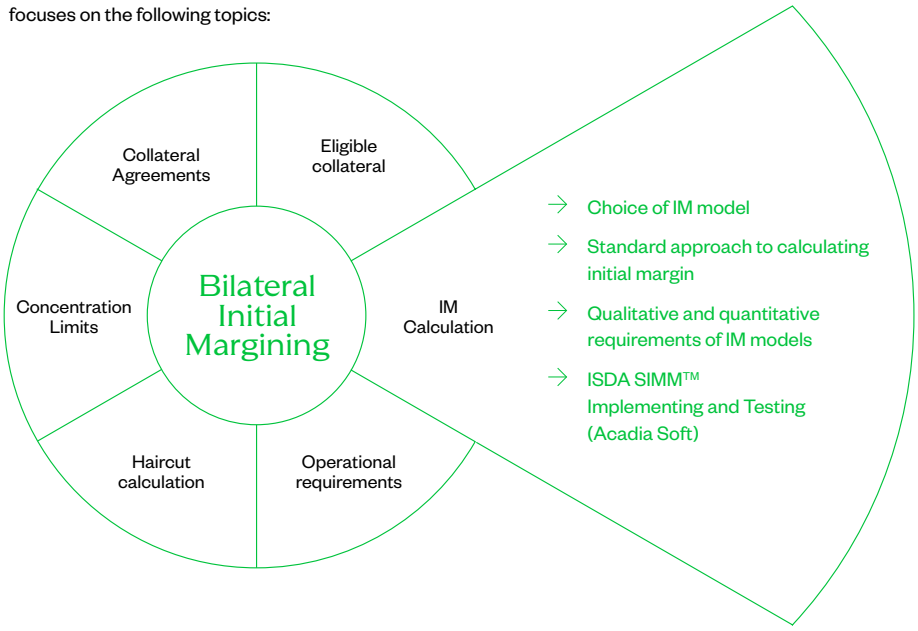
IT

Implementation of standard approach, ISDA SIMM™ or an alternative IM model.

Experience

In our current project with one of Germany's largest commercial banks, we have experienced that early testing with other counterparties provides important information about the quality and availability of required input data and processes. The preparation of input data for IM calculation as well as the reconciliation with counterparties are time-consuming and laborious tasks. We were able to gather experience in this area and retrieved lessons learned, which we like to share with interested customers.

Our workshop on bilateral initial margining focuses on the following topics:



Workshop Agenda

1) Initial Margining

- Background and regulatory overview
- Timeline (margin obligation)
- Initial margin calculation (frequency, approaches, ...)
- Standard method
- Internal Initial Margin models (concept, requirements, ...)
- ISDA SIMM™
- Data requirements (standard method and ISDA SIMM™)

2) Testing with a third-party provider (AcadiaSoft)

- Preparation and requirements
- Unilateral testing
- Bilateral testing
- Prototyping ISDA SIMM™
- Sample calculations

3) Lessons learned from testing and implementation

- Matching position data
- Product classification
- Bucket mapping
- Validation and alignment of interest rate sensitivities
- Calculation of cross-currency swap inputs for ISDA SIMM™

4) Questions and discussion