

# Initial Margin Landscape - A Long Road Ahead

Partner Content (CME Group) – *Neil Murphy, business manager of triResolve, discusses what the regulatory initial margin landscape changes mean to the market and how in-scope firms for phase 5 and 6 may decide to take an alternative approach to IM compliance*

Recent guidance from the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) has changed the regulatory initial margin landscape. As firms are getting ready to meet initial margin (IM) regulations, a potential one-year extension and removal of some documentation requirements may mean a welcome reprieve for some, but there is still a lot of work to be done.

## WHAT DOES THE RECENT GUIDANCE FROM BCBS IOSCO MEAN TO THE MARKET?

Although not yet formally legislated across all jurisdictions, it is now anticipated that the final phase of IM implementation will be split in two; phase 5 on 1 September 2020—firms with an aggregate average notional amount (AANA) greater than €50 billion/\$50 billion—and a new phase 6 on 1 September 2021—firms with an AANA greater than €8 billion/\$8 billion. The original phase 5 group of firms has now been split in two, with approximately 30 percent coming into scope in 2020 and 70 percent in 2021, giving smaller firms another year to get ready. An additional operational burden has also been alleviated for firms as they are not required to have legal documentation and custodial agreements in place ahead of breaching the €50 million/\$50 million call threshold per counterparty group.

For larger firms who expect to quickly breach the €50 million/\$50 million call threshold, there is no change. They need to continue preparing for the deadline as planned; selecting an IM calculation method and engine, establishing an IM collateral workflow, defining a reconciliation approach, and putting in place documentation with counterparties and custodians.

However, for smaller firms who are likely to be under the €50 million/\$50 million call threshold for a long time, or even indefinitely, this presents an opportunity to focus valuable resources on priority tasks, namely calculating and monitoring IM. Allowing them to defer the documentation challenge until their exposure nears the €50 million/\$50 million call threshold if required at all.

## WHAT IS IM MONITORING AND WHAT DO FIRMS NEED TO CONSIDER?

IM monitoring is the requirement for firms to calculate IM exposure on in-scope transactions and monitor this exposure against their fellow in-scope counterparties.

Regulation stipulates that IM can be calculated in one of two ways. Either through a regulatory approved model or through a schedule-based percentage of notional approach. The latter does not really allow for much netting and may be quite expensive, although there are some instances when it may be the preferable method of calculation. To date, the market has adopted the International

Swaps and Derivatives Association (ISDA) Standard Initial Margin Model (SIMM) model as it provides a standard way to calculate IM. SIMM requires firms to calculate sensitivities which then need to be fed into the model to calculate IM exposure amounts.

For IM monitoring to be effective, firms need to have the ability to pro-actively monitor IM amounts. 'Local' thresholds must be set, amounts which, when breached, signal a need to prioritise legal documentation. Upon breach of a local threshold, firms must allow sufficient time to establish legal documentation with custodians and counterparties ahead of breaching the regulatory IM threshold.

## **IS IM MONITORING RIGHT FOR MY FIRM?**

Whether you expect to be in-scope in either phase 5 or 6, you are required to calculate IM. However, based on the size and composition of your portfolio you may never exceed the €50 million/\$50 million call threshold.

Hence, you need to consider whether it is necessary to undertake the additional effort, not to mention cost, of implementing a full IM programme, including extensive documentation. A lighter, cheaper option may be more appropriate to begin with, to assist with preparing for compliance without undertaking unnecessary project steps. Should your IM exposure increase slowly over time, perhaps you may wish to consider switching from monitoring to margining.

## **WHAT ARE THE NEXT STEPS?**

Hopefully, by now you have confirmed when you are in-scope. Regardless of your phase, planning should be your key priority. Phase 6 firms should not take this additional time to defer IM projects, instead firms should continue their preparation. Calculation of IM exposure per counterparty relationship is essential since this will help firms estimate time to breach the €50 million/\$50 million call threshold and hence to determine whether monitoring is right for them.

## **HOW CAN TRIOPTIMA HELP?**

TriOptima offers a holistic IM Monitoring solution which starts with the calculation of trade sensitivities and IM exposure, monitors your IM versus your counterparties IM, and alerts you when a threshold is breached. With a single trade file and rapid onboarding, we aim to make IM monitoring effective and easy.

Here is how it works:

- Submit a trade file in any format and we calculate your trade level sensitivities
- We calculate the in-scope trades' IM exposure for each portfolio using both the ISDA SIMM and schedule approach. The ability to use both ISDA SIMM and a scheduled approach may mean lower exposure for a longer period
- We monitor the IM exposure for each relationship in triResolve Margin and compare it to your counterparty
- You set the local threshold and are automatically alerted when this is breached—allowing you to then prioritise the deferred documentation task

Once a local threshold is breached you can easily switch from IM monitoring to IM margining on triResolve Margin:

- IM margin calls are automatically generated and sent via AcadiaSoft's MarginSphere to your counterparties
- Upon agreement of margin call, a fully automated collateral workflow allows you to agree on collateral payment and send details to your chosen custodian or tri-party agent

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