



Safe,
Efficient
Markets

Impact of the Margining Reforms on Asia

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WGMR Framework

- In September 2013, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions published a framework for margin requirements for non-centrally cleared derivatives (“BCBS-IOSCO Framework”) that was intended to be used by G-20 regulators in adopting their own rules.
- In March 2015, BCBS IOSCO updated the implementation timetable.
- The BCBS-IOSCO Framework needs to be implemented by national regulators.

WGMR Key Requirements

- Margin requirements should apply to all uncleared transactions
 - Some FX carved out of framework
- Financial firms and systemically important non-financial entities to exchange initial margin (IM) and variation margin (VM)
 - Precise definition of financial firms, non-financial firms and systemically important non-financial firms to be determined by appropriate national regulation
- Limits on use of thresholds, minimum transfer amounts
 - Threshold limit applied at group level
- IM to be calculated using model meeting specified requirements, or standard schedule
- VM to be exchanged to cover full amount of exposure with sufficient frequency (eg daily)

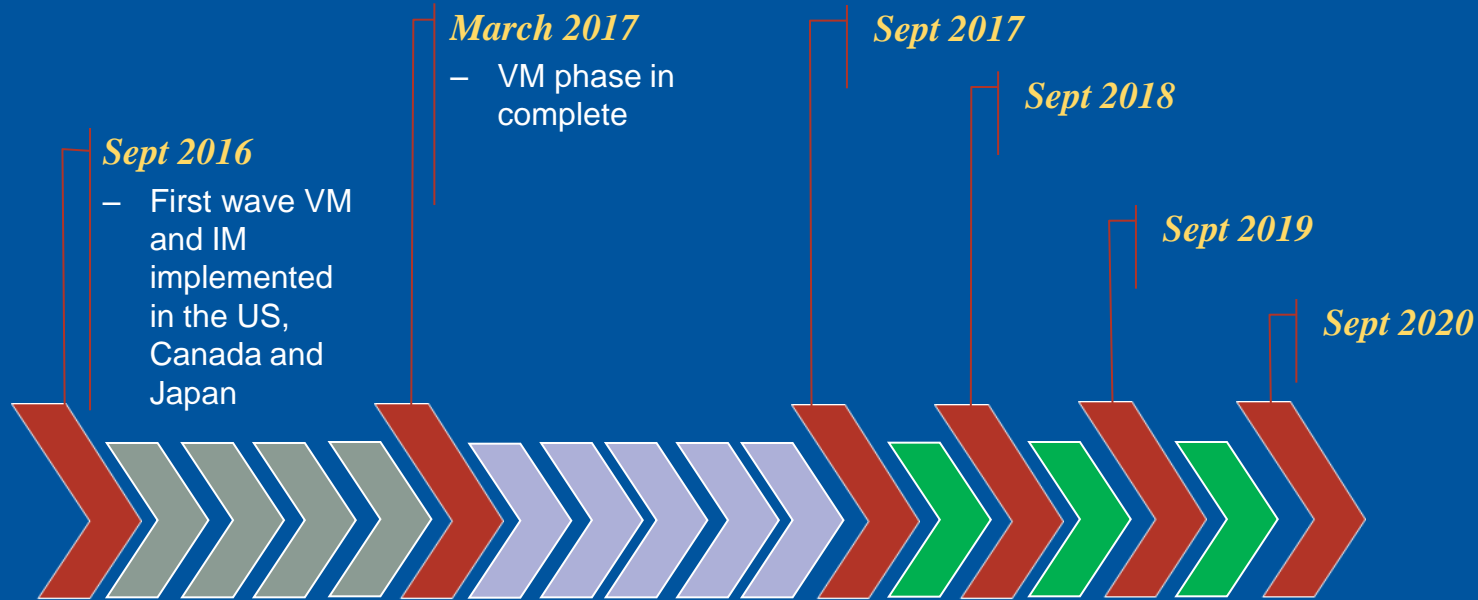
WGMR Key Requirements

- Collateral should be limited to highly liquid assets and subject to haircuts
 - National supervisors should develop their own list of eligible collateral assets
- IM should be exchanged on a gross basis, and held in a way that protects each party from the other's insolvency risk
- Requirements to be phased in

WGMR National Rules Current Status

Country/Region	Regulator/Authority	Rules Status
USA	Prudential Regulators	Final rules November 2015
Switzerland	Federal Council	Final rules November 2015 (Financial Market Infrastructure Ordinance). Update expected to harmonize with EU
USA	CFTC	Final substantive rules January 2016, final cross-border rules May 2016
Canada	OSFI	Final rules February 2016 (Guideline E 22)
Japan	JFSA	Final rules March 2016
South Africa	NT	Draft rules June 2015
Hong Kong	HKMA	Draft rules December 2015 and consultation conclusions August 2016
Australia	APRA	Draft rules February 2016
EU	European Supervisory Authorities	Draft rules March 2016
Singapore	MAS	Draft rules May 2016
India	RBI	Discussion paper May 2016

Uncleared Margin Rules - Implementation Timetable



First Wave

- Exchange of VM and IM if average aggregate notional amount of non-centrally cleared derivatives for group for the March, April and May prior to September (**AANA**) exceeds €3 trillion

March 2017

- VM requirements apply to all other covered entities

Sept 2017 - 2020

- IM AANA threshold decreases annually;
- Sept 2017 – € 2.25 trillion
- Sept 2018 – €1.5 trillion
- Sept 2019 – €0.75 trillion
- Sept 2020 – €8 billion

Application to Cross-Border Counterparty Parings

Cross-border application of PR Rules: Offshore Exclusion

- Prudential regulators exclude “foreign non-cleared swaps” of a “foreign covered swap entity” from the scope of the margin requirements.

Foreign Covered Swap Entity

Any covered swap entity that is not–

1. Organized under the laws of the United States or any State, including a U.S. branch, agency or subsidiary of a foreign bank;
2. A branch or office of an entity organized under the laws of the United States or any State; or
3. A subsidiary of an entity that is organized under the laws of the United States or any State.

Foreign Non-Cleared Swap

Neither the counterparty nor any party that provides a guarantee of either party’s obligations under the uncleared swap is–

1. Organized under the laws of the United States or any State (including a U.S. branch, agency, or subsidiary of a foreign bank) or a resident of the United States;
2. A branch or office of an entity organized under the laws of the United States or any State; or
3. A swap entity that is a subsidiary of an entity that is organized under the laws of the United States or any State.

A company is a “subsidiary” of another company if:

- The company is consolidated by the other company on financial statements under GAAP, IFRS or other similar standards, or would be if any such standards had applied; or
- A U.S. banking regulator has determined that a company is a subsidiary of another company because the regulator has concluded that either company provides significant support to, or is materially subject to the risks or losses of, the other company.

“US branch” determination:

- Note: The Prudential Regulators stated that they “would generally consider the entity to which the swap is booked as the counterparty.”

Cross-border Application of EMIR Rules

Financial counterparties (FC):

- An investment firm, credit institution, insurance undertaking, assurance undertaking, reinsurance undertaking, undertaking for collective investments in transferable securities (UCITS) and its managers, institution for occupational retirement provision and alternative investment fund managed by AIFMs (in each case authorised pursuant to relevant EU directives).

Non-financial counterparties (NFC):

- An undertaking established in the EU other than a financial counterparty or a central counterparty.

Third country entities (TCEs):

Entities that are not “established” in the EU. Obligation applies to a TCE where the contract is:

- Between a FC or NFC+ and a TCE that would be subject to the obligation (*i.e.*, an FC or NFC+) if it were established in the EU; or
- Between two TCEs that would be subject to the obligation if they were established in the EU provided the contract **has a direct, substantial or foreseeable effect within the EU** or where the obligation is necessary or appropriate to prevent evasion of the Regulation.

Entity Scope: EMIR Rules

	FC/NFC+	NFC-	TCE (FC/NFC+)	TCE (NFC-)
FC/NFC+				
NFC-				
TCE (FC/NFC+)				
TCE (NFC-)				

Margin Rules do not apply

Margin Rules apply

Margin Rules apply if there is a 'direct, substantial and foreseeable effect'

Cross-border application of AEJ rules

Hong Kong

Substituted compliance available if an AI's counterparty is subject to a foreign regulatory framework for which HKMA has made a comparability determination.

Exemption for transactions with counterparties from jurisdictions where netting and/or collateral arrangement is not enforceable.

Singapore

Deemed compliance available if (i) the margin requirements in the foreign jurisdiction are comparable; and (ii) the MAS Covered Entity can demonstrate that it has complied with the margin requirements of that foreign jurisdiction;

Exemption for transactions with counterparties from jurisdictions where netting is not enforceable.

Australia

Substituted compliance available subject to APRA approval and automatic deference regime for a foreign ADI, Category C insurer or EFLIC in Australia;

Exemption for transactions with counterparties from jurisdictions where netting and/or collateral arrangement is not enforceable

VM Margin Requirements Table

Relevant Foreign Jurisdiction (RFJ)	Counterparty	Is Counterparty required to collect VM under RFJ when trading with FIs in a jurisdiction with no margining rules?
N/A	Domestic counterparty	No
Korea/China etc	Counterparty in a jurisdiction with no margin regulation	No
US (PR)	US-based swap dealer (SD)	Yes unless certain exemptions are available
	Onshore branch of US-based SD	Yes
	Onshore subsidiary registered as SD (i.e. non-US SD)	No unless it has a US parent/guarantor or acting through a US branch
	Subsidiary guaranteed by a SD	No assuming subsidiary is not an SD
EU	Offshore EMIR-compliant bank	Yes unless certain exemptions are available *
	Onshore branch of EMIR-compliant bank	Yes unless certain exemptions are available *
	Onshore subsidiary guaranteed by EMIR-compliant bank	Yes if meet certain conditions **
	Stand-alone subsidiary of EMIR-compliant bank	No
Japan	Offshore Japanese bank	Yes ***
	Onshore branch of Japanese bank	Yes ***
	Onshore subsidiary of Japanese bank	No
HK	Offshore HK bank	Yes
	Onshore branch of HK bank	Yes
	Onshore subsidiary guaranteed by HK bank	Yes if meet certain conditions #
	HK branch of overseas bank	Yes if trades booked in Hong Kong
	Stand-alone subsidiary of HK bank	No
Singapore	Offshore Singapore bank	Yes
	Onshore branch or subsidiary of Singapore bank	No
Australia	Offshore Australian bank	Yes ##
	Onshore branch of Australian bank	Yes ##
	Onshore subsidiary of Australian bank	Yes if subsidiary is a Level 2 group entity ##

* If independent legal review (i) does not confirm that the netting agreement in the relevant third country can be legally enforced with certainty at all times; or (ii) confirms that no segregation arrangement with such third country party can meet the requirements under the draft RTS, then the EU party does not need to POST any VM/IM (such jurisdictions being "Non-Netting Jurisdiction"). The EU party does not need to COLLECT or POST VM/IM if (A) the third country is a Non-Netting Jurisdiction; (B) the independent legal review concludes that collecting collateral in accordance with the draft RTS is not possible; and (C) the exemption ratio is lower than 2.5%.

** Pursuant to Art 11(12) of EMIR, VM/IM requirements apply to transactions between two non-EU entities that would be subject to those requirements if they were established in the EU, provided that those transactions have a "direct, substantial and foreseeable effect" within the EU OR where such obligation is necessary or appropriate to prevent the evasion of any provisions of EMIR. An OTC derivative is deemed to have a "direct, substantial and foreseeable effect" within the EU where a non-EU subsidiary benefits from a guarantee provided by an EU financial counterparty if the guarantee: (a) covers (i) the entire liability of the non-EU subsidiary for an aggregated notional amount (ANA) of at least €8 billion or (ii) part of the liability of the non-EU subsidiary for an ANA of at least €8 billion divided by the percentage of the liability covered; AND (b) is at least equal to 5% of the sum of current exposures in OTC derivatives of the EU guarantor.

*** VM applies to a person who enters into OTC derivatives "as a business" who (i) has an average notional amount of non-cleared OTC derivatives (on a non-consolidated basis) equal to or more than JPY 300 billion; and (ii) is based in a netting-friendly jurisdiction.

VM applies if: (i) the guarantee is booked in HK; (ii) legal obligation of the guarantor is explicitly documented; (iii) guaranteed uncleared derivative exposure exceeds HK\$60 billion.

VM is only required if both parties exceed AUD 12 billion threshold. The threshold is reduced to AUD 3 billion from Sept 2017.

Preparation steps

WGMR – What is Being Done?

The ISDA Working Group on Margin Requirements has several workstreams in place to help the market prepare for the implementation of uncleared derivatives margin requirements.

- Model – the SIMM
- Operational build out
- Collateral documentation
 - Templates to address new initial and variation margin requirements
 - Protocol to provide scalable solutions for industry transition to regulatory VM

Preparation Steps I

- Determine own status for rules applicable to you and other rules
 - Party type
 - Aggregate notional volume
- Sort/Anticipate counterparties by
 - Type
 - Geography (rule applicability)
- Assess current margin documentation against rules
 - Credit support documentation
 - Custody documentation

Preparation Steps II

- Analyse need to re-document:
 - Counterparties where no margin is required
 - Counterparties where margin is required
 - VM/IM/Both
- New document needs:
 - Do I need a new ISDA Master?
 - Do I need new credit support documents?
 - Do I need new IM segregation documents?
- Consider - historical trades

Preparation Steps III

- Analyse operational needs and capabilities
 - Daily calculations and deliveries
 - Ability to run multiple CSAs and collateral flows
 - Ability to deliver and receive margin
 - IM modelling

Documentation – Architecture and Approach

- Classification: ISDA self disclosure form
- http://www.isda.org/publications/pdf/35345836_14_WGMR_Self_Disclosure_Letter_Template.pdf
- VM
 - New bookstore CSAs for VM under English / New York / Japanese law
 - VM Protocol
- IM
 - New bookstore CSD for IM under English law / CSA for IM under New York or Japanese law
 - 2 versions: Phase One and non-Phase One (latter to be published soon)
 - Custodial arrangements – ISDA Euroclear / Clearstream Documentation

ISDA SIMM™

ISDA SIMM™ : Model overview and motivation

SIMM™ avoids unnecessary complexity – an important element for the global Initial Margin project

The Initial Margin project is very different from regulatory capital projects.

The margin calculated by the model is not paid by the calculating firm, but by its counterparty. This is a crucial and a unique difference.

Because of this, the counterparty has a very strong interest in understanding the firm's calculation and needs to have confidence in it.

For that reason, ISDA members were very keen to have a standard model that could be widely adopted across the industry.

ISDA SIMM™ : Model overview and motivation

The key advantages of this approach are:

- Operational simplicity, compared with every bank making its own IM model
- Banks do not have to implement all their counterparties' models in order to check correctness of margin calls
- Consistent regulatory governance and oversight
- Reduction of the number of disputes as well as timely and transparent dispute resolution
- Enhanced predictability of future liquidity requirements
- Supports the use of derivatives by a wide range of counterparties, and reduces exclusion from the market

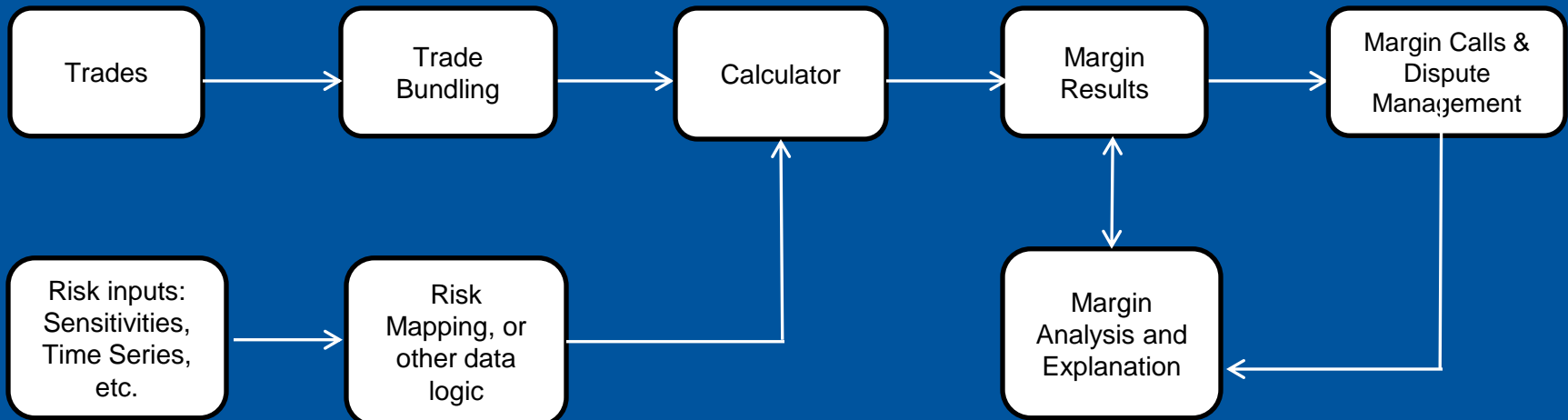
ISDA SIMM™: Nature

- SIMM™ is based on the existing regulatory-mandated “Sensitivity Based Approach” from FRTB.
- Some modifications and improvements have been made to adapt it for Initial Margin use.
- Model is based on risks, which are already calculated by banks. It includes all major and material risks, vega and convexity, as well as spread risk, basis risk and term structure.
- Based on standard variance-covariance ideas
- Allows netting and diversification within an asset class, but not between asset classes.
- Calculation scheme is simple to implement and fast to run.
- Based on calibrated parameters, but has light-weight data requirements.
- Like all models, it is an approximation to the truth, but the approximation is good-quality and has been tested by extensive backtesting.

Firm Level Application

Documentation

- Consistency in trade population designation by asset
- Trade feed timing to match margin calculation process needs
- Common product definition
- Common bundling rules
- Common agreement rule handling
- Transparent, predictable and replicatable methodology
- Readily available and common inputs
- Batch timings, processing times consistent with margin needs
- Reruns in case of errors or disputes
- Scale and speed
- Definition of monitoring criteria
- Exception and override handling
- Recalculation needs
- Exception, escalation and supervision rules
- Clearly defined process and data sharing protocols



- Timing and availability of risk data
- Data quality
- Standardized risk definitions
- Common risk factors
- Number of risk factors consistent with aims of transparency and reconciliation concerns
- Common mapping logic

- Ease in identifying margin result drivers
- Analysis and results conducive to dispute resolution