

Margin requirements for Non-Centrally Cleared Derivatives

Second consultative document by BCBS & IOSCO

Index

- 1 Scope
- 2 Types of Margin
- 3 Collateral
- 4 Legal Issues

Section 1

Scope

Material

- **All derivatives not cleared** by CCP'S
- Not clear if physically settled forwards & swaps will be included **Q1**

Personal

- **All financial firms & systemically-important non-financial** (definition of categories left to national regulation)
- **Bilateral**: both exchange or none
- **Out of scope**: sovereigns, central banks, multilaterals, BIS
- **Intra-group** translations: left to national regulators

Section 2. Types of Margin

Initial Margin

Objective: cover future exposure that could arise from future changes in the MTM value of the contract.

Calculation:

- **Models:**
 - **Standard** margin schedule
 - Quantitative **internal** model:
 - Approved by relevant supervisor
 - Continuous auditing
 - Offsets per asset class → no general cross offset
- **Use:**
 - One firm can use standard/internal depending on asset class
 - But no switch allowed

Exchange:

- **Outset** of each transactions
- **Gross two-way** exchange
- MTA of €100.000

Standardised initial margin schedule

Asset class	Initial margin requirement (% of notional exposure)
Credit: 0-2 years duration	2
Credit: 2-5 year duration	5
Credit: 5+ year duration	10
Commodity	15
Equity	15
Foreign Exchange/Currency	6
Interest Rate: 0-2 year duration	1
Interest Rate: 2-5 year duration	2
Interest Rate: 5+ year duration	4
Other	15

Section 2. Types of Margin

Initial Margin

Threshold: > 50 mn € on a consolidated basis

Phase-in: (see table)

No re-use or rehypothecation

- Requirements for I.M:
 - Immediately **available**
 - **Protects posting party** from bankruptcy of receiving

Q2 Should re-use be permitted?:

- To **finance/hedge customer positions** if re-used customer assets are protected
- If pledgee treats IM as **customer assets**
- If posting party has **first priority right** on posted IM in case of insolvency of receiving party.

If Average Notional Amount last quarter of year	Exceeds	Initial Margin will apply to contracts entered into starting
2015	€ 3 Trillion	2016
2016	€ 2.25 Trillion	2017
2017	€ 1.5 Trillion	2018
2018	€ 0.75 Trillion	2019
2019	€ 8 Billion	2020

Section 2. Types of Margin

Variation Margin

Objective: Covers MTM exposure arisen from changes in the market

Calculation:

- **Full exchange** (no threshold)
- **Daily**
- **M.T.A:** 100.000€:
- Subject to **netting agreements** → L.O. effectiveness updated

Applicability: 1.01.2015 for contracts entered into afterwards

Section 3

Collateral

Objective:

- Liquidation in a reasonable amount of time
- To generate proceeds
- To hold value in financial stress

Assets highly liquid:

- Cash
- High-quality govies and central bank securities
- High-quality corporate banks
- High-quality covered banks
- Equities in major stock indices
- Gold

List of eligible collateral assets to be developed by national supervisors**Limits:**

- Wrong-way risk (correlation between collateral provided and counterparty)
- Concentration

Section 3

Collateral

Appropriate haircuts

- Internal model
- Schedule: Stringent to force internal model

Standardised haircut schedule

Asset class	Haircut (% of market value)
Cash in same currency	0
High-quality government and central bank securities: residual maturity less than 1 year	0.5
High-quality government and central bank securities: residual maturity between 1 and 5 years	2
High-quality government and central bank securities: residual maturity greater than 5 years	4
High-quality corporate/covered bonds: residual maturity less than 1 year	1
High-quality corporate/covered bonds: residual maturity greater than 1 year and less than 5 years	4
High-quality corporate/covered bonds: residual maturity greater than 5 years	8
Equities included in major stock indices	15
Gold	15
Additional (additive) haircut on asset in which the currency of the derivative obligation differs from that of the collateral asset	8

Section 4

Legal Issues

Recognition of netting & Collateralisation:

- V.M: before 1.01.2015 but what about counterparties which legal regime does not recognise collateralisation? STOP trading?
- I.M.:
 - re-use prohibition → liquidity problems
 - concentration in NY/England to avoid legal problems?

Unlevel playing field:

- Intra-group
- Definitions of legal entities
- Eligible collateral: → wrong-way risk

Repapering:

- One contract + various situations (FX, phase-in...) → silos in the same M.A.?
- Dispute resolution