Margin requirements for Non-Centrally Cleared Derivatives

Second consultative document by BCBS & IOSCO
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# 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**

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Initial margin requirement (% of notional exposure)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit: 0-2 years duration</td>
<td>2</td>
</tr>
<tr>
<td>Credit: 2-5 year duration</td>
<td>5</td>
</tr>
<tr>
<td>Credit: 5+ year duration</td>
<td>10</td>
</tr>
<tr>
<td>Commodity</td>
<td>15</td>
</tr>
<tr>
<td>Equity</td>
<td>15</td>
</tr>
<tr>
<td>Foreign Exchange/Currency</td>
<td>6</td>
</tr>
<tr>
<td>Interest Rate: 0-2 year duration</td>
<td>1</td>
</tr>
<tr>
<td>Interest Rate: 2-5 year duration</td>
<td>2</td>
</tr>
<tr>
<td>Interest Rate: 5+ year duration</td>
<td>4</td>
</tr>
<tr>
<td>Other</td>
<td>15</td>
</tr>
</tbody>
</table>
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.

<table>
<thead>
<tr>
<th>If Average Notional Amount last quarter of year</th>
<th>Exceeds</th>
<th>Initial Margin will apply to contracts entered into starting</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>€ 3 Trillion</td>
<td>2016</td>
</tr>
<tr>
<td>2016</td>
<td>€ 2.25 Trillion</td>
<td>2017</td>
</tr>
<tr>
<td>2017</td>
<td>€ 1.5 Trillion</td>
<td>2018</td>
</tr>
<tr>
<td>2018</td>
<td>€ 0.75 Trillion</td>
<td>2019</td>
</tr>
<tr>
<td>2019</td>
<td>€ 8 Billion</td>
<td>2020</td>
</tr>
</tbody>
</table>
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
### Appropriate haircuts

- Internal model
- Schedule: Stringent to force internal model

### Standardised haircut schedule

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