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Deloitte regulatory news alert

EMIR Gears up

15 March 2016

New collateral requirements for OTC derivative contract not cleared by a CCP

Following the publication of the Consultation Paper in June 2015, the European Supervisory Authorities (EBA, EIOPA, ESMA - ESAs) published the 8th of March, 2016 their final draft Regulatory Technical Standards (RTS) on margin requirements for non-centrally cleared OTC derivatives under the European Market Infrastructure Regulation (EMIR).

Three main pillars:

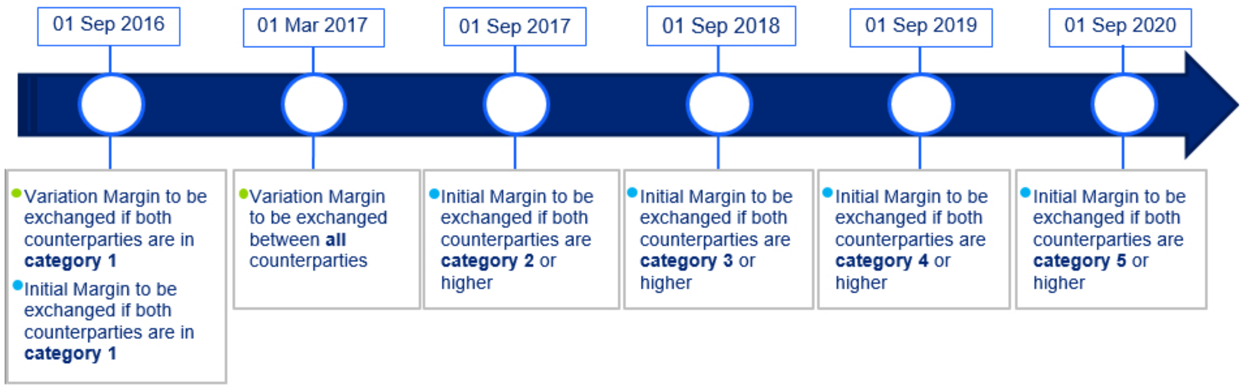
This final draft RTS covers three main parts:

1. An outline of the collateral eligible for the exchange of margins, the criteria to ensure that the collateral is sufficiently diversified and not subject to wrong-way risk, and the methods for determining appropriate collateral haircuts.
2. The operational procedures related to documentation, legal assessments of the enforceability of the agreements and the timing of the collateral exchange
3. The procedures for counterparties and competent authorities related to the treatment of intragroup derivative contracts

From September 2016, EMIR will require some financial and non-financial counterparties transacting in (non-centrally cleared derivatives) to exchange variation and initial margin:

- Daily exchange of Variation Margin (VM) will be phased in between 1st September 2016 and 1st September 2020
- Exchange two-way Initial Margin (IM) to cover future exposure from a counterparty default will be phased in between 1st September 2016 and 1st March 2017

The next milestones:



Category 1	The average notional amount of all derivative trades at group level ≥ 3 trillion Euro
Category 2	The average notional amount of all derivative trades at group level ≥ 2,25 trillion Euro
Category 3	The average notional amount of all derivative trades at group level ≥ 1,5 trillion Euro
Category 4	The average notional amount of all derivative trades at group level ≥ 0,75 trillion Euro
Category 5	The average notional amount of all derivative trades at group level ≥ 8 billion Euro

Key notes:

Main amendments to the second consultation paper published on June 2015

- **Scope of instruments**: The introduction of the margin requirements for single stock options and index options was postponed to avoid any regulatory arbitrage.
- **Segregation**: Cash initial margin cannot be re-used or re-hypothecated. Initial margin in the form of cash should be segregated through a third party or via other legally binding arrangements.
- **Concentration limits were relaxed** – in particular, for the treatment of government bonds.
- **Intragroup transactions**: Initial margin for intragroup transactions to be exchanged from 1 March 2017. This is to tackle the issue of the absence of equivalence with the US in the meantime.

Additional impacts for clients:

Even if margin is already being collected, possibly by a third party custodian, there will still be an impact

- The new rules regarding initial margin will apply to financial counterparties, non-financial counterparties and their third country equivalents, which belong to a group whose aggregate three month-end average notional amount of non-centrally cleared derivatives exceeds EUR 8 billion.
- Thresholds should always be calculated at group level. Investment funds should be treated as a special case and captured as a single group. Where the funds are distinct pools of assets they should be treated as separate entities when calculating the thresholds.
- The new rules regarding variation margin will apply to financial counterparties, non-financial counterparties exceeding the clearing thresholds and their third-country equivalents.
- Firms will need to assess their systems and procedures, as well as the models they will utilise to calculate margin, and factor in the increased trading cost arising from the rules and prepare for the resultant repapering. Firms should also consider whether directing non-cleared transactions to central counterparties will be a more cost-efficient solution for their business.
- The type of collateral which may be posted and received will be limited to specific classes of liquid instruments, with requirements on diversification. The haircut for each category of assets must not be lower than an amount determined by the regulator.
- For firms looking to utilise the intragroup transactions exemption, they should prepare their application for their regulator's approval.

How can Deloitte help you?

There every step of the way

1. Strategy definition and implementation

Design and calibrate a strategy for collateral management and practical implementation throughout the organisation

2. Regulatory healthcheck

A review of compliance with each requirement of the regulation, identifying any gaps with remediation actions

3. Transaction reporting

A fully integrated reporting solution for transaction reporting

4. Model calibration and validation

Design, calibrate, validate and document models created for the determination of credit quality, initial margin to be posted and collateral value (haircuts)

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Designed and produced by MarCom at Deloitte Luxembourg