

## Collateral management... you will not operate the same way

Financial players on both the buy- and sell-side, as well as corporate players, have had to take on an additional operational burden due to reporting requirements and risk mitigation techniques already in force.

With the European Union (EU) being one of the last global economies to implement the G20 decisions around derivatives, 2016 encompasses both:

- The phase-in of both new margin requirements (IM & VM) for OTC derivative contracts not cleared by a central counterparty (CCP)
- The mandatory clearing via a central counterparty (CCP) of certain types of derivatives like certain interest rate swaps and credit default swaps

The new regulatory framework (EMIR, UCITS V, AIFMD) will dramatically transform the management of collateral in the coming years. Organizations will have to calculate initial margin and closely monitor group-wide thresholds. The custodian accounts and segregation structures will need to be properly defined in order to meet liability requirements and also control operational costs. The allocation, definition of assets eligible for collateral, and rehypothecation restrictions put in place will require the optimization of all processes—from end-of-day back office tasks to on-going middle office tasks. There is now the opportunity to address these new requirements in a strategic manner and properly define your new collateral management model for tomorrow rather than rush through short-term workarounds.

## A team dedicated to you

Our team can support your firm in meeting the current and coming regulatory collateral requirements, with assistance ranging from strategic considerations to full implementation.

Deloitte's support represents a pragmatic and efficient approach based on proven expertise and includes the following services:

- Strategic definition and operational efficiency of collateral management business
- Support in defining target operational structure and account segregation models
- Regulatory requirements alignment check
- Transaction reporting solutions
- Creation and analysis of aspects related to valuation, credit risk and margin models

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## EMIR gears up

New collateral requirements for OTC derivative contracts cleared and not cleared by Central Counterparty (CCP)



## The collateral regulatory journey steps up a notch in 2016

In March 2015, the International Organization of Securities Commissions (IOSCO) and the Basel Committee on Banking Supervision (BCBS) set up a policy framework for margin requirements for non-centrally cleared derivatives.

This international framework serves as a reference for the European regulators for securities and markets (ESMA), banks (EBA), and insurers and pension funds (EIOPA) while writing the second consultation paper dated June 2015. The paper, introduced technical standards on risk mitigation techniques for OTC-derivatives which are not centrally cleared.

The new standards cover a variety of topics ranging from mandatory exchange of two-way initial margin (IM), variation margin (VM), eligibility and segregation requirements for collateral, and limits on re-use of collateral. Initial margin requirements will be phased in between 1 September 2016 and 1 September 2020, while variation margin requirements will be phased in between 1 September 2016 to 1 March 2017.

The introduction of margin requirements for non-centrally cleared derivatives presents significant commercial, operational, and legal challenges.

## Another link in the regulatory framework

These new margin requirements are also related to the impacts of CRD IV/CRR and UCITS V/AIFMD and will increase the need for financial counterparties as well as depository banks to improve the management of their exposures and the assets deposited and received as collateral. Ensuring the right collateral is in the right place at the right time will be the challenge ahead. This will require an ongoing follow-up, allocation, and segregation of collateral.

## Firms have to define a long-term strategic collateral management model

The new collateral and margin requirements framework will be phased in between September 2016 and September 2020 (see timeline on the right).

Among the new key requirements, counterparties will have to calculate the amount of IM (to cover price differences between margin calls) and VM (to cover mark-to-market exposures on derivative positions). Consequently, collateral will need to be posted as per the calculated margin amounts.

For the IM calculation, counterparties can use a standard method provided by the regulator (SMI) or an initial margin model (MRM), agreed upon between counterparties, according to parameters defined by the regulator. VM will be posted net, and will generally be required to be posted daily, which could prove to be operationally challenging for smaller entities and trades across time zones.

Collateral will need to be subject to both concentration limits and “wrong-way risk” checks. Wrong-way risk occurs when the value of collateral collected is strongly correlated with the credit quality of the counterparty or the underlying derivative portfolio.

Counterparties can expect challenges organizationally and operationally:

### Organizationally:

- Contracts between counterparties need to be reviewed and possibly amended
- Counterparties need to ensure the right type of collateral is available
- The appropriate segregation of margin needs to be put in place
- Governance and audit required for internal models will be used to determine the IM amount (MRM), collateral credit quality, and collateral value haircuts to apply
- Governance is required on the collateral exchange process

### Operationally:

- The amount of margin calls is expected to increase substantially, since exposures and collateral need to be monitored separately for trades agreed upon before and after entry into force

## Concerned entities and timeframe

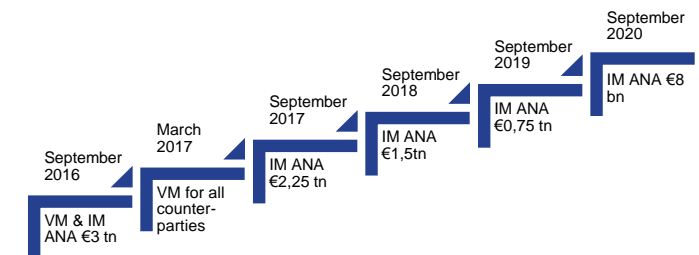
### Entities

The following entities are in the scope of these new regulations and may have to exchange IM and VM:

- Entities classified as “financial counterparties” (FC) under EMIR
- Entities classified as “non-financial counterparties” (NFC) under EMIR and which are above the EMIR clearing threshold (NFC+)
- Non-EEA entities which could be classified as FC or NFC

### Key dates for the phase-in of IM and VM

The requirements for the exchange of IM and VM will be phased in based on the aggregate average notional amount (ANA\*) of both counterparties at a consolidated group level of non-centrally cleared derivatives:



### Exemptions may apply:

- No collection of IM on physically settled foreign exchange forward and swaps (but VM must still be exchanged)
- If the total amount of IM to be collected is less or equal to €50 million
- In-scope entities do not have to exchange IM or VM, where the trade concerned is an intra-group transaction (in some cases this may involve regulatory approval)

\* average of month-end outstanding amount in March, April, and May of the mentioned year at a consolidated group level