THE COLLATERAL CHALLENGE

MARGIN RULES
FOR NON-CLEARED DERIVATIVES

BNP PARIBAS

The bank
for a changing
world

2017 COLLATERAL CHALLENGE IN EUROPE

European regulation on derivatives and collateral represents a challenge in 2017 for institutional investors and financial institutions. March 2017 is a key milestone as it introduces the mandatory daily variation margin exchange. As always with major regulatory change, the main challenge for market participants is to identify the key modifications required and to efficiently implement these.

This document forms part of a series of publications on the collateral challenge and its impacts on the OTC market industry.

What are the main provisions of the European Union regulation?

The **European Market Infrastructure Regulation** (EMIR) is the central regulation to impact derivatives markets in 2017. Market participants have -or will have- to comply with the new requirements summarised below:

Daily variation margin (VM) to be exchanged between entities (excluding NFC- or Non-Financial Counterparties below the clearing threshold)

- On **all over-the-counter derivatives from 1 March 2017** with some special exemptions
- Delayed application until 2018 for physically settled forex forwards
- Three-year temporary exemption for equity options (single stock and index)
- **Zero threshold**

Initial margin (IM) to be exchanged between entities (excluding NFC-) **subject to breach of a notional threshold by both entities**

- **Phased-in entry into force** from 3 February 2017 to 1 September 2020
  - Exemptions for physically settled Forex forwards, swaps and principal exchange of cross-currency swaps
  - Three-year temporary exemption for equity options (single stock and index)
- IM calculation according to standardised approach or internal method
- Segregation and no re-use of IM which should be subject to counterparty bankruptcy-remote arrangements
- **Threshold: EUR 50 million** applied at consolidated group's level

Treatment of collateral as defined by the new rules

- **Minimum transfer amount (MTA)** which should not be higher than EUR 500,000
- Collateral to **be "provided" on same day** as the margin call, when no IM is exchanged between counterparties
- **8% cross-currency haircut** to be applied to non-cash variation margin and to initial margin (cash and non-cash)
- Daily and two-way margining processes

These new rules will apply to contracts dealt after entry into force of the above requirements or to contracts subject to material economical amendments and dealt after entry into force of the above requirements

VARIATION MARGIN
NAVIGATING THE NEW RULES

YES

CLASSIFY YOUR ENTITIES ACCORDING TO EMIR
–

Are they either an FC or an NFC+?

YES

MAP YOUR COUNTERPARTIES
–

Do your counterparties fall under EMIR?

Have you mapped where they are based: the EU, the US or another country?

NO

IDENTIFY POTENTIAL EXEMPTIONS
–

Are any of your contracts eligible for intragroup exemption ?

Are any transactions temporarily exempt (e.g. physically settled forex forwards or equity options) ?

YES

MAP YOUR EXISTING AND POTENTIAL DERIVATIVES ACTIVITIES AND RELATED CONTRACTS
–

CONTRACTS AND AGREEMENTS IMPACTED BY THE NEW RULES

IDENTIFYING YOUR CHALLENGES

CONTRACTS AND AGREEMENTS IMPACTED BY THE NEW RULES

CONTRACTUAL CHALLENGES

–

Have you **identified contracts** which must comply with upcoming rules?

- **Eligible collateral:** are your eligibility matrices compliant with the new rules?
- **Minimum transfer amount:** do you have contracts whose MTA is above EUR 500K?
- **Cross-currency haircut:**
  - Do you manage contracts where the agreement base currency is different from the settlement currency?
  - If yes, an additional 8% cross-currency haircut on securities for variation margin will apply

Did you **start renegotiating your contracts**, through either the ISDA variation margin protocol or bilateral negotiation?

OPERATIONAL CHALLENGES

–

Have you **mapped the operational impacts** across your organisation?

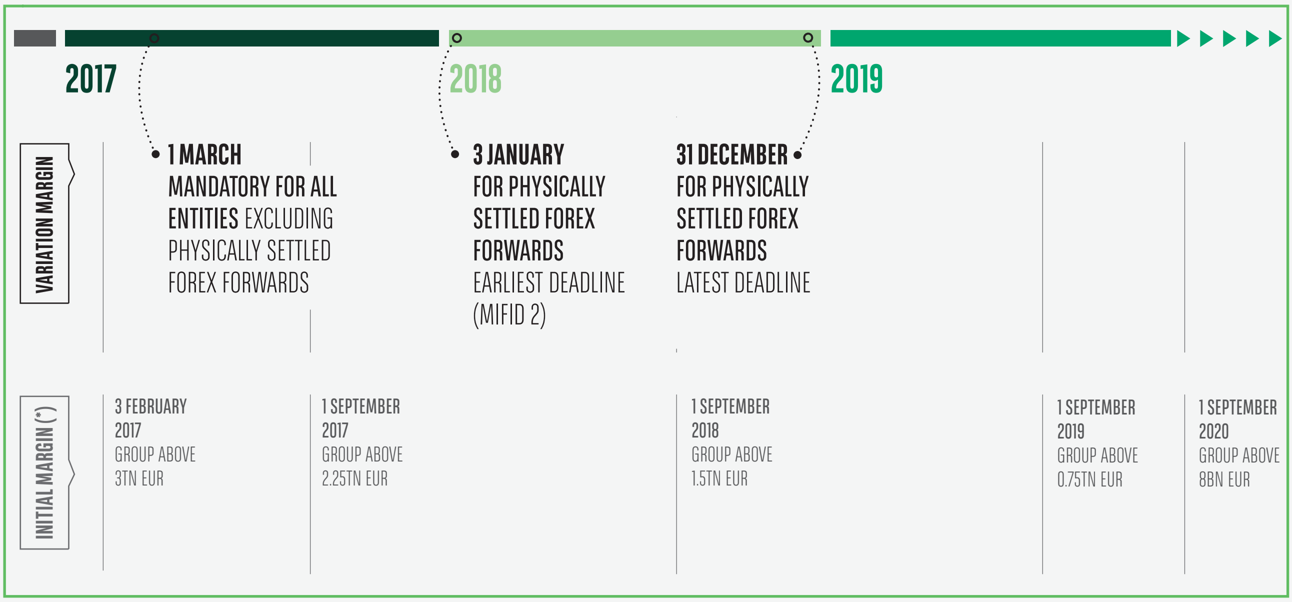
- **Volume:** have you estimated the potential increase in collateral movements and agreements?
- **Increased complexity:**
  - Are you ready to support the associated operational complexity?
  - Can you manage dual CSA (credit support annex) for contracts signed before and after EMIR entry into force?
- **Higher velocity:** are you able to manage daily processes and same day settlement (for instance, when dealing with a US counterparty under CFTC rules)

Have you estimated globally your new funding requirements?

Do you face any **collateral fragmentation challenges**?

EU milestones

For **variation margin**, 1 March 2017 is the **big bang for all** market participants - including asset managers, insurers, banks and brokers -. Initial margin will be implemented progressively and its target will be limited to major actors in the derivatives space, depending on the amount of non-centrally cleared derivatives.



(*) Each group has to calculate the aggregate average notional amount of non-centrally cleared derivatives that are recorded on the last business day of March, April and May of the year referred to in each of the points in Article 36(1) of the COMMISSION DELEGATED REGULATION (EU) 2016/2251 of 4 October 2016

Which transactions?

	VARIATION MARGIN	INITIAL MARGIN
OTC DERIVATIVES Including non-deliverable forwards, etc	1 March 2017	From 3 February 2017 to September 2020
PHYSICALLY SETTLED FOREX SWAPS	1 March 2017	No
PHYSICALLY SETTLED FOREX FORWARDS	from January 2018 (MiFID 2)	No
EQUITY OPTIONS (single stock and index)	Three-year exemption on investment margin and variation margin	

Collateral Access, our solution

Implementing new margin rules for uncleared OTC derivatives requires a strategic approach with the involvement of many teams across financial institutions' organisations. In addition to higher collateral demand, operational complexity and collateral protection necessitate a closer look.

We have been providing collateral solutions through our Collateral Access suite of services since 2010. As an experienced provider of collateral services, we can help you navigate new rules and complex implementation to ensure you are fully compliant. We work closely with the industry and clients to anticipate the impact of new regulations and provide efficient answers to the market in the face of change.

Glossary

CSA: credit support annex

Entities listed in Article 1(4) and 1(5) of EMIR:
EU public bodies in charge of or managing the public debt, the European Stability Mechanism or the European Financial Stability Facility, to quote a few

EMIR: European Market Infrastructure Regulation

EU: European Union

FC: financial counterparty according to EMIR classification

IM: initial margin

ISDA: International Swaps and Derivatives Association

MTA: minimum transfer amount

NDF: non-deliverable forward

NFC+: non-financial counterparties +, ie not an FC according to EMIR but above the clearing threshold

NFC-: non-financial counterparties -, ie not an FC according to EMIR but below the clearing threshold

OTC: over-the-counter

VM: variation margin

For additional information, please contact your relationship manager

FOLLOW US

FIND US

securities.bnpparibas.com

Printed on recycled paper with vegetable inks – Designed by the graphics department, corporate communications, BNP Paribas Securities Services.

170104C_CC_BR_EN

BNP PARIBAS

The bank
for a changing
world