

# Getting Ready for Initial Margin (IM) Regulatory Requirements

## What Steps Do I Need to Take?

Each September until 2020, increasing numbers of entities will be required to meet initial margin regulations as the threshold level for compliance reduces. Preparation for meeting these requirements will take significant time, and will involve intensive work to ensure systems, processes and documentation are in place.

Firms should consider taking the following steps when preparing to comply with regulatory initial margin requirements. These are not necessarily presented in chronological order – the precise order and timing will depend on a firm's specific circumstances.

- STEP 1: IDENTIFY IN-SCOPE ENTITIES EARLY
- STEP 2: MAKE EARLY DISCLOSURES TO COUNTERPARTIES
- STEP 3: EXCHANGE INFORMATION ON COMPLIANCE
- STEP 4: IDENTIFY SPECIAL CASES
- STEP 5: ESTABLISH CUSTODIAL RELATIONSHIPS
- STEP 6: PREPARE FOR COMPLIANCE
- STEP 7: NEGOTIATE/EXECUTE DOCUMENTATION
- STEP 8: FINALIZE PREPARATIONS

## About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 67 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional

banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website:

[www.isda.org](http://www.isda.org).

## STEP 1 IDENTIFY IN-SCOPE ENTITIES EARLY

**Determine which of your entities are likely to be in-scope for planning purposes.**

- ✓ This should include all entities that are: (i) in-scope for variation margin (VM) requirements; and (ii) estimated to have an aggregate average notional amount (AANA) of non-cleared derivatives that exceeds the level for the relevant future phase-in date.
- ✓ For Phase 4 (September 2019), the threshold is €750 billion; for Phase 5 (September 2020), it is €8 billion (or similar amounts in other currencies, depending on the applicable regulations).
- ✓ The final determinations can only be made after the AANA observation window (typically between March and May for a September implementation). But firms will need to conduct estimates long before the observation window in order to have enough time to prepare.
- ✓ This may require some systems development work:
  - AANA must be determined at the consolidated corporate group level.
  - Calculations may need to be made in multiple currencies, depending on which rules apply.
  - AANA must be determined at the principal level – ie, aggregated across investment managers (where used). This may require advance communication between a principal and its investment managers.

## STEP 2 MAKE EARLY DISCLOSURE TO COUNTERPARTIES

**Firms should disclose the status of estimated in-scope entities to counterparties in order to provide enough time to complete all steps with each party.**

- ✓ Early two-way disclosure is needed to allow each firm to determine the number of counterparty relationships that will be affected.
- ✓ Parties are encouraged to participate in ISDA or other industry working groups to share this information in line with any industry best practices.
- ✓ Disclosure will need to occur 12-18 months before the IM go-live date, but:
  - More time will be needed for later phases, because more counterparties will fall in-scope at the same time.
  - Where a principal uses multiple investment managers, consideration will need to be given to which entity makes the necessary calculations and disclosures, and how this is best achieved.
  - Disclosure of relevant contact information is also encouraged to facilitate counterparty communications, particularly if this differs across legal entities in a group.

## STEP 3 EXCHANGE INFORMATION ON COMPLIANCE

**Important decisions need to be made about how firms will comply with the IM requirements. This information should be exchanged with each counterparty.**

- ✓ Which custodian(s) will you and your counterparties use to post IM?
- ✓ How will you and your counterparties calculate IM (eg, using the ISDA Standard Initial Margin Model (ISDA SIMM™), regulatory tables (also known as grids) or some other method)?
- ✓ Determine minimum transfer amounts (MTAs) and IM thresholds, including how MTAs will be allocated between IM and VM. If you or your counterparty face each other via multiple entities in a group, determine how the IM threshold will be allocated.
- ✓ Agree on eligible collateral and haircuts with each counterparty and with custodians (as needed):
  - Firms posting only cash VM will need to plan to source additional forms of collateral to satisfy IM requirements.
  - Note any deadlines set by relevant custodians for submitting and activating collateral schedules.

## STEP 4 IDENTIFY SPECIAL CASES

**Determine whether any special cases apply.**

- ✓ This might include considering the impact of non-netting jurisdictions, local law/language documents, stamp tax, registration of security and entity specific regulatory requirements (eg, UCITS).
- ✓ Consider legal opinion coverage required for compliance with the regulations.

## STEP 5 ESTABLISH CUSTODIAL RELATIONSHIPS

**Firms should establish relationships with the relevant custodians, and provide information on all in-scope counterparty relationships.**

- ✓ This includes the custodian(s) you will use, and each custodian your counterparties will use. The work necessary to establish those relationships may depend on the type of custodian being used.
- ✓ KYC checks may need to be performed, which can take several weeks or months.
- ✓ New segregation accounts should be opened if needed.
- ✓ Enable communications with custodians.

## STEP 6 PREPARE FOR COMPLIANCE

**Firms will need to build up the necessary capacity for compliance in advance.**

- ✓ Prepare regulatory IM calculator (ie, ISDA SIMM and/or regulatory grid).
  - Prepare/map internal data inputs, including connection to the ISDA SIMM Crowdsourcing Utility (for equity and credit).
  - Develop calculation capacity, or set up with a vendor.
  - Conduct portfolio matching/ISDA SIMM test calculations with counterparties.
  - Obtain regulatory approval for use of the model, if necessary.
- ✓ Develop operational capacity as necessary (including any needed IT or other systems development):
  - Develop support for multiple IM and VM credit support annexes (CSAs) and collateral call issuance/reconciliation processes. Set up with any vendor(s) if needed.
  - Monitor wrong-way risk and concentration limits (depending on applicable regulations).
  - Derive and apply standard collateral haircuts based on external ratings and credit quality steps (EU regulations).
  - Calculate and apply FX haircuts where applicable for collected IM.
  - If using an outsourcing arrangement for any collateral management functions, ensure the relevant third-party collateral managers are sufficiently educated and prepared.
  - Even if a firm is not directly subject to regulations, it may need to develop systems to call for and receive eligible IM if the counterparty is required to post IM under regulations applicable to it.

## STEP 7 NEGOTIATE/EXECUTE DOCUMENTATION

**The necessary documentation will need to be negotiated and put in place with each counterparty ahead of the implementation date. This includes:**

- ✓ A bilateral IM CSA or collateral transfer agreement/security agreement for each counterparty pair.
- ✓ A trilateral account control agreement or similar documentation for each counterparty/custodian trio. This may involve additional documents if you are accessing a custodian via an intermediary.
- ✓ Eligible collateral schedules.
- ✓ An ISDA SIMM license agreement and ISDA SIMM Crowdsourcing Utility participation agreement (if needed).

## STEP 8 FINALIZE PREPARATIONS

**Check all necessary relationships are up and running, and everything has been tested.**

- ✓ Ensure account opening procedures are completed at all relevant custodians and internally within your firm's own systems.
- ✓ Test segregated account transfers with custodians.
- ✓ Test with all applicable third-party collateral managers.