Non-cleared margin requirements
The top five considerations

As the deadline for compliance with the new variation margin rules approaches – March 1, 2017 – it is important to review legal documentation, operational processes and support capabilities. To overcome the hurdles the new rules will create, firms should centralise and automate their workflows, says Jenny Nilsson, product marketing executive at triResolve, the portfolio reconciliation and margin management service from TriOptima

Financial firms with the largest global derivatives portfolios started to exchange initial and variation margin on their non-cleared derivatives from September 1, 2016. Although the initial implementation of the rules went fairly smoothly, one of the most important lessons was that preparation pays off. With variation margin 'big bang' looming on the horizon, TriOptima are pleased to share our top five items that all firms need to consider in preparation for March 1.

Jenny Nilsson

1. Have you reviewed your legal agreements?

The first task is to assess what counterparty relationships, entities and products are in scope. With the new rules applying only to trades executed after a firm's relevant compliance date – March 1 for most – institutions must address both internal and external considerations. For many firms this will involve important changes to derivatives documentation to ensure compliance with the requirements.

Internal considerations

- What agreements are in place with the identified covered counterparties?
- Which of these agreements meet the new regulatory standards?
- If you do not have regulatory compliant terms, do you want to amend your existing agreements or sign new agreements to reflect the compliant terms?

External considerations

- Once you have decided how you would like to structure your agreements, it is time to contact your counterparty. Both parties need to negotiate and agree to the structure.
- If you need to repaper agreements, decide how you wish to proceed: either bilaterally with your counterparty or through a third party mechanism, such as the International Swaps and Derivatives Association variation margin protocol and Isda Amend.

The Isda website provides a range of information to assist with the documentation process. There are guidelines and standard agreement templates available to download, as well as a protocol designed to facilitate the agreement of terms with your counterparties.

2. Are your operational capabilities adequate?

The new rules will create significant operational challenges, and firms need to ensure efficient and automated workflows are in place to overcome them. Resource-intensive and error-prone processes, such as calculations in Excel and communication via email, must become a thing of the past.

Multiple manual data checks and copy-and-pasting of collateral into emails is no longer viable in this new world. Examining your operational capabilities is critical, but what do you need to consider?

- Mandatory collateralisation, daily margin call calculation and no thresholds on variation margin will drive up margin call volumes significantly.
  - Can your system and processes manage the dramatic increase in margin call volumes?
- Previously you only calculated one call. Now you may have to calculate both legacy and regulatory variation margin and – if in scope – initial margin calls versus the same counterparty.
  - Can you ensure accuracy when calculating all these amounts?
  - Are you able to do this in parallel against any one counterparty, every day?
  - How can you process these calls most efficiently?
- Increased call volumes, combined with potential earlier notification deadlines and shrinking settlement time frames, may burden firms with higher daily workloads. In addition, the traditional email exchange of margin calls is being replaced by electronic messaging to ensure faster processing and maximum straight-through processing.
  - Is your process taking advantage of potential automation options?
  - How will you connect to electronic messaging networks?

As collateral management is a traditionally fragmented and largely manual process, firms need to drive change and establish a new solution that directly responds to the challenges the rules create.

3. How are you managing your disputes?

Margining is a powerful risk mitigation tool, but its effectiveness is limited if collateralisation is inaccurate. With the new rules in place and with collateral

management becoming a regulated part of the business for the first time, the industry is anticipating increased scrutiny of disputes.

Robust and auditable dispute resolution will prove imperative. All firms should assess their current dispute resolution processes by asking the following questions:

- How do you identify/reconcile, track, monitor and report differences in your underlying margin call data today?
- How do you efficiently investigate these differences internally and with your counterparty?
- Is this process robust and auditable?

Portfolio reconciliation is the foundation of effective collateral management. With the new demands on collateralisation it is important that firms have a robust and comprehensive portfolio reconciliation process that efficiently classifies issues, identifies dispute driving differences and has workflow tools to assist proactive investigation.

4. Bifurcated portfolios: are you able to distinguish between the trade populations?

In this new world, it will be common to have two agreements in place – one for legacy and one for new trades – against one counterparty. In this scenario, you must be able to differentiate between the two trade populations. This is important for both margin call calculation and portfolio reconciliation, as without this distinction of the different netting sets, firms will not be able to calculate the margin call.

This presents the industry with an additional operational challenge. For its users, triResolve has introduced functionality that enables firms to correctly differentiate trades between agreements. The only additional piece of information required from users is an added netting set name in the data feed.

5. Time is running out

Mandatory compliance is just around the corner; therefore, if you have not done so already, it is crucial that you act now. Firms should have agreements negotiated and solutions implemented as soon as possible, so processes are not only tested but are part of business-as-usual in advance of March 1.

Vendor solutions in the collateral management space have traditionally been complex, bespoke, installed solutions that require a large implementation project and come with a hefty price tag. Although these traditional collateral management solutions handle the calculation of the margin call well, this is only a single part of the puzzle. The industry needs to move away from manual data checks, copy-and-pasting of numbers, agreeing margin calls via email and moving from one system to another to investigate a disputed call. Collateral management requires transformation from a fragmented process to a standardised, centralised and automated workflow.

With timelines tight, if you have not moved already, it is important that you choose a solution that is quick to implement. We have no doubt that the industry is working hard to prepare for the non-cleared margin requirements, but although the finish line is in sight there is still much work to be done by market participants to be ready for the new world of collateral management.

About TriOptima

TriOptima, a NEX Group company, is the award-winning provider of over-the-counter (OTC) derivatives infrastructure services focused on reducing costs, eliminating operational and credit risk, and improving counterparty exposure management.

Used by over 1,800 group firms, triResolve is the leading counterparty exposure management service for OTC derivatives. A web-based network community service, triResolve offers a range of capabilities to manage operational and credit risk in OTC derivatives portfolios, including proactive portfolio reconciliation, collateral management and reporting validation.

TriOptima maintains offices in New York, London, Stockholm, Singapore and Tokyo.

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