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Margin requirements for non-centrally cleared OTC derivatives

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Operations managers contact group (OMCG)
meeting

Final steps to finalise margin requirements

February 2013

The Working Group on Margining Requirements (WGMR) of the BCBS and the IOSCO released for consultation the near-final margin requirements for non-centrally cleared OTC

Consultation questions:

Q1: Should physically-settled FX swaps and forwards be exempted?

- Exempted from initial margin (IM), but not variation margin (VM)?
- Could maturity of be a factor?

Q2: Should limited re-hypothecation be allowed?

Q3: Are phase-in arrangements appropriate?

- Should VM be introduced in the same way as IM?
- Permanent €8 billion notional amount trigger for IM requirements?

Q4: Accuracy and applicability of the QIS results

June 2013

The BCBS and the IOSCO should approve the final standards

Margin requirements for non-centrally cleared OTC derivatives

Purpose

Reduction of systemic risk

Promotion of central clearing

Concerns

Liquidity impact – roughly €0.7 trillion

Key elements

“Virtual” CCP – mandatory exchange of both IM and VM

Covered instruments: all non-centrally cleared OTCD (except for physically-settled FX swaps and forwards?)

Covered entities: all financial institutions and systemically important non-financials

IM held in a protected way, no re-hypothecation

IM: either internal model- or schedule-based

To reduce liquidity impact:

Non-zero IM threshold of €50 million

Some netting is allowed when using the standardised IM schedule

Broad list of eligible collateral

Four-year phase-in period of the IM requirement, starting in 2015, applies for new trades

Exemption of physically-settled FX swaps and forwards

Q1: Should physically-settled FX swaps and forwards be exempted?

Exempted in the US

Settlement risk is addressed through the use of **CLS** payment-vs-payment service

- The largest risk, but (i) in addition to it and (ii) as for other derivatives, there is also the replacement cost risk in the event of counterparty's default

BCBS supervisory guidance for managing settlement risk in FX transactions includes, as one element of prudent risk management, **exchanging the full amount of VM**

- To exempt from IM only, but to require VM?

Treatment of **cross-currency swaps**?

- Have longer tenor, are less liquid, and are not settled through CLS
- Options: (Not to) exempt? To exempt the FX component?
- In internal models, currency/rates derivatives are modelled together, but how to apply the standardised schedule?

Amount

“... should reflect an extreme, but plausible estimate ... based on historical data that incorporates a **period of significant financial stress.**”

- Conservative IM should reduce pro-cyclicality, but
- Commenters suggested that more details/clarity is needed, not least in order to ensure international consistency of internal model outputs

Potential for disputes

Dealers were not posting IM to each other

Internal IM models differ

IM will need to be computed for each asset class separately (FX/rates, credit, equity, commodities, other)

Industry-wide single IM model?

Some dealers seem to be considering jointly developing a consistent global IM approach

Initial margin threshold

A covered entity has the option of not collecting IM if it is under the €50 million threshold, but if IM exceeds the threshold, the firm has to collect from its counterparty the difference between the IM and the threshold

Liquidity savings vs. systemic risk and incentives for central clearing

Reduces the liquidity impact, but would leave without IM protection a significant share of OTC derivatives exposures – capital charges for exposures under the threshold would apply only for institutions with capital requirements

Reduces incentives for central clearing

Consolidated-to-consolidated exposure

The threshold is applied at the level of the consolidated group to which the threshold is being extended and is based on all non-centrally cleared derivatives between the two consolidated groups.

How to monitor exposures across the entire group in order to compute IM?

- Information will be needed about the group structures

Implications for the market structure

Market participants may start splitting their portfolios across counterparties in order to stay below the threshold, even if some bilateral netting benefits may be lost

Covered entities that have breached the €8 billion notional amount trigger and thus are subject to IM requirements may prefer transacting with covered entities that have not breached the trigger, since then their bilateral trades are exempt from IM requirements