FOR PROFESSIONAL CLIENTS, QUALIFIED INVESTORS, INSTITUTIONAL INVESTORS AND WHOLESALE INVESTORS ONLY
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Insight INVESTMENT

SEPTEMBER 2020

IMPLEMENTATION UPDATE
INITIAL MARGIN FOR NON-CENTRALLY CLEARED DERIVATIVES

OVERVIEW

Investors who have large books of non-centrally cleared derivatives will soon be required by their local regulators to post initial margin into a segregated collateral account. The requirements have already been implemented for the very largest investors; holders of EUR50bn or above in non-centrally cleared derivatives and then holders of EUR8bn or above will be phased in over the next two years. The full schedule was due to have completed in 2021 but owing to the disruption caused by COVID-19 it is delayed until 2022.

We urge clients to check if they are at or close to the September 2021 limits and to inform us as soon as possible if that is the case.

BACKGROUND

In March 2015, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) established minimum standards for margin requirements for non- centrally cleared derivatives.

The BCBS-IOSCO framework has two basic requirements for non-centrally cleared over-the- counter (OTC) derivatives:

- Variation margin (VM) is required to collateralise on a daily basis the mark-to-market exposure entered into on or after a specified compliance date.
- Initial margin (IM) is required in order to protect against potential losses which could stem from the movements in market value of derivative positions in the case of a counterparty default.

Insight has published a separate Implementation Update: Variation Margin for Non-Centrally Cleared Derivatives, explaining the steps we have taken in relation to the VM rules.

This note on IM implementation highlights the rules we believe are relevant to our clients and sets out the actions that we are taking to help our clients to fulfil their obligations.

Please note that this is not intended as an all-encompassing document on the IM requirements, and does not comprise legal advice. We take no responsibility for any omissions or inaccuracies in the interpretation of the rules. Insight's actions set out below, only apply to the mandates that we manage and will not apply to any client trades not managed by us.

WHAT ARE THE INITIAL MARGIN RULES?

For each regional set of margin rules, IM will be required to be posted and collected into a segregated collateral account. An indicative timetable for the IM rules is set out in the table below.

The relevant date for compliance with the IM rules is based on the size of the outstanding gross notional value of non-cleared trades of the entity with the smaller gross notional. Importantly, any entities with a gross notional of less than EUR8bn (or jurisdictional equivalent) will not be subject to the IM rules.

The calculation of the outstanding average aggregate notional amount (AANA) of all non-centrally cleared OTC derivatives (including physically settled foreign exchange contracts) of the entity's group of companies is measured as at the last business day of March, April and May in the relevant year for purposes of the EU rules. Such calculation requires the aggregation of all gross notional exposures across all investment managers trading derivatives on behalf of the entity. Offsetting positions cannot be netted for purposes of such calculation.

In order to assess whether or not clients will need to comply with the upcoming regulatory IM rules, we will be contacting clients to advise them of the AANA for the assets managed by Insight. We will also ask clients to confirm their total AANA for the assets in scope across all their investment managers. We will contact those clients who exceed the EUR8bn threshold and those who are under but close to the threshold to help make a determination and decide on next steps. An annual assessment of AANA will take place at the end of June each year to compare the value against the regulatory threshold for the following September.

Table 1: INITIAL MARGIN TIMETABLE

The dates at which rules on initial margin apply for those exceeding key thresholds for non-centrally cleared derivatives.

	1 September 2018	1 September 2019	1 September 2021	1 September 2022
BCBS-IOSCO	EUR1.5trn	EUR0.75trn	EUR50bn	EUR8bn
European Union	EUR1.5trn	EUR0.75trn	EUR50bn	EUR8bn
Australia	AUD2.25trn	AUD1.125trn	AUD75bn	AUD12bn
United States	USD1.5trn	USD0.75trn	USD50bn	USD8bn

HOW IS INITIAL MARGIN CALCULATED AND POSTED?

The IM amount is calculated daily for any entity which is above the EUR8bn threshold. Physically settled foreign exchange contracts count towards the EUR8bn threshold calculation; however, there is no requirement to post or collect IM in respect of such contracts. Margin is only required to be posted if the IM calculation amount in respect of the trades executed after the regulation comes into force exceeds EUR50m at the counterparty trading relationship level. IM is only required to be posted on any amount exceeding the EUR50m threshold. Only collateral types specified in the relevant collateral eligibility schedule can be used. IM must be posted to a segregated control account of a custodian or tri-party agent.

INSIGHT'S ACTIONS FOR UMBRELLA DERIVATIVES DOCUMENTATION

For clients using Insight's umbrella derivative documentation platform, Insight will use all reasonable endeavours:

- to ensure that Insight's umbrella derivatives documentation (including credit support deeds or other security agreements creating the security interest and the collateral eligibility schedule) complies with the relevant requirements for IM for non-centrally cleared derivatives;
- to negotiate tri-party account control agreements (or similar agreements) to govern the terms of the security arrangement with the relevant custodian, or the securities intermediary, including enforcement of the security interest;
- where required by regulation, to conduct legal reviews of the enforceability of netting arrangements under the derivatives documentation;
- to maintain and update relevant policies and risk management procedures; and
- to exchange IM with trading counterparties in a timely manner and in accordance with the relevant requirements for IM for non-centrally cleared derivatives.

ACTIONS REQUIRED BY CLIENTS

Clients should:

- determine whether their total AANA of non-centrally cleared OTC derivatives will breach, or is close to the EUR50bn September 2021 threshold,
- inform Insight as soon as possible if their AANA will breach a threshold and liaise with their custodian about actions, which might include setting up a segregated control account (these actions can take a year to implement), and
- monitor their AANA on an annual basis.

MINIMUM TRANSFER AMOUNTS FOR INSIGHT'S UMBRELLA DERIVATIVE DOCUMENTATION

The margin rules for each jurisdiction set out the highest permitted minimum transfer amount (MTA). For example, under the EMIR margin rules, counterparties may not have an MTA that exceeds EUR500,000. An entity's MTA must be shared between VM and IM, where applicable.

An appropriate MTA level in derivative documentation is important to ensure regulatory compliance and to manage collateral efficiency and counterparty risk. However, an MTA that is lower than necessary may cause additional collateral movements, which in turn is likely to incur associated third-party charges.

Insight will apply a default MTA of GBP/USD/EUR 250,000 in our derivative documentation (particularly in cases where Insight is a client's sole investment manager or manages the vast majority of a client's OTC derivatives) unless a client advises us otherwise. For a client that is in scope for IM, the entity's MTA must be allocated across both VM and IM, resulting in lower MTAs being applied for both VM and IM. The MTA may be further adjusted where necessary. To ensure a client's continuing compliance with its regulatory obligations, a client should instruct us as soon as possible if it wishes us to apply a different MTA.

CLIENTS WITH THEIR OWN DERIVATIVE DOCUMENTATION

If Insight trades using a client's own derivative documentation, then clients should ensure that documentation complies with the relevant margin rules.

Clients should provide any updated documentation to Insight with confirmation that this documentation is compliant with the relevant requirements.

NO ACTION REQUIRED FOR INVESTMENTS IN INSIGHT FUNDS

If clients are invested in Insight funds, including those in an Insight bespoke fund vehicle for the sole use of the client, the client will not be directly affected by the new margin rules, since it is the fund that must comply with the relevant requirements. Insight will take the necessary steps in relation to those funds.

ANY FURTHER QUESTIONS

If you have any questions about the requirements or the steps that Insight is taking, please do not hesitate to get in touch with your contact at Insight or your legal adviser.

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

The performance results shown, whether net or gross of investment management fees, reflect the reinvestment of dividends and/or income and other earnings. Any gross of fees performance does not include fees and charges and these can have a material detrimental effect on the performance of an investment.

Any target performance aims are not a guarantee, may not be achieved and a capital loss may occur. Funds which have a higher performance aim generally take more risk to achieve this and so have a greater potential for the returns to be significantly different than expected.

Portfolio holdings are subject to change, for information only and are not investment recommendations.

FIND OUT MORE

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