Uncleared Margin Rules

Contents

In response to the financial crisis, the G-20 mandated the Basel Committee on Banking Supervision (BCBS) and Board of International Organization of Securities Commissions (IOSCO) to develop consistent standards for non-centrally cleared over-the-counter (OTC) derivatives. In September 2013 BCBS-IOSCO published a global policy framework and timetable for OTC derivative margin reform which aimed to reduce systemic risk by ensuring collateral is available to offset losses caused by the default of a derivatives trading counterparty.

This framework and base level requirements have now been implemented in multiple jurisdictions under multiple regimes (described collectively herein as the un-cleared margin rules, "UMR") and require entities which enter into certain OTC derivative transactions on an un-cleared basis to exchange variation margin on a daily basis and in some cases collect and post initial margin (IM). IM is required to cover exposures that may arise in the period from default of one party to the time when the portfolio of OTC derivatives is closed out or replaced. Each party will both post and collect collateral to meet the IM requirement and such collateral will be subject to segregation requirements.

Short URL: https://ubs.com/umr

Would you like to find out more?

Get in touch
- Email us

Am I in Scope?

If you determine you are in scope please notify UBS as soon as possible.

The UMR requirements are implemented on a phase-in basis determined by Aggregate Average Notional Amount ("AANA") according to the relevant applicable regime. The AANA calculation is determined at group level and calculated over a 3 month period in each year, as provided under the relevant applicable regime. Note a distinct difference between the US and EMIR rules with the US rules requiring a daily average over the 3 month period and the EMIR rules requiring an average of month ends only.

The bilateral margin rules are not only imposed on dealers but also have a direct impact on a wide range of financial counterparties (including, for example, investment firms, credit institutions, insurance companies, pension schemes, collective investment schemes, alternative investment funds or equivalent fund entities) and non-financial counterparties who trade derivatives other than primarily for hedging purposes.

Accordingly, it is your responsibility to consider the rules which apply to you (or the funds you manage) based on your classification and the jurisdiction in which you are established and the swap dealer counterparties with which you are undertaking OTC derivative trading activity.

You may disclose your in-scope status by directly notifying UBS using the "Contact Us" section above or via the ISDA and/or Acadia self-disclosure service (see the Useful Links section).

Phase 1 to 5 of UMR have already been implemented according to the relevant AANA thresholds as below:

Phase 1 – September 2016	Phase 2 – September 2017	Phase 3 – September 2018	Phase 4 – September 2019	Phase 5 – September 2021	Phase 6 – September 2022
3 trillion $/€	2.25 trillion $/€	1.5 trillion $/€	0.75 trillion $/€	50 billion $/€	8 billion $/€

Phase 5 came into effect September 1, 2021 for entities whose AANA exceeds the following thresholds in an applicable regime:

Regime	AANA
Switzerland	CHF 50 billion
EU	EUR 50 billion
U.S.	USD 50 billion
Japan	JPY 7 trillion
Canada	CAD 75 billion
Hong Kong	HKD 375 billion
Singapore	SGD 80 billion
Australia	AUD 75 billion
Korea	KRW 70 trillion

Phase 6 comes into effect September 1, 2022 for entities whose AANA exceeds the following thresholds in an applicable regime

Regime	AANA
Switzerland	CHF 8 billion
EU	EUR 8 billion
U.S.	USD 8 billion
Japan	JPY 1.1 trillion
Canada	CAD 12 billion
Hong Kong	HKD 60 billion
Singapore	SGD 13 billion
Australia	AUD 12 billion
Korea	KRW 10 trillion

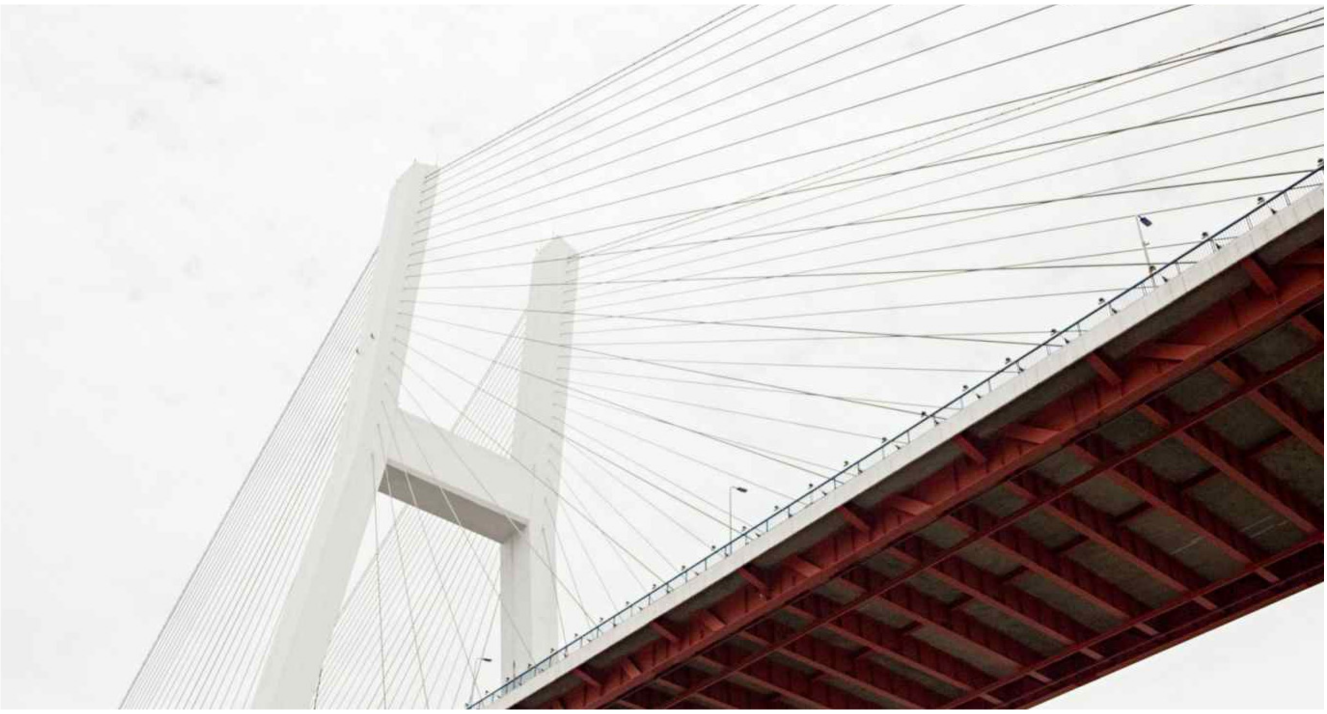
How is AANA Calculated?

In order to determine whether you are subject to IM under the UMR requirements, you need to determine if at a group level your consolidated notional non-cleared derivative balance exceeds the compliance threshold.

It is important to note that currently the AANA calculation under the EU and US rules (at a minimum), is calculated without regards to the exemptions provided for products that may be described as out of scope. This includes the notional amount of outstanding physically settled FX forwards and FX Swaps.

However, given the rules apply at counterparty level, for investment management firms the AANA calculation will be determined for each individual fund separately where they are legally segregated from each other, rather than looking across all funds that share the same Investment Manager / Adviser. Please note that consolidated seed funds may need to take into account the activity of the group to which they belong.

You will need to perform annual tests each year using the same Thresholds, measured over a 3 month period effective from the following 1st January. If you would like to discuss the options on testing, even prior to the required regulatory deadline, please contact us via the details in the contact us section.



Custodian Selection

Find out more about Custody providers, what to consider and UBS preferences.

The regulations stipulate that regulatory initial margin needs to be segregated with an entity independent from the posting party (or, for some regimes, segregated by other legally effective means). This custodian must operate a control account type structure which recognizes the security interest of the counterparty whose benefit you are posting on behalf of.

When selecting a custodian it is important to consider their service offering versus your specific requirements. Can they instruct movement of collateral? Can they provide optimization of collateral services if you require this? Can they monitor eligibility requirements? Can they provide monitoring and reporting?

You will also need to factor in the lead time to complete custodial set up. Documentation, including KYC, can take up to 3 months depending on the provider you selected. There are several third party custodians and tri-party agents who can support UMR collateral requirements for IM.

UBS uses tri-party custodians for our pledge and we can support BNYM Global, Clearstream or Euroclear, and would seek to align with you where possible for ease of negotiation and onboarding.

We are able to support your posting of Initial Margin (UBS as secured party) across all tri-party custodians (Euroclear, Clearstream, BONY and JP Morgan).

We can also support your posting via multiple 3rd party custodians.

Choose IM Methodology

Which do I choose, what are the differences?

The IM required to be posted or collected may be calculated using a margin model or using the regulatory prescribed schedule methodology (also known as Grid). The most commonly used and industry recognized margin model is the ISDA Standard Initial Margin Model (SIMM). You can choose to calculate IM based on either of these two approaches or outsource the service to a third party service provider.

SIMM Vs. Grid – What are the differences?

Grid serves as a fallback to SIMM or any other margin model. Although simple to implement, scheduled initial margin amounts would typically be 11 times higher than under a model-based initial margin regime, although this may depend on the directional nature of the portfolio. The calculation is based on a table (see below) assigning a trade-level initial margin based on a % of notional. Buckets for choosing margin rates are determined according to the asset class and its maturity. Long-dated Credit, Equity, Commodities and 'Other' carry the most punitive add-on factors.

The SIMM model was proposed by ISDA and the key inputs are the risk sensitivities (Deltas and Vegas). SIMM is a portfolio model allowing netting of offsetting risks. The overall SIMM margin requirement is the sum of the margin of the product classes:

SIMM = SIMMRatesFX + SIMMCredit + SIMMEquity + SIMMCommodity

The SIMM for each product class is calculated using the 6 risk classes and the correlation between them. The six risk classes are: IR, Credit (Qualifying), Credit (Non-Qualifying), Equity, Commodity and FX. The margin for each risk class is given by:

IM = DeltaMargin + VegaMargin + CurvatureMargin

These margins are calculated using risk weights and correlations supplied by ISDA. The model is recalibrated (on historical data including a period of stress) and then back tested annually by the industry.

Asset Class	Applicable Margin Rate (% of notional exposure)
Applicable Margin Rate (% of notional exposure)	2%
Credit:2-5 year residual maturity	5%
Credit: 5+year residual maturity	10%
Commodity	15%
Equity	15%
Foreign Exchange	6%
Interest Rate: 0-2year residual maturity	1%
Interest Rate: 2-5 year residual maturity	2%
Interest Rate: 5+ year residual maturity	4%
Other	15%

Step-by-step Calculation:

Step 1: Gross Initial Margin

GM =—∑ Trade Notional + Margin Rate

Step 2: Net to Gross Ratio:

NGR = Net replacement cost / Gross replacement cost

Where:

- Net replacement cost= max(0,∑ Trade level MTM)
- Gross replacement cost = ∑max(0, Trade level MTM)

Step 3: Net Initial Margin is the actual amount that needs to be posted

Net IM = 40% * GM + 60% * NGR * GM

Collateral Elections

Which asset types are eligible?

Collateral must consist of regulatory prescribed eligible collateral subject to criteria designed to ensure that such collateral is of sufficiently high quality, is adequately diversified and that wrong-way risk concerns are mitigated. Eligible collateral requirements vary by jurisdiction. Generally a broad set of collateral is acceptable including but not limited to Government Securities, Government guaranteed securities, Corporate bonds, and Equities. ISDA has developed a set of standard collateral schedules which if used will improve the lead time in agreeing with your counterparties

As part of your eligible collateral schedule and asset selection when posting collateral, you will need to ensure collateral posted to your account is in compliance with regulatory requirements. Depending upon your selection of custodial services or tri-party agent, this service may be operated by them on your behalf.

Prescribed haircuts must be applied to eligible collateral depending on their credit quality, and as a minimum must meet the most restrictive regulatory haircuts based on the regulators that govern the relationship. In addition an 8% FX haircut will apply where the collateral currency differs from the termination currency.

Legal Documentation

Find out about documentation architecture.

The contractual framework for meeting IM requirements is time consuming as account control agreements between both parties' custodians need to be in place as well as bilateral IM credit support agreements. It is suggested to start repapering negotiations with dealers and setting-up custodians' accounts at least 6 months before the expected implementation date. Past experience shows though that late comers might get caught in delays and operational burdens therefore an As Soon As You Can approach is advised, particularly in view of the number of entities potentially in-scope for Phase 6.

Documentation architecture will vary depending on the type of custodian (central securities depository or third party bank custodian) chosen by the posting party:

Central Clearing Depository (Tri-Party service)*	
Clearstream	Euroclear
2019 CTA	2019 CTA
2019 Security Agreement (Pledgor) 2019 Security Agreement (Pledgee)	2019 Security Agreement

*Central Clearing Depository requires membership documentation for posting party.

Bank Custodian (Tri-Party or Third Party Service)		
M CSA/CSD (bilateral agreement)		
Account Control Agreement (trilateral Agreement)		
2019 IM CTA (bilateral agreement) **		
2019 Security Agreement (NY Law) (bilateral agreement)		
2019 Security Agreement (English Law) (bilateral agreement) ***		
Account Control Agreement (trilateral agreement)		
IM/CSA/CSD Versions:		
New York Law	English Law	Japanese Law
2016 IM CSA	2016 IM CSD	2016 IM CSA
2018 IM CSA	2018 IM CSD	

** Bank Custodian CTA has been developed for use where parties are choosing a Custodian located outside the U.S. or U.K.

*** Further Security Agreements are being drafted based on location of disclosed custodians

Margin Process

Operational considerations and requirements

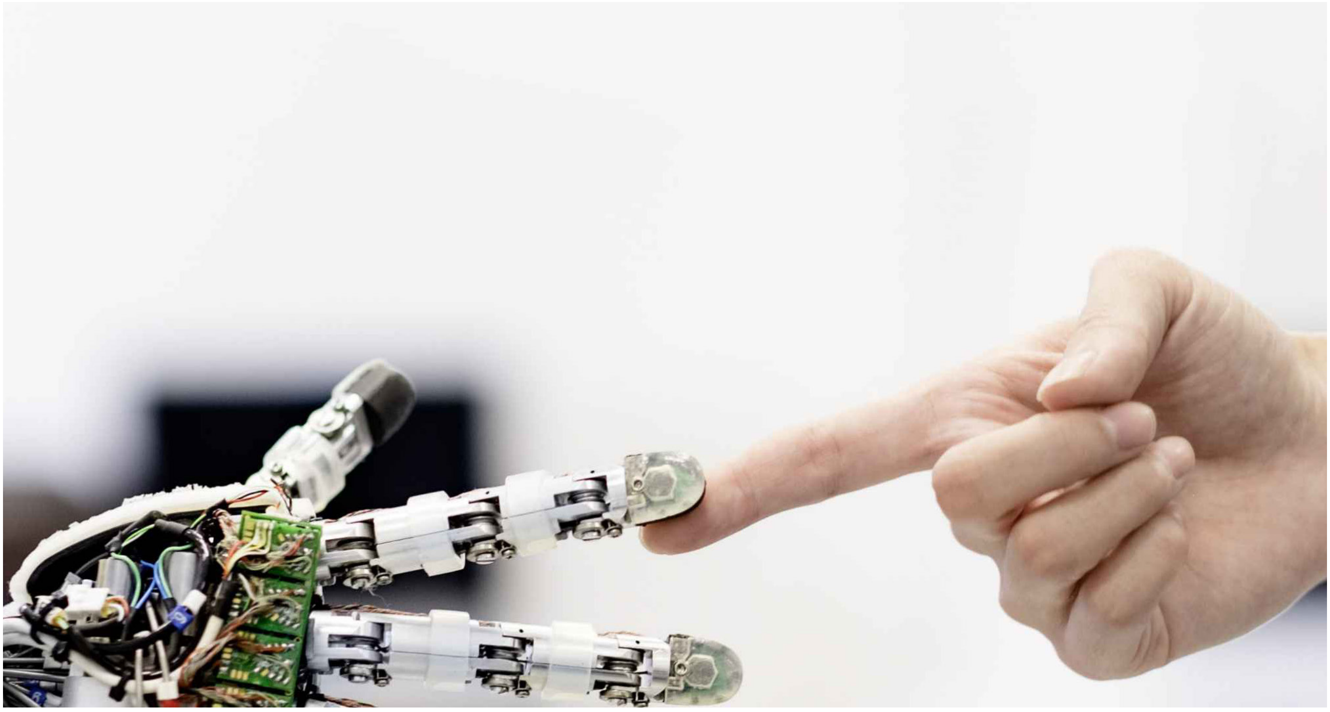
Regulatory Initial margin is calculated gross and 2-way, meaning you will need to perform calculations of IM along with management of margin calls and reconciliations. The calculation of initial margin needs to follow specific calculation methodologies under SIMM or Grid as outlined above.

You may wish to consider using a vendor that is licensed to perform SIMM calculations and can offer margin call processing services on your behalf.
If you are not currently posting house IM today UBS is able to support the Direct Margin approach. If you post a form of House IA, VaR or IM today on an in-scope fund, UBS currently supports the following margin approaches:

- Allocated Approach
  Under this scenario, the calculation would calculate the existing House requirement and a SIMM or GRID requirement, take whichever is greater and then move and segregate the regulatory component and the delta moved in line with how it settles today.

Example:
House = CHF 10 mm
SIMM/GRID = CHF 5 mm
A margin call of 5 mm would be generated, to align with regulatory compliance
A second margin call of 5 mm (delta between 10mm and 5 mm) would align with existing margin call process

- Greater Of Approach
  Under this scenario, the calculation would calculate the existing House requirement and a SIMM or GRID requirement and issue a margin call for whichever is of the greatest value. For regulatory compliance, the full amount would need to be segregated accordingly.



Portfolio Reconciliation

How will you manage reconciliation and reporting requirements?

Post trade monitoring and portfolio reconciliations will be required. If SIMM is the calculation model selected between the parties then additional 'trade sensitivities' will need to be reconciled along with the pre-existing trade reconciliations that take place today.

Considerations should also be given to the support model for IM dispute resolution. Depending on a firm's current internal organisation, a more specific quantitative skill set may be required to enhance the process.

Eligibility Control

What are the ongoing monitoring requirements?

As part of your eligible collateral schedule and asset selection when posting collateral, you will need to ensure collateral posted to your account is in compliance with regulatory requirements.

Depending upon your selection of custodial services or tri-party agent, this service may be operated by them on your behalf.

IM Monitoring

What is IM Monitoring?

Regulators have recently clarified that in-scope entities are not required to establish full Initial Margin (IM) arrangements with a counterparty until such time that their SIMM IM exposure exceeds the USD 50m (or relevant currency equivalent) threshold beyond which margin is required to be pledged. This relief was provided on the basis that such in-scope entities have sufficient controls in place to monitor IM and prevent the breaching of thresholds. By monitoring IM, in-scope entities and their respective counterparties are not required to:

1. maintain a custodian account for pledging/receiving regulatory IM
2. negotiate a custodian ACA
3. negotiate an IM collateral schedule
4. negotiate a bilateral IM agreement e.g. CSA/CSD/CTA/Security agreement

Who is IM Monitoring designed for?

IM Monitoring is available for counterparties who the in-scope entity determines are unlikely to breach the threshold beyond which Initial Margin is required to be pledged and the in-scope entity has sufficient controls in place to prevent such a breach.

What is the UBS offering?

As an alternative to full IM arrangements, UBS is prepared to agree to monitoring terms where appropriate as described above. Please note that for counterparties where we have neither agreed a full IM arrangement or monitoring terms, post the regulatory go-live date, in accordance with our own risk management policies we will not be able to conduct in-scope OTC Derivatives business. There are industry tools available for clients to assist in monitoring their IM.

Documentation

Japanese clients are required to sign the ISDA document "Japan Initial Margin Threshold Agreement" and agree monitoring terms/parameters. Non-Japanese clients are also required to agree the monitoring terms/parameters, and we have a standard bi-lateral monitoring letter available for this purpose.

At A Glance

Steps to consider for UMR readiness

What products are in scope for the Initial Margin under UMR?

The table below indicates some of the broad categories of derivatives which are generally considered in scope for IM under UMR for each of the US PR, EU, Swiss and Japan rulesets. However, please note that a full analysis of the product and its specific product features and the relevant margin rules should be undertaken before coming to any definitive conclusion as to its regulatory treatment. Note the scope may be different for AANA assessment and variation margining requirements.

Type of OTC Derivative	Prudential Regulator	EU	Switzerland	Japan
Interest Rate	Yes	Yes	Yes	Yes
Foreign Exchange (“FX”), except;	Yes	Yes	Yes	Yes
FX Spot	No	No	No	No
Physically settled FX Swaps	No	No	No	No
Principal payments on crosscurrency swaps	No	No	No	No
Equity				
Swaps based on securities or index	Yes	Yes	Yes	Yes
Options based on securities or index	No	No*	Yes**	Yes
Commodities, except	Yes	Yes	Yes	Yes
Physically settled forwards	No	Yes***	Yes***	No
Credit				
Based on single name	Yes	Yes	Yes	Yes
Based on index	Yes	Yes	Yes	Yes

*The EU Rules provide for a deferral in the application of margin requirements to equity single stock and index options. This deferral is currently due to expire on January, 4 2024.

**Single stock options, equity basket options and similar equity derivatives (e.g. derivatives on equity baskets) are out of scope until January 4, 2024.

*** The EU and Swiss rules provide that physically settled forwards may be considered in scope if they are considered to have the characteristics of other derivative financial instruments.

Which rules apply to UBS?

UBS AG will be directly subject to

1. Swiss rules (note, UBS will not be relying on EMIR equivalency/substituted compliance);
2. b) US Prudential Regulators' (PR) rules will apply when (a) trading out of one of its US branches with any counterparty; or (b) trading out of one of its non-US branches with a US Entity counterparty or a non-US Entity counterparty that is guaranteed by a US Entity. "US Entity" for this purpose includes an entity organized under US laws (including any of its non-US branches or offices), a US branch of a non-US entity, a U.S. resident natural person, and a swap entity (i.e. registered swap or security-based swap dealer or registered major swap or security-based swap participant) that is a subsidiary of a US entity;
3. EMIR (where acting out of an EU branch and facing an EU branch of a non-EU counterparty);
4. Japanese rules when trades are booked into a branch in that jurisdiction with any in-scope counterparty;
5. Australian, Hong Kong or Singapore rules when trades are booked into a branch in that jurisdiction with any in-scope client. However, the margin rules in these jurisdictions permit UBS to rely on substituted compliance with the Swiss rules. It is UBS's intention to rely on these substituted compliance provisions and solely apply the Swiss rules.

UBS Europe SE will be directly subject to EMIR

This may result in multiple margin rules applying to a single trading relationship, particularly once the rules applicable to the jurisdiction of both parties are taken into account. Where this occurs, unless and until any substituted compliance is permitted, UBS's approach is to apply the strictest elements from a combination of the applicable rulesets to the trading relationship.

What do I need in order to exchange IM in line with UMR?

UMR requires in-scope entities to have relevant margin documentation in place by the required regulatory deadline and to begin exchanging regulatory IM once a €50 million (or relevant currency equivalent) threshold has been exceeded (the "IM Threshold"). In some cases, monitoring of the IM threshold alone may be sufficient before the obligation to exchange margin is triggered. See the "Advocacy" section.

Any existing house IM requirement with UBS will remain in place regardless of the UMR requirements. For further information regarding margin documentation, see "Legal Documentation" under the FAQs section.

What is the Minimum Transfer Amount?

This will be determined based on the applicable regimes, the total amount is aggregated across both variation and initial margin. Note that each of the IM and VM documentation will specify an MTA.

What is the maximum threshold I can choose?

The threshold is applied at a group level and would need to be allocated across entities impacted by the regulation. UBS would typically agree an amount with an FX buffer to allow for currency movements across the different regulations. Please note this threshold applies to regulatory IM only and is not applicable to any existing non-regulatory initial margin arrangement we may have in place with you.

Do I need to paper if I only trade out of scope products?

No. If you exclusively trade out-of-scope products with UBS there is no requirement to repaper. Please do however, check your trading relationship with UBS against in the in-scope product table under item 2 to be certain that you are not captured under any of the UMR rulesets.

Do the UMR requirements apply to trades entered into before the applicable regulatory deadline?

The UMR requirements apply to uncleared OTC derivative transactions entered into or novated after the relevant regulatory deadline. In addition, material restructurings of existing transactions entered into before the applicable regulatory deadline effected after such date will bring such transactions into scope of the requirements where, broadly speaking, the amendment has the equivalent economic effect of entry into a new transaction. To the extent existing transactions are not materially amended after the applicable regulatory deadline they will generally not be impacted by UMR.

Equity prime brokerage clients

For clients of Equity Prime Brokerage ('EQPB') that receive portfolio cross margin and / or consolidated margin statements there will be a number of changes:

- The current EQPB house initial margin calculation methodology will not change, however we will introduce a further margin calculation for SIMM and show these amounts on the EQPB consolidated margin statements.
- Eligible collateral will need to be posted by you to the segregated custody account to cover the IM requirement (net of any Threshold), and any further collateral needed to cover the remaining house initial margin would be posted to the EQPB account as per the current margin process.
- Note that segregating initial margin is likely to increase indebtedness and potential for rehypothecation or unsecured funding charges. The posting of SIMM by UBS to your custodian also increases the funding costs.
- In addition to the new legal documentation we will need to review your Prime Brokerage Agreements and other margin documentation to ensure that they are compliant with the regulations.

If you would like to discuss any points specific to EQPB then please contact your GFS Platform Sales representative

Industry advocacy

Papering under the regulatory threshold.
On March 5, 2019, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (BCBS/IOSCO) issued guidance (the “BCBS/IOSCO Repapering Guidance”) related to the framework for margin requirements for non-centrally cleared derivatives noting that UMR does not specify documentation, custodial or operational requirements if the bilateral initial margin amount (“Reg IM”) does not exceed the UMR’s €50 million (or relevant currency equivalent) initial margin threshold. At present we do not have a definite view from all national competent regulators that this guidance will be acceptable.

Some regulators have issued their own guidance related to the BCBS/IOSCO Repapering Guidance and for those who have not, the industry is currently engaging with such regulators to ascertain whether further guidance is to be expected and/or whether any parameters or conditions will be imposed when deferring re-papering in reliance on the BCBS / IOSCO Repapering Guidance. The best way for UBS to maintain your liquidity with certainty will be to put in place documentation in advance of your adherence deadline.

Final Phase Extension & AANA Adjustments.
On July 23, 2019 BCBS/IOSCO issued a statement revising the final implementation phase timeline. In addition, on April 03, 2020 BCBS/IOSCO announced an extension of Phase 5 to September 01, 2021 and Phase 6 to September 01, 2022 in response to the impact of COVID-19. The corresponding AANA Calculation Periods have also been amended in line with the new dates. Phase 6 is the final implementation phase, September 1, 2022 for entities with an AANA greater than €8 billion (or equivalent currency).

We encourage our Phase 6 clients to continue to engage with us to address papering requirements as Custodians have indicated early completion deadlines for documentation and collateral eligibility schedules. For clients that wish to pursue a monitoring arrangement, we also encourage you to contact us to discuss monitoring terms.

Would you like to find out more?

Get in touch
- Email us

Useful links

SIMM Calculations
- ISDA has published a list of licensed vendors
- BIS: Margin Requirements for non-centrally cleared derivatives
- Guidance on AANA Calculations (US)
- ISDA guidance on Calculating AANA for US Regulations

In Scope Products
- ISDA In scope product grid

Self-Disclosure
- ISDA self-Disclosure Service

Please do not hesitate to contact us at SH-UMR_ClientQueries@ubs.com if you have any questions, concerns in relation to Phase 6 of UMR Initial Margin Implementation or alternatively reach out to your usual UBS contact.

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