UMR Compliance FAQ

Your questions answered - Back to the (UMR) Future webinar

Given the delay granted by legislators for Uncleared Margin Rules (UMR), we have been analysing the impact for in scope entities.

We hope that UMR compliance is not as heavy lifting as some might think. As the 'Back to the future' movie says - "There's that word again, 'heavy.' Why are things so heavy in the future? Is there a problem with the Earth's gravitational pull?" – we are here to provide you with the tools and guidance on how to reduce the heavy lifting and make this process as light, smooth and efficient as possible!

UMR is more than a compliance exercise

During our recent webinar, we discussed a shift to improved practice which will ultimately create a more robust and efficient workflow process in the collateral world.

Our experts answered your questions

Cristina Grigore, Director, Product Management, IHS Markit
Hiroshi Tanase, Executive Director, Senior Product Manager, Derivatives Valuations, IHS Markit
Joe Midmore, Chief Commercial Officer, OpenGamma
Chetan Joshi, Founder, COO, Margin Reform
Mark Higgins, Liquidity Management & Collateral Segregation, BNY Mellon

AANA Calculation and in scope instruments

Q) For credit default indices, if cleared through the exchange they have no impact on AANA or SIMM, is that correct?

Cristina Grigore: Cleared derivatives are not subject to AANA calculation and therefore not required to be included in calculation of Initial Margin. For a complete list of derivatives subject to non-cleared margin rules that need to be included, see this ISDA link.

Q) For equity index options, what are you seeing in light of the distinct treatment by jurisdictions (i.e., they're in scope for US margin rules but out of scope of EU margin rules) and do you have a view as to whether the EU or others are likely to make the temporary exemption from margining equity index options permanent?

Chetan Joshi: This answer can be broken into two parts. Firstly, regarding differences between jurisdictions, we are seeing firms discussing these during the first step of selfdisclosure. As both parties need to agree what regulations are in scope for both of them. In scope counterparties have to build solutions to support 1) their home jurisdiction and 2) worst of jurisdiction (US vs EU). For the second part of the question, regarding the exemption becoming permanent, EMIR has a time-limited derogation under the Margin Regulatory Technical Standards (Margin RTS) for equity options and indexes until 4th January 2021. Industry bodies, have urged the European Commission and the ESAs (European Supervisory Authorities) to consider amending the Margin RTS to permanently exempt these transactions, or else to significantly extend the period of deferred application ('temporary derogation') to allow further observation of developments in other jurisdictions and to avoid an unlevel playing field for EU market participants engaged in global derivatives markets.

Custodian related questions

Q Can "Buy side" firms opt for a tri-party model? Or are they required to choose a third party?

Mark Higgins: At BNY Mellon, we are open to using both platforms. Historically, Tri-party was used by the largest bank/broker dealers when posting collateral/margin, while third party was used by the buy side, of which we had mostly Hedge Funds posting Independent Amounts to their PB's. Times have changed and we are now able to offer Tri-party to a wider range of new clients, with business approvals permitting. The expansion into Tri-party in 2020 is perhaps reflected by the fact that we have a quarter third party and three quarters Tri-party based ACA's this year.

Q How does the tri-party / third party split change when looking at how the buy-side are delivering versus receiving IM?

Mark Higgins: The one quarter vs three quarters split considers all our ACA's, where BNY Mellon is being used to post margin. What we can't see is how our clients are receiving all their margin across all clients and platforms. However, I think it is safe to say that pretty much every Bank/Broker Dealer will be posting to the Buy side client using a Tri-party based platform from one of the four main agents (TPA's). If you had asked me two years ago, I would have said that I expect the majority of Buy side firms to post using their Custodian / 3rd Party platform. While that might be true for those wedded to other Custodians, it's not always the case now at BNY Mellon.

Q Is the compliance deadline for third parties later than for tri-parties?

BNY Mellon Phase 5 Documentation Deadlines		
Collateral Administration	**Requirement:**	**Date:**
SIMM to Seg	Finalized Trade Files	January 29, 2021
	CSA's	March 31, 2021
Initial Margin Segregation	**Requirement:**	**Date:**
Triparty	Executed ACA & ECS	
	Non-RULE Users	February 26, 2021
	RULE Users	March 31, 2021
Third Party	Execute ACA	February 26, 2021

NOTE: ECS templates should be submitted 4 weeks prior to the date you would like begin eligible collateral negotiations with your counterparties

IM Calculation and Margin Optimization related questions

Q) For our portfolios Schedule IM is significantly lower than SIMM IM and we know a few cases where highly directional OTC derivatives portfolios hedging key market risks would attract lower uncleared margin posting requirements under schedule. What is the relevance of SIMM in these cases?

Hiroshi Tanase: It is true that Schedule IM produces lower margin amounts for certain highly directional portfolios. This is because the margin amounts are determined under Schedule IM simply with the use of pre-defined percentages that are applied to the trade notional (before the netting adjustment is applied). Therefore, SIMM underperforms Schedule IM if a portfolio satisfies certain risk characteristics such as long duration interest rate risk with little risk offsets. However, all directional portfolios may not be the same. Some may be directional but not very long-dated; some may be purely long-only currently but are constructed under a mandate that allows tactical short positions in shorter maturities for enhanced performance. So, the key question for those firms with directional portfolios is whether the risk characteristics observed currently, which are giving rise to much smaller IM amounts under Schedule IM, are expected to be permanent or are subject to change in the future. In other words, the relevance of SIMM is that of providing a risk-based – and therefore, futureproof – solution to those firms whose portfolio risk may shift from being purely directional and favourable under Schedule IM to being less favourable under Schedule IM under different future trading conditions. While the decision to use Schedule IM may be sensible for some firms, the decision should be made carefully.

Margin Reform UMR Survey

Like to gain more insight on the UMR industry status as a whole? Take part in [Margin Reform's UMR survey]() and once the results are in it should help shed more light on the industry readiness. It will take 10-15 minutes to complete and the benefits are as follows:

1. You can assess if your UMR project approach is in line with your peers.

2. Determine your overall collateral capability against the market by responding to targeted questions.
3. Receive a free summarised report with anonymised results versus your peers.

For additional information please reach out on email or visit our webpage.