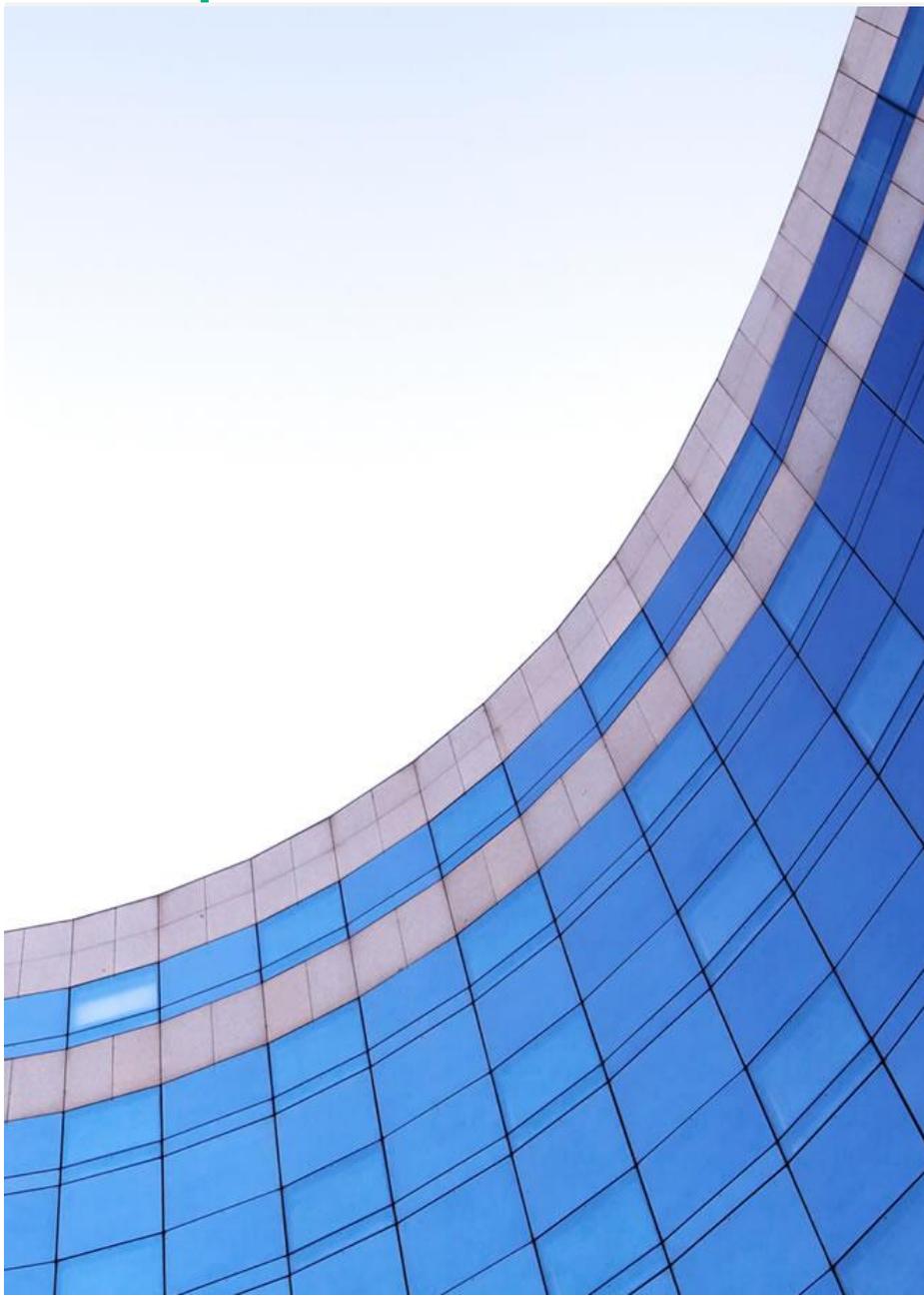


BANKING & FINANCE

Phase 6: Initial Margin for non-cleared derivatives over-the-counter ("OTC")

VdA EXPERTISE



September 2022

ISDA estimates that more than 775 counterparties with an excess of 5,400 relationships may become subject to regulatory IM requirements in Phase 6. More than 800 of those relationships may need to exchange IM following September 1, and therefore should be actively implementing the required measures at this stage.

Pursuant to EMIR (European Market Infrastructure Regulation), obligations to provide collateral in the form of Initial Margin (IM) to certain counterparties have been implemented gradually (since 2017) upon the verification of certain requirements. Phase 6, which represents the final global compliance phase for phasing in the rules for the provision of initial margin to counterparties, has started on 1 September 2022.

Several phases of implementation of the IM requirements have been determined, divided according to certain thresholds, by reference to the average aggregate notional amount (AANA). On each phase, once the applicable threshold is crossed, the IM requirements would become enforceable upon the relevant counterparties. For phase 6, it is estimated that such requirement to provide IM will be applicable for the first time to hundreds of global counterparties that belong to a consolidated group for which the AANA of derivatives transactions exceeds €8 billion, or a similar amount in local currency.

What is Initial Margin (IM)?

The IM regulation requires OTC derivatives counterparties to provide margin on a segregated basis to cover current and potential future exposure during the period between the last margin collection and the time when derivatives positions are closed out following the counterparty's default.

To the extent they are in compliance with the applicable requirements, counterparties will be subject to the obligation to provide IM, potentially impacting various parts of collateral management and OTC derivatives processing, such as the calculation of IM, the exchange of IM that needs to be segregated, risk management processes and liquidity management.

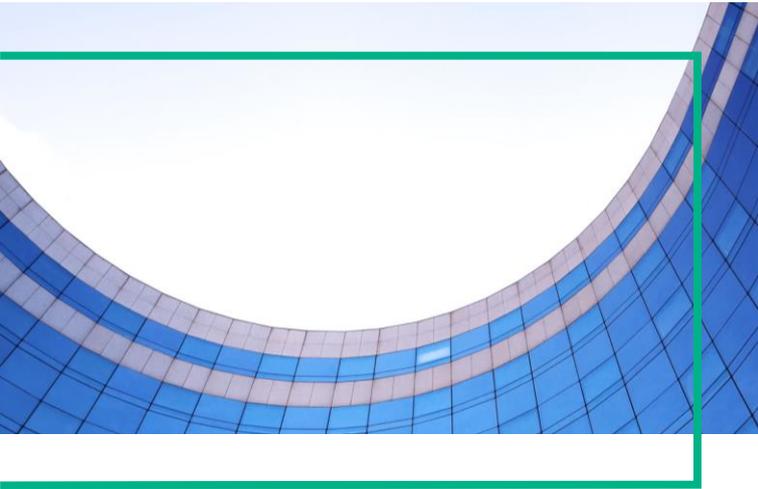
However, only new transactions, i.e. those derivative transactions executed on or after 1 September 2022, entered into with entities also subject to the IM obligations, are now subject to the IM obligations.

What are the steps that clients must take to comply with the IM regulations?

Firstly, clients should identify those entities that are: (i) covered under the scope of the initial margin (IM) requirements; and (ii) estimated to have an AANA of non-cleared derivatives that exceeds €8 billion or a similar amount in local currency. The AANA applied to non-cleared OTC derivatives is calculated in month-end amounts in March, April and May of each year for the purposes of applicability of the IM requirements after September 2022.

In case the AANA calculation indicates that the relevant entity is covered by Phase 6, the company shall disclose it to its counterparties as soon as possible in order to allow sufficient time to complete the required steps of the IM requirements.

Furthermore, certain decisions must be made by clients regarding the manner in which they will comply with IM requirements. Specifically, a determination must be made as to (i) the operational mechanisms to put in place, (ii) the requirement to create custodial relationships, (iii) the legal review of contractual documents to be conducted, including negotiation and execution of any relevant documents and (iv) whether any special situation will apply to a particular case / transaction.



What are the transactions excluded from IM obligations?

Certain transactions are excluded from IM obligations, such as:

1. Those OTC derivative transactions that, after AANA calculations are made, not exceed the exchange threshold of €8 billion at group level or a similar amount in local currency.
2. The legacy derivatives (pre-existing derivative transactions vis-à-vis the referred date) are not subject to the obligation to provide IM.

Furthermore, changes to derivative agreements that take place after 1 September but are solely intended to address the cessation of benchmarks do not trigger IM obligations in relation to the amended transactions.

3. Having regard to the EMIR regulations and according to the understanding of the Basel Committee on Banking Supervision and IOSCO dated 5 March 2019, if the parties to a derivative determine that they are subject to the regulatory IM requirements after completion of the AANA calculations, but anticipate that the aggregate amount of IM under a certain relationship with a counterparty will not exceed €50 million, certain IM requirements may be set aside.

Clients must assess their status and start implementing the steps they will need to take to comply with these new IM provisions (which came into force on 1 September 2022) as soon as possible.

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