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RESTRICTED

Final Draft Regulatory Technical Standards

on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012



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1. Executive Summary

The European Supervisory Authorities (ESAs) have been mandated to develop common draft regulatory technical standards (RTS) that outline the concrete details of the regulatory framework which implements Article 11 of Regulation (EU) No 648/2012 (EMIR)¹. The EMIR introduces a requirement to exchange margins on non-centrally cleared OTC derivatives. Specifically, the EMIR delegates powers to the Commission to adopt RTS specifying:

1. the risk-management procedures for non-centrally cleared OTC derivatives;
2. the procedures for counterparties and competent authorities concerning intragroup exemptions for this type of contract; and
3. the criteria for the identification of practical or legal impediment to the prompt transfer of funds between counterparties.

The EMIR mandates the ESAs to develop standards that set out the levels and type of collateral and segregation arrangements required to ensure the timely, accurate and appropriately segregated exchange of collateral. This will include margin models, the eligibility of collateral to be used for margins, operational processes and risk-management procedures. In developing these standards, the ESAs have taken into consideration the need for international consistency and have consequently used the BCBS-IOSCO framework as the natural starting point. In addition, a number of specific issues have been clarified so that the proposed rules will implement the BCBS-IOSCO framework while taking into account the specific characteristics of the European financial market.

The second consultation paper, published on June 2015², built on the proposals outlined in the ESAs' first consultation paper³. The ESAs, after reviewing all the responses to the first consultation paper, engaged in intensive dialogues with other authorities and industry stakeholders in order to identify all the operational issues that may arise from the implementation of this framework.

These draft RTS prescribe the regulatory amount of initial and variation margins to be posted and collected and the methodologies by which that minimum amount should be calculated. Under both approaches, variation margins are to be collected to cover the mark-to-market exposure of the OTC derivative contracts. Initial margin covers the potential future exposure, and counterparties can choose between a standard pre-defined approach based on the notional value of the contracts and an internal modelling approach, where the initial margin is determined based on the modelling of the exposures. This allows counterparties to decide on the complexity of the models to be used.

¹ [Regulation \(EU\) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.](#)

² [Second Joint Consultation on draft RTS on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP \(EBA/JC/CP/2015/002\).](#)

³ [Joint Consultation on draft RTS on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP \(JC/CP/2014/03\), issued by the EBA, EIOPA and ESMA on 14 April 2014.](#)



The draft RTS also outline the collateral eligible for the exchange of margins. The list of eligible collateral covers a broad set of securities, such as sovereign securities, covered bonds, specific securitisations, corporate bonds, gold and equities. In addition, the RTS establish criteria to ensure that collateral is sufficiently diversified and not subject to wrong-way risk. Finally, to reflect the potential market and foreign exchange volatility of the collateral, the draft RTS prescribe the methods for determining appropriate collateral haircuts.

Significant consideration has also been given to the operational procedures that have to be established by the counterparties. Appropriate risk-management procedures should include specific operational procedures. The draft RTS provide the option of applying an operational minimum transfer amount of up EUR 500 000 when exchanging collateral.

With regard to intragroup transactions, a clear procedure is established for the granting of intragroup exemptions allowed under the EMIR. This procedure will harmonise the introduction of such procedures and provide clarity on these aspects.

The draft RTS also acknowledge that a specific treatment of certain products may be appropriate. This includes, for instance, physically settled FX swaps, which may not be subject to initial margin requirements.

Furthermore, to allow counterparties time to phase in the requirements, the standard will be applied in a proportionate manner. Therefore, the requirements for the initial margin will, at the outset, apply only to the largest counterparties until all counterparties with notional amounts of non-centrally cleared derivatives in excess of EUR 8 billion are subject to the rules, as from 2020. The scope of application for counterparties subject to initial margin requirements is therefore clearly specified.

Quantitative and qualitative aspects concerning the costs and benefits of the proposed rules are discussed in the annex. The annex supplements the proposal and illustrates the reasoning behind the policy choices made.



2. Background and rationale

The EMIR establishes provisions aimed at increasing the safety and transparency of the over-the-counter (OTC) derivative markets. Among other requirements, it introduces a legal obligation to clear certain types of OTC derivatives through central counterparties (CCPs). However, not all OTC derivative contracts will be subject to the clearing obligation or would meet the conditions to be centrally cleared. In the absence of clearing by a CCP, it is essential that counterparties apply robust risk-mitigation techniques to their bilateral relationships to reduce counterparty credit risk. This will also mitigate the potential systemic risk that can arise in this regard.

Therefore, Article 11 of the EMIR requires the use of risk-mitigation techniques for transactions that are not centrally cleared and, in paragraph 15, mandates the ESAs to develop RTS on three main topics: (1) the risk-management procedures for the timely, accurate and appropriately segregated exchange of collateral; (2) the procedures concerning intragroup exemptions; and (3) the criteria for the identification of practical or legal impediment to the prompt transfer of funds between counterparties belonging to the same group.

The ESAs consulted twice on this set of RTS, in 2014 and 2015. The ESAs also engaged in intensive dialogues with other authorities and industry stakeholders in order to identify all the operational issues that may arise from the implementation of this framework.

To avoid regulatory arbitrage and to ensure a harmonised implementation at both the EU level and globally, it is crucial for individual jurisdictions to implement rules consistent with international standards. Therefore, these draft RTS are aligned with the margin framework for non-centrally cleared OTC derivatives issued by the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) on September 2013⁴. The international standards outline the final margin requirements, which the ESAs have endeavoured to transpose into the RTS.

The overall reduction of systemic risk and the promotion of central clearing are identified as the main benefits of this framework. To achieve these objectives, the BCBS-IOSCO framework set out eight key principles and a number of detailed requirements. It is the opinion of the ESAs that this regulation is in line with the principles of that framework.

These draft RTS are divided into three main parts: the introductory remarks, a draft of the RTS and the accompanying material, including a cost-benefit analysis and an impact assessment. The draft RTS document is further split into chapters in line with the mandate. A number of topics are covered in the first chapter, such as general counterparties' risk-management procedures, margin methods, eligibility and treatment of collateral, operational procedures and documentation.

⁴ [Margin requirements for non-centrally cleared derivatives – final document, issued by BCBS and IOSCO on March 2015.](#)



The last two chapters cover the procedures for counterparties and competent authorities concerning the exemption of intragroup OTC derivative contracts.

The sections below describe in greater detail the content of these draft RTS.

Counterparties' risk-management procedures required for compliance with Article 11(3) of the EMIR

The first part of these draft RTS outlines the scope of the application of these requirements by identifying the counterparties and transactions subject to the following provisions. The EMIR requires financial counterparties to have risk-management procedures in place that require the timely, accurate and appropriately segregated exchange of collateral with respect to OTC derivative contracts. Non-financial institutions must have similar procedures in place, if they are above the clearing threshold. Consistent with this goal, to prevent the build-up of uncollateralised exposures within the system, the RTS require the daily exchange of variation margin with respect to transactions between such counterparties.

Subject to the provisions of the RTS, the entities mentioned above, i.e. financial and certain non-financial counterparties, will also be required to exchange two-way initial margin to cover the potential future exposure resulting from a counterparty default. To act as an effective risk mitigant, initial margin calculations should reflect changes in both the risk positions and market conditions. Consequently, counterparties will be required to calculate and collect variation margin daily and to calculate initial margin at least when the portfolio between the two entities or the underlying risk measurement approach has changed. In addition, to ensure current market conditions are fully captured, initial margin is subject to a minimum recalculation period.

In order to align with international standards, the requirements of the RTS will apply only to transactions between identified OTC derivative market participants. The provisions of the RTS on initial margin will therefore apply to entities that have an OTC derivative exposure above a predetermined threshold, defined in the draft RTS as above EUR 8 billion in gross notional outstanding amount. This reduces the burden on smaller market participants, while still achieving the margin framework's principle objective of a sizable reduction in systemic risk. These draft RTS impose an obligation on EU entities to collect margins in accordance with the prescribed procedures, regardless of whether they are facing EU or non-EU entities. Given that non-financial entities established in a third country that would be below the clearing threshold if established in the Union would have the same risk profile as non-financial counterparties below the clearing threshold established in the Union, the same approach should be applied to them in order to prevent regulatory arbitrage.

The RTS recognise that the exchange of collateral for only minor movements in valuation might lead to an overly onerous exchange of collateral and that initial margin requirements will have a measurable impact. Therefore, the RTS include a threshold to limit the operational burden and a threshold for managing the liquidity impact associated with initial margin requirements. Both thresholds are fully consistent with international standards.



The first threshold ensures that the exchange of initial margins does not need to take place if a counterparty has no significant exposures to another counterparty. Specifically, it may be agreed bilaterally to introduce a threshold of up to EUR 50 million, which will ensure that only counterparties with significant exposures will be subject to the initial margin requirements.

The second threshold (minimum transfer amount) ensures that, when market valuations fluctuate, new contracts are drawn up or other aspects of the covered transactions change; an exchange of collateral is only necessary if the change in the initial and variation margin requirements exceeds EUR 500 000. Similarly to the first threshold, counterparties may agree on the introduction of a threshold in their bilateral agreement as long as the minimum exchange threshold does not exceed EUR 500 000. Therefore, the exchange of collateral only needs to take place when recalculated changes to the margin requirements are above the agreed thresholds, to limit the operational burden relating to these requirements.

In the first consultation paper, the draft RTS were developed on the basis that counterparties in the scope of the margin requirements are required to collect margins. As two counterparties that are subject to EU regulation are both obliged to collect collateral, this would imply an exchange of initial margins. The underlying assumption was also that counterparties in equivalent third country jurisdictions would also be required to collect, so Union counterparties trading with third country counterparties were expected to post and collect initial and variation margins. Respondents to the first consultation and third country authorities highlighted that this would not always be the case, as some entities might be not covered by margin rules in a third country jurisdiction. In the final draft RTS counterparties are required not only to collect but also to post margins. This approach ensures that Union counterparties are not put at a competitive advantage with respect to entities in other major jurisdictions.

For derivative contracts with counterparties domiciled in certain emerging markets, the enforceability of netting agreements or the protection of collateral cannot be supported by an independent legal assessment (non-netting jurisdictions). Where such assessments are negative, counterparties should rely on alternative arrangements such as posting collateral to international custodians. As this is not always a viable solution, these situations should be treated as special cases. The final RTS prescribe that, where possible, a Union counterparty should collect collateral and post it to its counterparty; however, where a jurisdiction lacks proper infrastructures, the Union counterparty should be allowed to only collect collateral without posting any, as this would result in sufficient protection for the counterparty subject to the EMIR. In order to avoid undermining the objectives of the EMIR, OTC derivative contracts that are not covered by margin exchange at all should be strictly limited; this can be achieved by setting a maximum ratio between the total notional amount of OTC derivative contracts with counterparties in non-netting jurisdictions and the total amount at group level.

The group-wide aggregate notional amount determines when counterparties are in the scope of the variation margin requirements and determines when and what counterparties are in the scope of the initial margin requirements. The RTS prescribe that all intragroup OTC derivatives are to be included in the calculation and but should be counted only once. Intragroup derivatives exempted under



Articles 11(5) to (10) of the EMIR should also be included in the calculation. This is in line with the similar treatment of intragroup transactions for the calculation of the aggregated notional amount for the clearing threshold. Furthermore, this approach was chosen to align with prevailing international practices.

The use of cash initial margin is limited: a maximum of 20% of the total collateral collected from a single counterparty can be maintained in cash per single custodian. This requirement applies only to systemically important banks, GSIs and OSIs, dealing among themselves. Other counterparties would have no limit on posting or collecting cash IM. The final RTS prescribe that when a counterparty exchange IM in cash the choice of the custodian should be taken into account the custodian's credit quality; this is because cash is difficult to be segregated and therefore there is a credit risk toward the custodian itself. The RTS do not set any limit on the exposures or constraints on the credit quality of the custodian itself; in particular, there is no reference to any minimum external rating. Furthermore, the final RTS provide that cash VM should not be subject to a currency mismatch haircut but cash IM should be subject to a currency mismatch haircut, like any other collateral.

Margin calculation

Section 4 of the final RTS outlines the approach that counterparties may use to calculate initial margin requirements: the standardised approach and the initial margin models.

The standardised approach mirrors the mark-to-market method set out in Articles 274 and 298 of Regulation (EU) No 575/2013 (CRR). It is a two-step approach: firstly, derivative notional amounts are multiplied by add-on factors that depend on the asset class and the maturity, resulting in a gross requirement; secondly, the gross requirement is reduced to take into account potential offsetting benefits in the netting set (net-to-gross ratio). Unlike the mark-to-market method, the add-on factors are adjusted to align with those envisaged in the international standards.

Alternatively, counterparties may use initial margin models that comply with the requirements set out in the RTS. Initial margin models can either be developed by the counterparties or be provided by a third-party agent. The models are required to assume the maximum variations in the value of the netting set at a confidence level of 99% with a risk horizon of at least 10 days. Models must be calibrated on a historical period of at least three years, including a period of financial stress; in particular, in order to reduce procyclicality, observations from the period of stress must represent at least 25% of the overall data set. To limit the recognition of diversification benefits, a model can only account for offset benefits for derivative contracts belonging to the same netting set and the same asset class. Additional quantitative requirements are set out to ensure that all relevant risk factors are included in the model and that all basis risks are appropriately captured. Furthermore, the models must be subject to an initial validation, periodical back-tests and regular audit processes. All key assumptions of the model, its limitations and operational details must be appropriately documented.

Cross-border transactions where jurisdictions apply different definitions of OTC derivatives or a different scope of the margin rules are addressed in a separate article. The strict requirements



impose limits on the calculation of margins in a netting set only to non-centrally cleared OTC derivatives that are in the scope of the margin rules in one or the other jurisdiction. This should avoid margin calculations being improperly reduced, for example by including in the calculation other products that are not non-centrally cleared OTC derivatives.

Eligibility and treatment of collateral

The final RTS set out the minimum requirements for collateral to be eligible for the exchange of margins by counterparties and the treatment of collateral, its valuation and the haircuts to be applied.

Even if margin is exchanged in an amount appropriate to protect the counterparties from the default of a derivative counterparty, the counterparties may nevertheless be exposed to loss if the posted collateral cannot be readily liquidated at full value should the counterparty default. This issue may be particularly relevant during periods of financial stress. The RTS provide counterparties with the option of agreeing on the use of more restrictive collateral requirements, i.e. a subset of the eligible collateral as set out in the RTS.

Assets that are deemed to be eligible for margining purposes should be sufficiently liquid, not be exposed to excessive credit, market and FX risk and hold their value in a time of financial stress. Furthermore, with regard to wrong-way risk, the value of the collateral should not exhibit a significant positive correlation with the creditworthiness of the counterparty. The accepted collateral should also be reasonably diversified. To the extent that the value of the collateral is exposed to market and FX risk, risk-sensitive haircuts should be applied. This ensures that the risk of losses in the event of a counterparty default is minimised.

The draft RTS set out a list of eligible collateral, eligibility criteria, requirements for credit assessments and requirements regarding the calculation and application of haircuts. Wrong-way risk and concentration risk are also addressed by specific provisions. Additionally, the RTS require that risk-management procedures include appropriate collateral-management procedures. A set of operational requirements is therefore included to ensure that counterparties have the capabilities to properly record the collected collateral and manage the collateral in the event of the default of the other counterparty.

The ESAs have adopted the key principles outlined in the international standards and have adapted these principles to take into account EU-wide market conditions. This will ensure a harmonised EU implementation of the RTS whilst respecting the conditions of the relevant markets. The ESAs consider it appropriate to allow a broad set of asset classes to be eligible collateral and expect that bilateral agreements will further restrict the eligible collateral in a way that is compatible with the complexity, size and business of the counterparties. As a starting point, the list of eligible collateral is based on the provisions laid down by Articles 197 and 198 of the CRR, relating to financial collateral available under the credit risk mitigation framework of institutions, and includes only funded protection. All asset classes on this list are deemed to be eligible in general for the purposes of the RTS. However, all collateral has to meet additional eligibility criteria such as low credit, market and FX risk.



The ESAs have considered several methodologies to ensure that the collected collateral is of sufficient credit quality. In particular, in accordance with Regulation No 462/2013 on credit rating agencies (CRA 3), the ESAs introduced mitigants against an excessive reliance on external ratings.

Furthermore, the use of either an internal or external credit assessment process remains subject to a minimum level of credit quality. Namely, the RTS allow the use of internal-ratings-based (IRB) approaches by credit institutions authorised under the CRR. The current disclosure requirements are sufficient to allow counterparties the necessary degree of understanding of the methodology. If there is not an approved IRB approach for the collateral or if the two counterparties do not agree on the use of the internal-ratings-based approach developed by one counterparty, the two counterparties can define a list of eligible collateral relying on the external credit assessments of recognised external credit assessment institutions (ECAIs). The minimum level of credit quality is set out with reference to a high Credit Quality Step (CQS) for most collateral types. The use of the CQS must be consistent with the Implementing Technical Standards (ITS) of the ESA on the mapping of credit assessments to risk weights of ECAIs under Article 136 of the CRR.

The risk of introducing 'cliff effects' possibly triggering a market sell-off after a ratings downgrade where counterparties would be required by the regulation to replace collateral has also been addressed in the development of the RTS with the introduction of concentration limits. As the risk of cliff effects may not be sufficiently mitigated by the introduction of internal credit assessments, these draft RTS also allow the minimum level of credit quality set out in the RTS to be exceeded for a 'grace period' following a downgrade. However, this is conditional on the counterparty starting a well-defined process to replace the collateral.

Two requirements are necessary on top of the other provisions on the collateral eligible for the exchange of margins: measures preventing wrong-way risk on the collateral and concentration limits. The RTS do not allow own-issued securities to be eligible collateral, except on sovereign debt securities. However, this requirement extends to corporate bonds, covered bonds, other debt securities issued by institutions and securitisations. These requirements will reduce concentration risk in the collateral placed in margins and are considered necessary to fulfil the requirement to have sufficient high-quality collateral available following the default of a counterparty.

The ESAs considered the peculiar market characteristics of sovereign debt securities and their investors. As many smaller market participants tend to have substantial investments in local sovereign securities and a diversification may increase, instead of reducing, their risk profile, the ESAs are of the opinion that concentration limits for this particular asset class should be required only for systemically important entities. However, the existing identification of systemically important banks (GSIs and OSIs) would only be valid for that particular sector. Therefore, the draft RTS include an additional threshold that, referring to the total amount of collected initial margin, aims to identify other major participants in the OTC derivative market that are not banks. For the sake of consistency, the diversification requirements for this asset class only apply to trades between systemically important counterparties and not to trades between them and smaller counterparties.

The collateral requirements set out in the draft RTS strive to strike a good balance between two conflicting objectives. Firstly, there is the need to have a broad pool of eligible collateral that also



avoids an excessive operational and administrative burden on both supervisors and market participants. Secondly, the quality of eligible collateral must be sufficient while limiting cliff effects in the form of introducing reliance on ECAI ratings. However, the risk of losses on the collateral is not only mitigated by ensuring collateral of sufficiently high quality; it is also considered necessary to apply appropriate haircuts to reflect the potential sensitivity of the collateral to market and foreign exchange volatilities. The current draft RTS allow either the use of internal models for the calculation of haircuts or the use of standardised haircuts. Haircut methodologies provide transparency and are designed to limit procyclical effects.

In order to provide a standardised haircut schedule, haircuts in line with the credit risk mitigation framework have been adopted across the different levels of Credit Quality Steps. It should be noted that the international standards provide haircut levels in the standardised method (standard schedule), also derived from the standard supervisory haircuts adopted in the Basel Accord's approach to the collateralised transactions framework. However, the standard schedule presented in the international standards only contains haircuts for collateral of very high credit quality with an external credit assessment equivalent to CQS 1. The list of eligible collateral in the draft RTS includes collateral with a lower, albeit still sufficiently high, credit quality. The draft RTS extend the standardised schedule of haircuts based on the credit risk mitigation framework of the CRR.

The section on eligible collateral has been drafted to ensure full alignment with the international standards. It was considered important to take into account the specificities of the European markets, but also to provide a harmonised approach that would ensure consistency of implementation across EU jurisdictions.

Operational procedures

The RTS recognise that the operational aspects relating to the exchange of margin requirements will require substantial effort to implement in a stringent manner. It is therefore necessary for counterparties to implement robust operational procedures that ensure that documentation is in place between counterparties and internally at the counterparty. These requirements are considered necessary to ensure, that the requirements of the RTS are implemented in a careful manner that minimises the operational risk of these processes.

The operational requirements include, among other things, clear senior management reporting, escalation procedures (internally and between counterparties) and requirements to ensure sufficient liquidity of the collateral. Furthermore, counterparties are required to conduct tests on the procedures, at least on an annual basis.

Segregation requirements must be in place to ensure that collateral is available in the event of a counterparty defaulting. In general, operational and legal arrangements must be in place to ensure that the collateral is bankruptcy remote.

The BCBS-IOSCO framework does not generally allow re-use or re-hypothecation of initial margins and restricts re-use to very specific cases. After considering the characteristics of the European market, where re-use and re-hypothecation subject to the restrictions of the international standards



would be of limited use, the ESAs propose that the RTS do not include this possibility. As a special case, the RTS allow a third-party custodian or holder to re-invest initial margin posted in cash as this seems to be common market practice and the use of cash IM is usually disincentivised by the same custodians because of the additional costs related to it.

Procedures concerning intragroup derivative contracts

In accordance with Article 11(6) to 11(10) of the EMIR, intragroup transactions can be exempted from the requirement to exchange collateral if certain requirements regarding risk-management procedures are met and there are no practical or legal impediments to the transferability of own funds and the repayment of liabilities. Depending on the type of counterparties and where they are established, there is either an approval or a notification process.

Without further clarification, there would be a risk that competent authorities would follow very different approaches regarding the approval or notification process. Therefore, these draft RTS specify a number of key elements including the amount of time that competent authorities have to grant an approval or to object, the information to be provided to the applicant and a number of obligations on the counterparties.

To ensure that the criteria for granting an exception are applied consistently across the Member States, the draft RTS further clarify which requirements regarding risk-management procedures have to be met, and specify the practical or legal impediments to the prompt transfer of own funds and the repayment of liabilities.

The ESAs considered the interaction of the provision concerning the exemption of intragroup OTC derivatives and the recognition of third countries' regulatory regimes referred to in Article 13(2) of the EMIR. A special provision is included to avoid a situation where exemption cannot be granted because the determination is still pending. [Since this would lead to a disproportionate implementation of the margin requirements, it is necessary to postpone the introduction of the requirements concerning initial margin to allow competent authorities to provide a response to the groups applying for an exemption.

Phase-in of the requirements

A last article deals with transitional provisions and phase-in requirements. In order to ensure a proportionate implementation, the RTS propose that the requirements will enter into force on 1 September 2016, giving counterparties subject to these requirements time to prepare for the implementation. The initial margin requirements will be phased in over a period of four years. Initially, the requirements will only apply to the largest market participants. Subsequently, after four years, more market participants will become subject to the requirements. Specifically, from 1 September 2016, market participants that have an aggregate month-end average notional amount of non-centrally cleared derivatives exceeding EUR 3 trillion will be subject to the requirements from the outset. From 1 September 2020, any counterparty belonging to a group whose aggregate month-end average notional amount of non-centrally cleared derivatives exceeds EUR 8 billion will be subject to the requirements. Similarly, but with a shorter timescale, the requirements for the



implementation of variation margin will be binding for the major market participants from September 2016 and for all the other counterparties that fall within the scope of these RTS by 1 March 2017. Therefore, the requirements of these RTS are fully aligned with the BCBS and IOSCO standards, as amended in March 2015⁵.

During the development of the RTS, the issue of the risks posed by physically settled foreign exchange contracts was carefully considered. To maintain international consistency, entities subject to the RTS may agree not to collect initial margin on physically settled foreign exchange forwards and swaps, or the principal in cross-currency swaps. Nevertheless, counterparties are expected to post and collect the variation margin associated with these physically settled contracts, which is assessed to sufficiently cover the risk. It should be noted, however, that in the EU there is currently no unique definition of physically settled FX forwards and introducing this requirement before such a common definition is introduced at Union level would have significant distortive effects. For this reason, the draft RTS introduce a delayed application of the requirement to exchange variation margins for physically settled FX forwards. Given that this inconsistency at EU level is expected to be solved via the Commission delegated act defining these type of derivatives under MiFID II, the postponement is linked to the earlier of the date of entry into force of this delegated act and 31 December 2018. This is to provide certainty regarding the full application of these RTS should there be delays in the adoption of this delegated act.

Uncertainty about whether or not equity options or options on equity indexes will be subject to margin in other jurisdictions justifies caution in the implementation of the margin requirements within the Union. The final draft RTS include a phase-in of three years for these kinds of options to avoid regulatory arbitrage.

The phase-in requirements give smaller market participants more time to develop the necessary systems and implement the RTS. Moreover, it is important to streamline the implementation of this framework and to align it with international standards in order to achieve a global level playing field.

The approval process for the exemption referred to in Article 11(5) to 11(10) of the EMIR may not be completed by the 1 September 2016. Therefore, Union counterparties belonging to the same group should not be required to collect and post initial margin when dealing among them, even where the exemption process is not complete. The ESA acknowledge the cost that requiring initial margin for intragroup transaction would have, especially considering the fact that those requirements may apply only for a short period of time until when the exemption is granted. However, counterparties belonging to the same group should at least exchange variation margin in accordance with the BCBS-IOSCO framework schedule. This does not require setting aside dedicated financial resources. Furthermore, exchanging variation margin is already common practice among major derivative dealers, which are the ones in the scope of the first phase of the initial margin requirements. For this reason the ESAs introduced a specific deadline for the exchange of initial margins for non-exempted intragroup transactions (1 March 2017), which would allow the relevant authorities to complete the assessment of the relevant requests for exemptions.

⁵ [Margin requirements for non-centrally cleared derivatives, issued by the Basel Committee and IOSCO on March 2015.](#)





3. Draft regulatory technical standards on risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty under Article 11(15) of Regulation (EU) No 648/2012



Brussels, **XXX**
[...](2015) **XXX** draft

COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

Supplementing Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories of the European Parliament and of the Council with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty

(Text with EEA relevance)



EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Article 11(15) of Regulation (EU) No 648/2012 ('the Regulation') as amended by Regulation (EU) No 575/2013 ('CRR') empowers the Commission to adopt, following submission of draft standards by the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Market Authority, which constitute the European Supervisory Authorities (ESA), and in accordance with either Articles 10 to 14 of Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010 and Regulation (EU) No 1095/2010 delegated acts specifying the risk-management procedures, including the levels and type of collateral and segregation arrangements, required for compliance with paragraph 3 of Article 11 of the Regulation, the procedures for the counterparties and the relevant competent authorities to be followed when applying exemptions under paragraphs 6 to 10 and the applicable criteria referred to in paragraphs 5 to 10 including in particular what should be considered as practical or legal impediment to the prompt transfer of own funds and repayment of liabilities between the counterparties.

In accordance with Article 10(1) of Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010 and Regulation (EU) No 1095/2010 establishing the ESA, the Commission shall decide within three months of receipt of the draft standards whether to endorse the drafts submitted. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In accordance with the third subparagraph of Article 10(1) of Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010 and Regulation (EU) No 1095/2010, the ESA have carried out a public consultation on the draft technical standards submitted to the Commission in accordance with Article 11(15) of Regulation (EU) No 648/2012. A discussion paper and two consultation papers were published on the ESA websites respectively on 6 March 2012, 14 April 2014 and 10 June 2015. Together with these draft technical standards, the ESA have submitted an explanation on how the outcome of these consultations has been taken into account in the development of the final draft technical standards submitted to the Commission.

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010 or Regulation (EU) No 1095/2010, the ESA have submitted its impact assessment, including its analysis of the costs and benefits, related to the draft technical standards submitted to the Commission. This analysis is available at <https://eiopa.europa.eu/Pages/Publications/Draft-Regulatory-Technical-Standards-on-margin-requirements-for-non-centrally.aspx>.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

This delegated act covers three mandates in the following areas:

- a) the risk-management procedures, including the levels and type of collateral and segregation arrangements;



b) the procedures for the counterparties and the relevant competent authorities to be followed when applying exemptions for intragroup OTC derivative contracts;

c) the applicable criteria on what should be considered as practical or legal impediment to the prompt transfer of own funds and repayment of liabilities arising from OTC derivative contracts between the counterparties belonging to the same group.

Therefore, this delegated act is structured in three chapters in line with each of the areas covered by the mandate. Since the first chapter is more complex, it was necessary to split it further in various sections. A final chapter includes transitional and final provisions.

The first chapter covers all the requirements concerning the risk management procedures for the margin exchange, detailed procedures for specific cases, the approaches to be applied for the margin calculation, the procedures around the margin collection, the eligibility, valuation and treatment of collateral, the operational aspects and requirements concerning the trading documentation.

The second chapter includes the procedures for the counterparties and the relevant competent authorities when applying exemptions for intragroup derivative contracts including process, timing and notifications to authorities.

The criteria for applying exemptions for intragroup derivative contracts and what has to be considered a practical or legal impediment are specified in the third chapter. In particular, legal impediments include not only regulatory constraints but also constraints that may arise by internal restrictions or legally binding agreements within and outside the group.

A fourth chapter includes transitional and final provisions. The need for international convergence, regulatory arbitrage and specific characteristic of the OTC derivative market within the Union make necessary a staggered implementation of these requirements in some specific cases such as intragroup transactions, equity options and foreign exchange forwards.

In developing this delegated act, the ESA took into account the Basel Committee-IOSCO margin framework for non-centrally cleared OTC derivatives and the Basel Committee guidelines for managing settlement risk in foreign exchange transactions.



COMMISSION DELEGATED REGULATION (EU) .../..

of **XXX**

Supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) 648/2012 of 4 July 2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories¹, and in particular the third subparagraph of Article 11(15) thereof,

Whereas:

- (1) Counterparties have an obligation to protect themselves against credit exposures to derivatives counterparties by collecting margins. This Regulation lays out the standards for the timely, accurate and appropriately segregated exchange of collateral. These standards apply on a mandatory basis only to the portion of collateral that counterparties are required by this Regulation to collect or post. However, counterparties which agree to collecting or posting collateral beyond the requirements of this Regulation should be able to choose to have such collateral to be covered by these standards or not.
- (2) Over-the-counter derivatives (OTC derivative contracts) entered into by clients or indirect clients cleared by a central counterparty (CCP) may be cleared through a clearing member intermediary or through an indirect clearing arrangement. Under the indirect clearing arrangement, the client or the indirect client posts the margins directly to the CCP, or to the party that is between the client or indirect client and the CCP. Indirectly cleared OTC derivative contracts are considered as centrally cleared and are therefore not subject to the risk management procedures set out in this Regulation.
- (3) Counterparties subject to the requirements of Article 11(3) of Regulation (EU) 648/2012 should take into account the different risk profiles of non-financial counterparties that are below the clearing threshold referred to in Article 10 of that Regulation when establishing their risk management procedures for OTC derivative contracts with such entities. It is therefore appropriate to allow counterparties to determine whether or not the level of counterparty credit risk posed by a non-financial counterparty that is below that clearing threshold needs to be mitigated through the exchange of collateral. When taking this decision, the counterparty credit risk resulting from the transactions with the non-financial counterparty should be taken into account

¹

OJ L 201, 27.7.2012, p.1.



together with the size and nature of the OTC derivative contracts. Given that non-financial entities established in a third country that would be below the clearing threshold if established in the Union can be assumed to have the same risk profile as non-financial counterparties below the clearing threshold established in the Union, the same approach should be applied to both types of entities in order to prevent regulatory arbitrage.

- (4) A CCP may enter into non-centrally cleared OTC derivative contracts in the context of customer position management upon the insolvency of a clearing member. These trades are subject to requirements on the part of the CCP as referred to in point 2 of Annex II of Delegated Regulation (EU) No 153/2013² and are reviewed by the competent authorities. These non-centrally cleared OTC derivative contracts are an important component of a robust and efficient risk management processes for a CCP. The additional liquidity needs that those trades could trigger, were they covered by regulatory margin requirements, would fall under the responsibility of the CCP. As this would potentially increase systemic risk, instead of mitigating it, the risk management procedures set out in this Regulation should not apply to such trades.
- (5) Counterparties of OTC derivatives contracts need to be protected from the risk of a potential default of the other counterparty. Therefore, two types of collateral in the form of margins are necessary to properly manage the risks to which those counterparties are exposed. The first type is variation margin, which protects counterparties against exposures related to the current market value of their OTC derivative contracts. The second type is initial margin, which protects counterparties against expected losses which could stem from movements in the market value of the derivatives position occurring between the last exchange of variation margin before the default of a counterparty and the time that the OTC derivative contracts are replaced or the corresponding risk is hedged.
- (6) Initial margins cover current and potential future exposure due to the default of the other counterparty and variation margins reflect the daily mark-to-market of outstanding contracts. For OTC derivative contracts that imply the payment of a premium upfront to guarantee the performance of the contract, the counterparty receiving the payment of the premium ('option seller') is not exposed to current or potential future exposure if the counterparty paying the premium defaults. Also, the daily mark-to-market is already covered by the premium paid. Therefore, where the netting set consists solely of such option positions, the option seller should be able to choose not to collect additional initial or variation margins for these types of OTC derivatives, whereas the option buyer should collect both initial and variation margins as long as the option seller is not exposed to any credit risk.
- (7) While dispute resolution processes contained in bilateral agreements between counterparties are useful for minimising the length and frequency of disputes, counterparties should, at a first stage, collect at least the undisputed amount in case the amount of a margin call is disputed. This will mitigate the risk arising from the

² Commission Delegated Regulation (EU) No 153/2013, of 19 December 2012, supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties (OJ L 52, 23.2.2013, p.41).



disputed transactions and therefore ensure that OTC derivative contracts are collateralised in accordance with this Regulation. However, both parties should make all necessary and appropriate efforts, including timely initiation of dispute resolution protocols, to resolve the dispute and exchange any required margin in a timely fashion.

- (8) In order to guarantee a level playing field across jurisdictions, where a counterparty established in the Union enters into a OTC derivative contract with a counterparty that is established in a third country and would be subject to the requirements of this Regulation if it was established in the Union, initial and variation margins should be exchanged in both directions. Counterparties should remain subject to the obligation of assessing the legal enforceability of the bilateral agreements and the effectiveness of the segregation agreements. When such assessments highlight that the agreements might not be in compliance with this Regulation, counterparties established in the Union should identify alternative processes to post collateral, such as relying on third-party banks or custodians domiciled in jurisdictions where the requirements in this Regulation can be guaranteed.
- (9) It is appropriate to allow counterparties to apply a minimum transfer amount when exchanging collateral in order to reduce the operational burden of exchanging limited sums when exposures move only slightly. However, it should be ensured that such minimum transfer amount is used as an operational tool and not with the view to serving as an uncollateralised credit line between counterparties. Therefore, a maximum level should be set out for that minimum transfer amount.
- (10) For operational reasons, it might in some cases be more appropriate to have separate minimum transfer amounts for the initial and the variation margin. In those cases it should be possible for counterparties to agree on separate minimum transfer amounts for variation and initial margin with respect to OTC derivative contracts subject to this Regulation. However, the sum of the two separate minimum transfer amounts should not exceed the maximum level of the minimum transfer amount set out in this Regulation. For practical reasons, it should be possible to define the minimum transfer amount in the currency in which margins are normally exchanged, which may not be the Euro. However, recalibration of the minimum transfer amount should be frequent enough to maintain its effectiveness.
- (11) The scope of products subject to the proposed margin requirements is not consistent across the Union and other major jurisdictions. Where this Regulation require that only OTC derivative contracts governed by Regulation (EU) No 648/2012 are included in the margin calculations for cross-border netting sets, the two counterparties would have to double the calculations to take into account different definitions or different scope of products of the margin requirements. Furthermore, this would likely increase the risk of disputes. Allowing the use of a broader set of products in cross-border netting sets that includes all the OTC derivative contracts that are subject to regulation in one or the other jurisdiction would facilitate the process of margin collection. This approach is consistent with the systemic risk-reduction goal of this Regulation, since all regulated products will be subject to the margin requirements.
- (12) Counterparties may choose to collect initial margins in cash, in which case the collateral should not be subject to any haircut. However, where initial margins are



collected in cash in a currency different than the currency in which the contract is expressed, currency mismatch may generate foreign exchange risk. For this reason, a currency mismatch haircut should apply to initial margins collected in cash in another currency. For variation margins collected in cash no haircut is necessary in line with the BCBS-IOSCO framework, even where the payment is executed in a different currency than the currency of the contract.

- (13) When setting the level of initial margin requirements, the international standard setting bodies referred to in Recital 24 of Regulation (EU) No 648/2012 have explicitly considered two aspects in their framework. This framework is the Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions Margin requirements for non-centrally cleared derivatives, March 2015 ('BCBS-IOSCO framework'). The first aspect is the availability of high credit quality and liquid assets covering the initial margin requirements. The second is the proportionality principle, as smaller financial and non-financial counterparties might be hit in a disproportionate manner from the initial margin requirements. In order to maintain a level playing field, this Regulation should introduce a threshold below which two counterparties are not required to exchange initial margin that is exactly the same as in the BCBS-IOSCO framework. This should substantially alleviate costs and operational burden for smaller participants and address the concern about the availability of high credit quality and liquid assets without undermining the general objectives of Regulation (EU) No 648/2012.
- (14) While the thresholds should always be calculated at group level, investment funds should be treated as a special case as they can be managed by a single investment manager and captured as a single group. Where the funds are distinct pools of assets and they are not collateralised, guaranteed or supported by other investment funds or the investment manager itself, they are relatively risk remote from the rest of the group. Such investment funds should therefore be treated as separate entities when calculating the thresholds. This approach is consistent with the BCBS-IOSCO framework.
- (15) With regard to initial margin, the requirements of this Regulation will likely have a measurable impact on market liquidity, as assets provided as collateral cannot be liquidated or otherwise reused for the duration of the OTC derivative contract. Such requirements will represent a significant change in market practice and will present certain operational and logistical challenges that will need to be managed as the new requirements come into effect. Taking into account that the variation margin already covers realised fluctuations in the value of OTC derivatives contracts up to the point of default, it is considered proportionate to apply a threshold of EUR 8 billion in gross notional amounts of outstanding OTC derivative contracts to the application of the initial margin requirements under this Regulation. This threshold applies at the group level or, where the counterparty is not part of a group, at the level of the single entity. Further, counterparties that are above this threshold and therefore subject, *prima facie*, to the initial margin requirements should have the option of not collecting initial margin for an amount of up to EUR 50 million, calculated at group level, and an amount of up to EUR 10 million, calculated at intragroup level. The aggregated gross notional amount of outstanding OTC derivative contracts should be used as the measure given that it is an appropriate benchmark, or at least an acceptable proxy, for



measuring the size and complexity of a portfolio of non-centrally cleared OTC derivatives. It is also a benchmark that is easy to monitor and report. These thresholds are also in line with the BCBS-IOSCO framework for non-centrally cleared OTC derivatives.

- (16) Exposures arising from either OTC derivative contracts or to counterparties that are permanently or temporarily exempted or partially exempted from margins according to this Regulation, should also be included in the calculation of the aggregated gross notional amount. This is due to the fact that all the contracts contribute to the determination of the size and complexity of a counterparty's portfolio. Therefore, non-centrally cleared OTC derivatives such as physically-settled foreign exchange swaps and forwards, cross currency swaps, swaps associated to covered bonds for hedging purposes and derivatives entered into with exempted counterparties or with respect to exempted intragroup transactions are also relevant for determining the size, scale and complexity of the counterparty's portfolio and should therefore also be included in the calculation of the thresholds.
- (17) It is appropriate to set out in this Regulation special risk management procedures for certain types of products that show particular risk profiles. The exchange of variation margin without initial margin should, consistently with the BCBS-IOSCO framework, be considered an appropriate exchange of collateral for physically-settled foreign exchange products. Similarly, as cross-currency swaps can be decomposed in a sequence of foreign exchange forwards, only the interest rate component should be covered by initial margin.
- (18) The Commission Delegated Act referred to in Article 4(2) of Directive 2014/65/EU introduce a harmonised definition of physically-settled foreign exchange forwards within the Union. At this juncture, these products are defined in a non-homogenous way in the Union. Therefore, in order to avoid creating an un-level playing field within the Union, it is necessary that the corresponding risk mitigation techniques in this Regulation are aligned to the date of entry into force of that Delegated Act. A specific date on which the margin requirements for such products will enter into force even in absence of that Delegated Act is also laid down in this Regulation to avoid excess delays in the introduction of the risk mitigation techniques set out in this Regulation, with respect to the BCBS-IOSCO framework.
- (19) In order to ensure a level playing field for Union counterparties on a global level, in order to avoid market fragmentation, and acknowledging the fact that in some jurisdictions the exchange of variation and initial margin for single-stock options and equity index options is not subject to equivalent margin requirements, the treatment of those products should be aligned to international practices. This can be achieved by a delayed implementation of the requirements concerning the margin exchange given there is no international alignment on the margins for those types of options.
- (20) Recital 24 of Regulation (EU) No 648/2012 states that this Regulation should take into account the impediments faced by covered bonds issuers or cover pools in providing collateral. Under a specific set of conditions, covered bonds issuers or cover pools should therefore not be required to post collateral. This includes the case where the relevant OTC derivative contracts are only used for hedging purposes and where a regulatory overcollateralization is required. This should allow for some flexibility for



covered bonds issuers or cover pools while ensuring that the risks for their counterparties are limited.

- (21) Covered bond issuers or cover pools may face legal impediments to posting and collecting non-cash collateral for initial or variation margin or posting variation margin in cash. However, there are no constraints on a covered bond issuer or cover pool to return cash previously collected as variation margin. Counterparties of covered bond issuers or cover pools should therefore be required to post variation margin in cash and should have the right to get back part or all of it, but the covered bond issuers or cover pools should only be required to post variation margin for the amount in cash that was previously received. The reason behind this is that a variation margin payment could be considered a claim that ranks senior to the bond holder claims, which could result in a legal impediment. Similarly, the possibility to substitute or withdraw initial margin could be considered a claim that ranks senior to the bond holder claims facing the same type of constraints.
- (22) Counterparties should always assess the legal enforceability of their netting and segregation agreements. Where, because of the legal framework of a third country, these assessments turn out to be negative ('non-netting jurisdictions'), it can happen that counterparties have to rely on arrangements different from the two-way exchange of margins. With a view to ensuring consistency with international standards, to avoid that it becomes impossible for Union counterparties to trade with counterparties in those jurisdictions and to ensure a level playing field for Union counterparties it is appropriate to set out a minimum threshold below which counterparties can trade with those non-netting jurisdictions without exchanging initial or variation margins. Where the counterparties have the possibility to collect margins and it is ensured that for the collected collateral, as opposed to the posted collateral, the provisions of this Regulation can be met, Union counterparties should always be required to collect collateral. Exposures from those contracts that are not covered by any exchange of margin because of the legal impediments in non-netting jurisdictions should be constrained by setting a limit, as capital is not considered equivalent to margin exchange in relation to the exposures arising from OTC derivative contracts. The limit should be set in such a way that it is simple to calculate and verify. To avoid the build-up of systemic risk and to avoid that such specific treatment would create the possibility to circumvent the provisions of this Regulation, the limit should be set at a very low level. These treatments would be considered sufficiently prudent, because there are also other risk mitigation techniques as an alternative to margins. For example, credit institutions usually have to hold capital for cross border OTC derivative contracts with counterparties in non-netting jurisdictions on a gross basis because the netting arrangements are not legally enforceable and therefore not recognised for regulatory purposes.
- (23) In case that collateral cannot be liquidated immediately after default, it is necessary to take into account the time period from the most recent exchange of collateral covering a netting set of OTC derivative contracts with a defaulting counterparty until the OTC derivative contracts are closed out and the resulting market risk is re-hedged, which is known as 'margin period of risk' ('MPOR') and is the same tool as that used in Article



272(9) of Regulation (EU) No 575/2013 of the European Parliament and of the Council³. Nevertheless, as the objectives of the two Regulations differ, and Regulation (EU) No 575/2013 sets out rules for calculating the MPOR for the purpose of own funds requirements only, this Regulation should include specific rules on the MPOR that are required in the context of the risk management procedures for non-centrally cleared OTC derivatives. The MPOR should take into account the processes required by this Regulation for the exchange of margins. Normally, both initial and variation margin are exchanged no later than the end of the following business day. An extension of the time for the exchange of variation margin could be compensated by an adequate rescaling of the MPOR. Therefore, taking into account possible operational issues, it should be allowed to extend the time for the exchange of variation margin where such an extension is included in the rescaling of the MPOR. Alternatively, where no initial margin requirements apply an extension is allowed if an appropriate amount of additional variation margin has been collected.

- (24) When developing initial margin models and when estimating the appropriate MPOR, counterparties should take into account the need to have models that capture the liquidity of the market, the number of participants in that market and the volume of the relevant OTC derivative contracts. At the same time there is the need to develop a model that both parties can understand, reproduce and on which they can rely to solve disputes. Therefore counterparties should be allowed to calibrate the model and estimate MPOR dependent only on market conditions, without the need to adjust their estimates to the characteristics of specific counterparties. This in turn implies that counterparties may choose to adopt different models to calculate the initial margin, and that the initial margin requirements are not symmetrical.
- (25) While there is a need for recalibrating an initial margin model with sufficient frequency, a new calibration might lead to unexpected levels of margin requirements. For this reason, an appropriate time period should be established, during which margins may still be exchanged based on the previous calibration. This should allow counterparties to have enough time to comply with margin calls resulting from the recalibration.
- (26) Collateral should be considered as being freely transferable in the case of a default of the collateral provider if there are no regulatory or legal constraints or third party claims, including those of the third party custodian. However, certain claims, such as costs and expenses incurred for the transfer of the collateral, in the form of liens routinely imposed on all securities' transfer should not be considered an impediment. Otherwise it would lead to a situation where an impediment would always be identified.
- (27) The collecting counterparty should have the operational capability to appropriate and, where necessary, to liquidate the collateral in the case of a default of the collateral provider. The collecting counterparty should also be able to use the cash proceeds of liquidation to enter into an equivalent contract with another counterparty or to hedge

³ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).



the resulting risk. Having access to the market should be a pre-requisite for the collateral taker to enable it to either sell the collateral or repo it within a reasonable amount of time. This capability should be independent of the collateral provider and should therefore include having broker arrangements and repo arrangements with other counterparties or comparable measures.

- (28) Collateral collected must be of sufficiently high liquidity and credit quality to allow the collecting counterparty to liquidate the positions without significant price changes in case the other counterparty defaults. The credit quality of the collateral should be assessed relying on recognised methodologies such as the ratings of external credit assessment institutions. In order to mitigate the risk of mechanistic reliance on external ratings, however, this Regulation should introduce a number of additional safeguards. These should include the possibility to use an approved Internal Rating Based ('IRB') model and the possibility to delay the replacement of collateral that becomes ineligible due to a rating downgrade, with the view to efficiently mitigating potential cliff effects that may arise from excessive reliance on external credit assessments.
- (29) While haircuts mitigate the risk that collected collateral is not sufficient to cover margin needs in a time of financial stress, other risk mitigants are also needed when accepting non-cash collateral. In particular, counterparties should ensure that the collateral collected is reasonably diversified in terms of individual issuers, issuer types and asset classes.
- (30) The impact on financial stability of collateral liquidation by non-systemically important counterparties may be expected to be limited. Further, concentration limits on initial margin might be burdensome for counterparties with small OTC derivative portfolios as they might have only a limited range of eligible collateral. Therefore, even though collateral diversification is a valid risk mitigant, non-systemically important counterparties should not be required to diversify collateral. On the other hand, systemically important financial institutions and other counterparties with large OTC derivative portfolios trading with each other should apply the concentration limits at least to initial margin and that should include Member States' sovereign debt securities. Those counterparties are sophisticated enough to either transform collateral or to access multiple markets and issuers to sufficiently diversify the collateral posted. Article 131 of Directive 2013/36/EU⁴ provides for the identification of institutions as systemically important under Union law. However, given the broad scope of Regulation (EU) No 648/2012, a quantitative threshold should be introduced so that the requirements for concentration limits apply also to counterparties that might not fall under the existing classifications of systemically important institutions but which should nonetheless be subject to concentration limits because of the size of their OTC derivative portfolio. Recital (26) of the EMIR suggests that counterparties such as pension scheme arrangement should be subject to the bilateral collateralisation requirements; the same recital, however, recognises the need to avoid excessive burden from such requirements on the retirement income of future pensioners.

⁴ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).



Therefore it would be disproportionate to require those counterparties to apply the requirements to monitor the concentration limits in the same manner as for other counterparties. Consequently, it is appropriate to provide that the monitoring of such exposures is carried out on a less frequent basis than for other counterparties, provided that the exposures of such counterparties remain significantly below the level where the concentration limits start applying. For the same reasons, where this condition is only temporarily not met it is appropriate to provide the possibility for those counterparties to return to the monitoring of such exposures on a less frequent basis.

- (31) In order to limit the effects of the interconnectedness between financial institutions that may arise from non-centrally cleared derivative contracts, different concentration limits should apply to the different classes of debt securities issued by the financial sector. Therefore, stricter diversification requirements should be set out for debt securities issued by institutions and used as collateral for initial margin purposes. On the one hand, the difficulties in segregating cash collateral should be acknowledged by allowing participants to post a limited amount of initial margin in the form of cash and by allowing custodians to reinvest this cash collateral in accordance with the relevant rules on custody services. On the other hand, cash held by a custodian is a liability that the custodian has towards the posting counterparty, which generates a credit risk for the posting counterparty. Therefore, in order to address the general objective of Regulation (EU) No 648/2012 to reduce systemic risk, the use of cash as initial margin should be subject to diversification requirements at least for systemically important institutions. Systemically important institutions should be required to either limit the amount of cash initial margin collected for the purpose of this Regulation or to diversify the exposures relying in more than one custodian.
- (32) The value of collateral should not exhibit a significant correlation with the creditworthiness of the collateral provider or the value of the underlying non-centrally cleared derivatives portfolio, since this would undermine the effectiveness of the protection offered by the collateral collected. Accordingly, securities issued by the collateral provider or its related entities should not be accepted as collateral. Counterparties should be required to monitor that collateral collected is not subject to more general forms of wrong way risk.
- (33) It should be possible to liquidate assets collected as collateral for initial or variation margin in a sufficiently short time in order to protect collecting counterparties from losses on non-centrally cleared OTC derivatives contracts in the event of a counterparty default. These assets should therefore be highly liquid and should not be exposed to excessive credit, market or foreign exchange risk. To the extent that the value of the collateral is exposed to these risks, appropriately risk-sensitive haircuts should be applied.
- (34) In order to ensure timely transfer of collateral, counterparties should have efficient operational processes in place. This requires that the processes for the bilateral exchange of collateral are sufficiently detailed, transparent and robust. A failure by counterparties to agree upon and provide an operational framework for efficient calculation, notification and finalisation of margin calls can lead to disputes and fails that result in uncollateralised exposures under OTC derivative contracts. As a result, it is essential that counterparties set clear internal policies and standards in respect of



collateral transfers. Any deviation from those standards should be rigorously reviewed by all relevant internal stakeholders that are required to authorise those deviations. Furthermore, all applicable terms in respect of operational exchange of collateral should be accurately recorded in detail in a robust, prompt and systematic way.

- (35) Trading relationship documentation should be produced by counterparties entering into multiple OTC derivative contracts in order to provide legal certainty. As a result, the trading relationship documentation should include all material rights and obligations of the counterparties applicable to non-centrally cleared OTC derivative contracts. Where parties enter into a single, one-off OTC derivative contract, the trading relationship documentation could take the form of a trade confirmation that includes all material rights and obligations of the counterparties.
- (36) Collateral protects the collecting counterparty in the event of the default of the posting counterparty. However, both counterparties are also responsible for ensuring that the collateral collected does not increase the risk for the posting counterparty in case the collecting counterparty defaults. For this reason, the bilateral agreement between the counterparties should allow both counterparties to access the collateral in a timely manner when they have the right to do so, hence the need for rules on segregation and for rules providing for an assessment of the effectiveness of the agreement in this respect, taking into account the legal constraints and the market practices of each jurisdiction.
- (37) The re-hypothecation, re-pledge or re-use of collateral collected as initial margins would create new risks due to claims of third parties over the assets in the event of a default. Legal and operational complications could delay the return of the collateral in the event of a default of the initial collateral taker or the third party or even make it impossible. In order to preserve the efficiency of the framework and ensure a proper mitigation of counterparty credit risks, the re-hypothecation, re-pledge or re-use of collateral collected as initial margin should therefore not be permitted.
- (38) Given the difficulties in segregating cash, the current practices on the exchange of cash collateral in certain jurisdictions and the need of relying on cash instead of securities in certain circumstances where transferring securities may be impeded by operational constraints, cash collateral collected as initial margin should always be held by a central bank or third party credit institution, since this ensures the separation from the two counterparties in the OTC derivative contract. To ensure such separation, the third party credit institution should not belong to the same group as either of the counterparties. Credit institutions that are not able to segregate cash collateral should be allowed to reinvest cash deposited as initial margin.
- (39) When a counterparty notifies the relevant competent authority regarding the exemption of intragroup transactions, in order for the competent authority to decide whether the conditions for the exemption are met, the counterparty should provide a complete file including all relevant information.
- (40) For a group to be deemed to have adequately sound and robust risk management procedures, a number of conditions have to be met. The group should ensure a regular monitoring of the intragroup exposures. The timely settlement of the obligations resulting from the intragroup OTC derivative contracts should be guaranteed, based



on the monitoring and liquidity tools at group level, which are consistent with the complexity of the intragroup transactions.

- (41) In order to for the exemption for intragroup transactions to be applicable, it must be certain that no legislative, regulatory, administrative or other mandatory provisions of applicable law could legally prevent the intragroup counterparties from meeting their obligations to transfer monies or repay liabilities or securities under the terms of the intragroup transactions. Similarly, there should be no operational or business practices of the intragroup counterparties or the group that could result in funds not being available to meet payment obligations as they fall due on a day-to-day basis, or in prompt electronic transfer of funds not being possible.
- (42) This Regulation includes a number of detailed requirements to be met for a group to obtain the exemption from posting margin for intragroup transactions. In addition to those requirements, where one of the two counterparties in the group is domiciled in a third-country for which an equivalence determination under Article 13(2) of Regulation (EU) No 648/2012 has not yet been provided, the group has to exchange, and where appropriate segregate, variation and initial margins for all the intragroup transactions with the subsidiaries in those third-countries. In order to avoid a disproportionate application of the margin requirements and taking into account similar requirements for clearing obligations, this Regulation should provide for a delayed implementation of that particular requirement. This would allow enough time for completing the process to produce the equivalence determination, while not requiring an inefficient allocation of resources to the groups with subsidiaries domiciled in third-countries.
- (43) Taking into account the principle of proportionality, counterparties that have smaller portfolios and therefore generally smaller operations should be allowed more time to adapt their internal systems and processes in order to comply with the requirements of this Regulation. In order to achieve a proper balance between mitigating the risks of OTC derivatives and the proportionate application of this Regulation, as well as achieve international consistency and minimise possibilities of regulatory arbitrage with the view to avoiding economic disruptions, a phase-in period of the requirements is necessary. The phase-in period for the requirements introduced in this Regulation are consistent with the schedule agreed in the BCBS-IOSCO framework.
- (44) In order to avoid any retroactive effect of this Regulation, the requirements hereunder should apply only to new contracts entered into after the relevant phase-in dates. Exchanges of variation margin and initial margin on contracts entered into before these dates should not be subject to the regulatory obligation to modify the existing bilateral agreements as this would impact their market value.
- (45) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority to the Commission.
- (46) The European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority have conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the



opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010⁵, the opinion of the Insurance and Reinsurance Stakeholder Group and the Occupational Pensions Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1094/2010⁶, and the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010⁷,

HAS ADOPTED THIS REGULATION:

CHAPTER I

Counterparties' Risk Management Procedures required for compliance with paragraph 3 of Article 11 of Regulation (EU) No 648/2012

SECTION 1

RISK MANAGEMENT PROCEDURES

Article 1

General requirements

1. The risk management procedures required for compliance with Article 11(3) of Regulation (EU) No 648/2012 (the 'risk management procedures') shall apply to financial counterparties within the meaning of Article 2(8) of Regulation (EU) No 648/2012 and non-financial counterparties referred to in Article 10 of Regulation (EU) No 648/2012 (the 'counterparties').
2. The risk management procedures required for compliance with Article 11(3) of Regulation (EU) No 648/2012 shall apply throughout the life of all over-the-counter ('OTC') derivative contracts that were subject to the requirements of this Regulation at the contract's inception date.
3. The risk management procedures shall provide for all of the following, unless otherwise provided in Articles 2, 3 and 4:
 - (a) the collection of collateral as initial margin, in accordance with Article 14, without the possibility of offsetting the initial margin amounts between the two counterparties;
 - (b) the collection of collateral as variation margin in accordance with Article 13;

⁵ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

⁶ Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

⁷ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).



- (c) the *ex-ante* agreement between the counterparties on a list of eligible collateral fulfilling the requirements of Article 22.
4. For the purposes of this Regulation, initial margin means the collateral collected by a counterparty to cover its current and potential future exposure in the interval between the last margin exchange and the liquidation of positions following a default of the other counterparty or hedging the risk.
 5. For the purposes of this Regulation, variation margin means the collateral collected to reflect the results of the daily marking-to-market of outstanding contracts referred to in Article 11(2) of Regulation (EU) No 648/2012.
 6. The collateral referred to in points (a) and (b) of paragraph 3 shall meet the eligibility criteria referred to in Section 5, and shall be adjusted according to the modalities referred to in Articles 28 and 29 of that Section.

SECTION 2

RISK MANAGEMENT PROCEDURES FOR SPECIFIC CASES

Subsection 1

Potential exemptions from the requirement to collect collateral

Article 2

Non-financial counterparties

The risk management procedures may provide that no collateral is exchanged in relation to transactions with non-financial counterparties other than those referred to in Article 10 of Regulation (EU) No 648/2012, or with non-financial entities established in a third country that would be considered non-financial counterparties other than those referred to in Article 10 of Regulation (EU) No 648/2012 if they were established in the Union.

Article 3

Transactions with third country counterparties

Where a counterparty established in the Union enters into an OTC derivative contract with a counterparty that is established in a third country and would be subject to this Regulation if it was established in the Union, the risk management procedures shall provide that initial and variation margin are exchanged between the counterparties and that the collateral is maintained and protected, in accordance with this Regulation.

Article 4

Minimum transfer amount

1. The risk management procedures may provide that no collateral is collected from a single counterparty where the amount due from the last collection of collateral is equal to or lower than a certain amount to be agreed by the counterparties ('minimum transfer amount') and which cannot be greater than EUR 500 000 or the equivalent amount in another currency.



2. Where counterparties agree on a minimum transfer amount, the amount due shall be calculated as the sum of:
 - (a) the variation margin due from its last collection calculated in accordance with Article 13;
 - (b) the initial margin due from its last collection calculated in accordance with Article 14;
 - (c) any excess collateral that may have been provided to or returned by both counterparties.
3. Counterparties may agree on separate minimum transfer amounts for initial and variation margins, provided that the sum of those two minimum transfer amounts is equal to or lower than the amount set out in paragraph 1.
4. Where the amount of collateral due to the collecting counterparty exceeds the minimum transfer amount agreed by the counterparties, the collecting counterparty shall collect the full amount of collateral due without deduction of the minimum transfer amount. Counterparties that agree to separate the minimum transfer amount in accordance with paragraph 3 shall collect the full amount of initial or variation margin due, without any deduction where it exceeds the minimum transfer amount for initial or variation margin, respectively.

Article 5

Margin calculation with third country counterparties

1. Where a counterparty is domiciled in a third country using a definition of OTC derivative contracts that is different from that of Regulation (EU) No 648/2012, counterparties shall calculate margins for all contracts that meet either definition of an OTC derivative contract, provided that the counterparty domiciled in the third country is subject to margin requirements for those contracts which are considered as OTC derivative contracts under the third country regulatory regime.
2. For the purposes of calculation of the margins, where a netting agreement is in place between two counterparties, one of which is domiciled in a third country, that agreement has to meet the same conditions as if both counterparties were domiciled in the EU.

Article 6

Treatment of OTC derivative contracts in the context of a CCP's position management upon the insolvency of a clearing member

Where a central counterparty (CCP) is an authorised credit institution and therefore qualifies as a financial counterparty in accordance with Article 2(8) of Regulation (EU) No 648/2012, the risk management procedures may provide that no initial margin or variation margin is collected in relation to the OTC derivative contracts referred to in Annex II, paragraph 2 of Commission Delegated Regulation (EU) No 153/2013.



Subsection 2 Potential exemptions in calculating levels of initial margin

Article 7 Foreign exchange contracts

1. The risk management procedures may provide that initial margins are not collected with respect to:
 - (a) physically settled OTC derivative contracts that solely involve the exchange of two different currencies on a specific future date at a fixed rate agreed at the inception of the contract covering the exchange ('foreign exchange forwards');
 - (b) physically settled OTC derivative contracts that solely involve an exchange of two different currencies on a specific date at a fixed rate that is agreed at the inception of the contract covering the exchange, and a reverse exchange of the two currencies at a later date and at a fixed rate that is also agreed at the inception of the contract covering the exchange ('foreign exchange swaps');
 - (c) the exchange of principal of an OTC derivative contract by which the two counterparties solely exchange the principal and any interest payments in one currency, for the principal and any interest payments in another currency, at specified points in time according to a specified formula ('currency swap').

Article 8 Threshold based on notional amount

1. The risk management procedures may provide that initial margins are not collected for all new contracts from January of each calendar year where one of the two counterparties has at entity level an aggregate month-end average notional amount or belongs to a group which has an aggregate month-end average notional amount of non-centrally cleared derivatives for the months March, April and May of the preceding year below EUR 8 billion.
2. Both of the following shall be included in the calculation of the group aggregate month-end average notional amount:
 - (a) all non-centrally cleared OTC derivative contracts of the group;
 - (b) all intragroup non-centrally cleared OTC derivative contracts of the group, taken into account only once.
3. Investment funds may be considered distinct entities and treated separately when applying the thresholds referred to in paragraph 1, only where the funds are distinct segregated pools of assets for the purposes of the fund's insolvency or bankruptcy that are not collateralised, guaranteed or supported by other investment funds or the investment managers.



Article 9

Threshold based on initial margin amount

1. The risk management procedures may provide that a counterparty is not required to collect initial margins where:
 - (a) neither counterparty belongs to any group and the sum of all initial margins required to be collected by that counterparty is equal to or lower than EUR 50 million;
 - (b) the counterparties are part of different groups and the sum of all initial margins to be collected from all counterparties belonging to the posting group by all counterparties belonging to the collecting group is equal to or lower than EUR 50 million;
 - (c) both counterparties belong to the same group and the sum of all initial margins required to be collected by that counterparty is equal to or lower than EUR 10 million.

2. Where a counterparty applies one of the thresholds referred to in paragraph 1, all of the following shall apply:
 - (a) the counterparty applying the threshold referred to in paragraph 1 may reduce the amount of initial margin collected by the value of the threshold;
 - (b) the risk management procedures of the group applying the threshold referred to in paragraph 1(b) shall determine how to allocate the received initial margin amongst the relevant entities within the group;
 - (c) the risk management procedures of the group applying the threshold referred to in paragraph 1(b) shall include provisions on monitoring, at group level, whether the threshold is exceeded and provisions on the maintenance of appropriate records of the group's exposures to each single counterparty in the same group.

3. Investment funds may be considered distinct entities and treated separately when applying the thresholds referred to in paragraph 1, only where the funds are distinct pools of assets for the purposes of the fund's insolvency or bankruptcy that are not collateralised, guaranteed or supported by other investment funds or the investment managers.

Subsection 3

Potential exemptions from the requirement to post or collect initial or variation margin

Article 10

Treatment of derivatives associated to covered bonds for hedging purposes

1. Subject to the conditions set out in paragraph 3, the risk management procedures relating to derivatives associated to covered bonds may specify the following:
 - (a) that variation margin is not posted by the covered bond issuer or cover pool;
 - (b) that initial margin is not posted or not collected or neither.



2. The covered bond issuer or cover pool shall collect variation margin, in cash and shall return the collected amount where it is no longer due.
3. Paragraph 1 applies where all of the following conditions are met:
 - (a) the OTC derivative contract is not terminated in case of resolution or insolvency of the covered bond issuer or cover pool;
 - (b) the counterparty to the OTC derivative contract ranks at least *pari passu* with the covered bond holders. A more junior ranking of the counterparty to the OTC derivative contract concluded with covered bond issuers or with cover pools for covered bonds is permitted only where the counterparty is the defaulting or the affected party;
 - (c) the OTC derivative contract is registered or recorded in the cover pool of the covered bond in accordance with national covered bond legislation;
 - (d) the OTC derivative contract is used only to hedge the interest rate or currency mismatches of the cover pool in relation to the covered bond;
 - (e) the netting set as defined in Article 272(4) of Regulation (EU) 575/2013 ('netting set') does not include OTC derivative contracts unrelated to the cover pool of the covered bond;
 - (f) the covered bond to which the derivatives are associated meets the requirements of paragraphs (1), (2) and (3) of Article 129 of Regulation (EU) No 575/2013;
 - (g) the cover pool of the covered bond to which the OTC derivative contract is associated is subject to a regulatory collateralisation requirement of at least 102 %.

Article 11

Treatment of derivatives with counterparties in jurisdictions where legal enforceability of netting agreements or collateral protection may not be ensured

1. Where a counterparty concludes OTC derivative contracts with counterparties domiciled in the third-country jurisdictions meeting the conditions of paragraph 4, that counterparty does not need to post any variation or initial margin for those contracts.
2. Where a counterparty concludes OTC derivative contracts with counterparties domiciled in a third-country jurisdiction, that counterparty does not need to either collect or post variation or initial margin for those contracts, where all of the following conditions are met:
 - (a) the OTC derivative contracts are entered into with a counterparty domiciled in a third-country jurisdiction meeting the conditions of paragraph 4;
 - (b) the legal reviews referred to in paragraph 4 conclude that collecting collateral in accordance with this Regulation is not possible;
 - (c) the ratio calculated in accordance with paragraph 3 is lower than 2.5%.



3. A counterparty shall calculate the ratio referred to in paragraph 2(c) as follows:
 - (a) it shall add the notional outstanding amounts of the OTC derivative contracts of the group to which it belongs, for which no margin is collected for all the counterparties in all the jurisdictions meeting the conditions of paragraph 4;
 - (b) it shall calculate the notional outstanding amount for all the OTC derivative contracts of the group to which it belongs, excluding intragroup transactions;
 - (c) it shall divide the amount resulting from point (a) with that resulting from point (b).
4. In order to apply the treatment laid down in paragraphs 1, 2 and 3, either of the following conditions shall be met:
 - (a) the legal review referred to in Article 32(2) does not confirm that the bilateral netting arrangements in the jurisdiction concerned can be legally enforced with certainty at all times;
 - (b) the legal review referred to in Article 33(5) confirms that no segregation arrangement with a counterparty domiciled in the jurisdiction concerned can meet the requirements referred to in paragraphs 1 to 3 of Article 33.

SECTION 3

CALCULATION AND COLLECTION OF MARGINS

Article 12 *Calculation date*

1. Counterparties shall calculate variation margin at least on a daily basis and initial margin at least as prescribed in Article 14(3).
2. For the purpose of setting the dates for the margin calculation, the following shall apply:
 - (a) where two counterparties are located in the same time-zone the calculation shall refer to the netting set of the previous business day;
 - (b) where two counterparties are not located in the same time-zone, the calculation shall refer to the transactions in the netting set entered into before 16:00 hours of the previous business day of the time-zone where it is first 16:00 hours.

Article 13 *Calculation of variation margin*

1. The amount of variation margin to be collected by a counterparty shall be the outstanding balance between the aggregated value of all contracts in the netting set calculated in accordance with Article 11(2) of Regulation (EU) No 648/2012, and the value of all variation margin previously posted, collected or settled.



2. Variation margins shall be collected in one of the following ways:
 - (a) by collecting in cash in accordance with point (a) of Article 22(2);
 - (b) by collecting in non-cash collateral in accordance with points (b) to (r) of Article 22(2), subject to the requirements referred to in Section 5 and the haircut requirements referred to in Section 6.
3. Variation margins shall be collected within one of the following:
 - (a) within the business day of the calculation;
 - (b) where the conditions in paragraph 4 are met, within two business days after the calculation date.
4. The collection of variation margin in accordance with paragraph 3(b) may be applied only to netting sets that meet either of the following conditions:
 - (a) for all the derivative contracts not subject to initial margin requirements by virtue of Regulation (EU) No 648/2012 and this Regulation, where the collecting counterparty has collected, at or before the calculation date of the variation margin, an amount of variation margin calculated in the same manner as that applicable to initial margins in accordance with Article 17, adjusted by the number of days in between, and including, the calculation date and the collection date; in case no mechanism for segregation is in place between the two counterparties, these may offset the amounts to be collected.
 - (b) for derivative contracts subject to initial margin requirements, where the initial margin has been rescaled in accordance with paragraph 5.
5. For the purpose of paragraph 4(b), initial margin may be adjusted in one of the following ways:
 - (a) by increasing the margin period of risk ('MPOR') referred to in Article 17(2) by the number of days in between, and including, the calculation date and the collection date;
 - (b) by increasing the initial margin calculated in accordance with Article 15 by the number of days in between, and including, the calculation date and the collection date adjusted using an appropriate methodology.
6. The part of the collateral related to variation margin referred to in paragraph 4(a) shall be collected in accordance with Article 22.
7. In the event of a dispute over the amount of variation margin due for collection, counterparties shall collect, in the same time frame as referred to in this Article, at least the part of the variation margin amount that is not being disputed.

Article 14

Calculation of initial margins

1. A counterparty shall calculate the amount of initial margin to be collected using either the standardised approach laid down in Article 15 ('standardised approach') or the initial margin models referred to in Article 16 ('initial margin models') or both.



Where both of these approaches are used, the total initial margin requirements for a netting set shall be the sum of the initial margins calculated according to the two approaches.

2. The counterparties shall agree on the method each counterparty uses to determine the initial margin it has to collect. Where one or both counterparties rely on an initial margin model they shall agree on the characteristics of the model and the data used for the calibration referred to in Article 18. Counterparties are not required to agree on a common methodology.
3. The total amount of initial margins shall be calculated no later than the business day following one of these events:
 - (a) where a new OTC derivative contract is executed or added to the netting set;
 - (b) where an existing OTC derivative contract expires or is removed from the netting set;
 - (c) where an existing OTC derivative contract triggers a payment or a delivery other than the posting and collecting of margins;
 - (d) where the initial margin is calculated in accordance with the standardised approach and an existing contract is reclassified in terms of the asset category referred to in paragraph 1 of Annex IV as a result of reduced time to maturity;
 - (e) where no calculation has been performed in the preceding ten business days.
4. Initial margins shall be collected in one of the following ways:
 - (a) by collecting in cash, in accordance with point (a) of Article 22(2);
 - (b) by collecting non-cash collateral in accordance with points (b) to (r) of Article 22(2), subject to the requirements referred to in Section 5 and the haircut requirements referred to in Section 6.
5. Initial margin shall be collected within the business day of calculation.
6. In the event of a dispute over the amount of initial margin due for collection, counterparties shall collect, in the same time frame as referred to in this Article, at least the part of the initial margin amount that is not being disputed.

SECTION 4

APPROACHES FOR CALCULATING INITIAL MARGIN

Article 15

Standardised approaches

Where a counterparty uses the standardised approach, the initial margin for each netting set shall be calculated in accordance with Annex IV.



Article 16
Initial margin models

1. Where a counterparty uses an initial margin model, that model may be developed by any of, or both, counterparties or by a third party agent.
2. Where a counterparty uses an initial margin model developed by a third party agent, the counterparty shall remain responsible for ensuring that that model complies with the requirements referred to in this Section.
3. At the request of one of the two counterparties the other counterparty shall provide all the information necessary to explain the determination of a given value of initial margin in a way that a knowledgeable third party would be able to verify the calculation.

Article 17
Confidence interval and margin period of risk

1. The assumed variations in the value of the contracts in the netting set for the calculation of initial margins using an initial margin model shall be based on a one-tailed 99 percent confidence interval over a MPOR of at least 10 days.
2. The MPOR of a netting set for the calculation of initial margins using an initial margin model shall include:
 - (a) the period that may elapse from the last margin exchange of variation margin to the default of the counterparty;
 - (b) the estimated period needed to replace the OTC derivative contracts or hedge the risks taking into account the level of liquidity of the market where that type contracts or risks are traded, the total volume of the OTC derivative contracts in that market and the number of participants in that market.

Article 18
Calibration of the model

1. Initial margin models shall be calibrated based on historical data from a period of at least three years and not exceeding five years.
2. The data used in initial margin models shall include the most recent continuous period from the calibration date and shall contain at least 25% of data representative of a period of significant financial stress ('stressed data').
3. Where the most recent data period does not contain at least 25% of stressed data, the least recent data in the time series shall be replaced by data from a period of significant financial stress, until the overall proportion of stressed data is at least 25% of the overall data set.
4. The period of financial stress used for calibration shall be identified and applied separately at least for each of the asset classes referred to in Article 19(2).
5. The model shall be calibrated using equally weighted data.



6. The parameters may be calibrated for shorter periods than the MPOR and adjusted to the MPOR by an appropriate methodology.
7. The model shall be recalibrated at least every 12 months. Counterparties shall have written policies which set out the circumstances that would trigger an earlier recalibration.
8. Counterparties shall establish procedures for adjusting the margins to be collected in response to changing market conditions. These procedures may allow each counterparty to post the additional initial margin resulting from the recalibration of the model over a period that ranges between one and thirty business days.
9. The quality of the process relating to the data used in the model in accordance with paragraph 1, including the selection of appropriate data provider, the cleaning of the data and interpolation of the data, shall be ensured.
10. Proxies shall be used only where both of the following conditions are met:
 - (a) where available data is insufficient or is not reflective of the true volatility of an OTC derivative contract or portfolio of OTC derivative contracts;
 - (b) where the proxies lead to a conservative level of margins.

Article 19

Diversification, hedging and risk offsets across underlying classes

1. Initial margin models shall include only non-centrally cleared OTC derivative contracts within the same netting set. Initial margin models may account for diversification, hedging and risk offsets arising from the risks of OTC derivative contracts that are in the same netting set, provided that the diversification, hedging or risk offset is carried out within the same underlying asset class referred to in paragraph 2 and not across such classes.
2. For the purpose of accounting for diversification, hedging and risk offsets referred to in paragraph 1, the following underlying asset classes shall be considered:
 - (a) interest rates, currency and inflation;
 - (b) equity;
 - (c) credit;
 - (d) commodities and gold;
 - (e) other.

Article 20

Integrity of the modelling approach

1. Initial margin models shall be conceptually and practically sound and shall capture all the material risks arising from entering into the OTC derivative contracts included in the netting set.
2. Counterparties shall calculate the initial margin to be collected without taking into account any correlations between the unsecured exposure and the collateral.



3. Initial margin models shall meet the following requirements:
 - (a) the model shall incorporate risk factors corresponding to the individual currencies in which the OTC derivative contracts in the netting sets are denominated;
 - (b) the model shall incorporate interest rate risk factors corresponding to the individual currencies in which the OTC derivative contracts are denominated;
 - (c) for exposures to interest-rate risk in the major currencies and markets, the yield curve shall be divided into a minimum of six maturity buckets;
 - (d) the model shall capture the risk of movements between different yield curves and between different maturity buckets;
 - (e) the model shall use a separate risk factor at least for each equity or equity index that is significant for the OTC derivative contracts within the netting set;
 - (f) the model shall use a separate risk factor at least for each commodity or commodity index which is significant for the OTC derivative contracts within the netting set;
 - (g) the model shall account for, in a conservative manner, the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios;
 - (h) the model shall capture the idiosyncratic risk for credit underlyings;
 - (i) the model shall capture the risk of movements between similar, but not identical, underlying risk factors and the exposure to changes in values arising from maturity mismatches;
 - (j) the model shall capture main non-linear dependences.
4. A counterparty shall monitor the performance of the model on a continuous basis. The performance analysis shall include a comparison between the risk measures generated by the model and realized market value of the derivatives in the netting set ('back-testing') every three months. The counterparties shall retain records of the results of that analysis.
5. The risk management procedures shall outline the methodologies used for undertaking back-testing, including statistical tests of performance.
6. The risk management procedures shall describe what results of the back-testing would lead to a model change, recalibration or other remediation action.
7. The modelling approach shall reflect the nature, scale and complexity of the risks inherent in the underlying OTC derivative contracts. The initial margin model shall reflect factors like parameter uncertainty, correlation, basis risk and data quality in a prudent manner.



Article 21

Qualitative requirements

1. Initial margin models shall be subject to an internal governance process that continuously assesses the validity of the outcome produced by the initial margin model.
2. For the purposes of paragraph 1, a counterparty shall carry out all of the following:
 - (a) it shall ensure that suitably qualified parties, independent from the parties developing the model, carry out an initial validation;
 - (b) a follow up validation whenever a significant change is made to the initial margin model and at least once a year;
 - (c) a regular audit process to assess the integrity and reliability of the data sources and the management information system used to run the model, the accuracy and completeness of data used, the accuracy and appropriateness of volatility and correlation assumptions.
3. The documentation of the risk management procedures shall meet all of the following conditions:
 - (a) it shall be sufficient to ensure that any knowledgeable third-party would be able to understand the design and operational detail of the initial margin model;
 - (b) it shall contain the key assumptions and the limitations of the initial margin model;
 - (c) it shall define the circumstances under which the assumptions of the initial margin model should no longer be considered valid.
4. The counterparties shall maintain clear documentation showing all changes to the initial margin model and detailing the results of the validation carried out after those changes.

SECTION 5

ELIGIBILITY AND TREATMENT OF COLLATERAL

Article 22

Eligible collateral for initial and variation margin

1. For the purposes of Article 11(3) of Regulation (EU) No 648/2012, asset classes for which the counterparty has no access to the market or is unable to liquidate the collateral in a timely manner in case of default of the posting counterparty shall not be eligible for initial and variation margin.
2. A counterparty shall only collect collateral from the following asset classes:
 - (a) cash in the form of money credited to an account in any currency, or similar claims for the repayment of money, such as money market deposits accounts;
 - (b) gold in the form of allocated pure gold bullion of recognised good delivery;



- (c) debt securities issued by Member States' central governments and central banks;
- (d) debt securities issued by Member States' regional governments or local authorities according to Article 115(2) of Regulation (EU) No 575/2013;
- (e) debt securities issued by Member States' public sector entities according to Article 116(4) of Regulation (EU) No 575/2013;
- (f) debt securities issued by Member States' regional governments or local authorities not meeting the requirements of Article 115(2) of Regulation (EU) No 575/2013;
- (g) debt securities issued by Member States' public sector entities not meeting the requirements of Article 116(4) of Regulation (EU) No 575/2013;
- (h) debt securities issued by multilateral development banks listed in Article 117(2) of Regulation (EU) No 575/2013;
- (i) debt securities issued by the international organisations listed in Article 118 of Regulation (EU) No 575/2013;
- (j) debt securities issued by third countries' governments and central banks;
- (k) debt securities issued by third countries' regional governments or local authorities that meet the requirements of the first subparagraph of Article 115(2) of Regulation (EU) No 575/2013 and third countries' public sector entities that meet the requirements of Article 116 (4) of Regulation (EU) No 575/2013;
- (l) debt securities issued by third countries' regional governments or local authorities not meeting the requirements of the first subparagraph of Article 115(2) of Regulation (EU) No 575/2013 or third countries' public sector entities not meeting the requirements of the first subparagraph of Article 116 (4) of Regulation (EU) No 575/2013;
- (m) debt securities issued by credit institutions and investment firms including bonds referred to in Article 52(4) of Directive 2009/65/EC;
- (n) corporate bonds;
- (o) the most senior tranche of a securitisation, as defined in Article 4(62) of Regulation (EU) 575/2013, that is not a re-securitisation as defined in Article 4(64) of that Regulation;
- (p) convertible bonds provided that they can be converted only into equities which are included in a main index as referred to in point (a) of Article 197 (8) of Regulation (EU) No 575/2013;
- (q) equities included in a main index as referred to in point (a) of Article 197(8) of Regulation (EU) No 575/2013;
- (r) shares or units in undertakings for collective investments in transferable securities (UCITS), provided that the criteria in Article 26 are met.



Article 23
Collateral management

The risk management procedures of the counterparty collecting collateral shall ensure that all of the following are in place:

- (a) a re-evaluation on a daily basis of the assets held as collateral;
- (b) legal arrangements and a collateral holding structure that allow access to the received collateral where it is held in third party custody;
- (c) where initial margin is maintained with the collateral provider, that the securities are maintained in insolvency-remote custody accounts;
- (d) that cash accounts for initial margin are maintained at central banks or credit institutions which fulfil both of the following conditions:
 - (i) they are authorised in accordance with Regulation (EU) No 575/2013;
 - (ii) they are neither the posting nor the collecting counterparties;
- (e) that the unused collateral can be made available to the liquidator or other insolvency official of the defaulting counterparty;
- (f) that, in the event of the default of the collecting counterparty, the initial margin is freely transferable back in a timely manner to the posting counterparty;
- (g) that the non-cash collateral is transferable without any regulatory or legal constraints or third party claims, including those of the liquidator of the collecting counterparty or third party custodian, other than liens for fees and expenses incurred in providing the custodial accounts and other than liens routinely imposed on all securities in a clearing system in which such collateral may be held;
- (h) that the collateral is returned in whole other than costs and expenses incurred for the process of appropriation of collateral.

Article 24
Credit quality assessment

1. The collecting counterparty shall assess the credit quality of assets belonging to the asset classes referred to in points (c), (d) and (e) of Article 22(2) that are not denominated or funded in the issuer's domestic currency and in points (f), (g), (j) to (n) and (p) of Article 22(2) using one of the following methodologies:
 - (a) an approved internal model as referred to in Article 25;
 - (b) the approved internal model referred to in Article 25 of its counterparty, where the counterparty is established in the Union, or third country counterparty, where the third country counterparty is subject to laws applying prudential supervisory and regulatory requirements equivalent to those applied in the Union in accordance with Article 127 of Directive 2013/36/EU;



- (c) a credit quality assessment issued by a recognised External Credit Assessment Institution (ECAI) according to Article 4(98) of Regulation (EU) No 575/2013 or export credit agency referred to in Article 137 of that Regulation.
2. The collecting counterparty shall assess the credit quality of assets belonging to the asset class referred to in point (o) of Article 22(2) using the methodology referred to in point (c) of paragraph 1.
 3. The risk management procedures shall require that assets referred to in in points (f), (g), (j) to (p) of Article 22(2) are only eligible as collateral for the purposes of Article 11(3) of Regulation (EU) No 648/2012 where their credit quality has been assessed as credit quality step 3 or above.
 4. The risk management procedures shall require that assets referred to in points (c), (d) and (e) of Article 22(2) that are not denominated or funded in the issuer's domestic currency are only eligible as collateral for the purposes of Article 11(3) of Regulation (EU) No 648/2012 where their credit quality has been assessed as credit quality step 4 or above.
 5. For the purposes of paragraphs 3 and 4 the credit quality assessment shall be mapped to credit quality steps in accordance with Articles 136 and 270 of Regulation (EU) No 575/2013.
 6. The counterparties shall have procedures in place for the case where the credit quality of the collateral assessed using the methodology referred to in paragraphs 1 and 2, falls below the limits set out in paragraphs 3 and 4. Such procedures shall meet all of the following requirements:
 - (a) they shall prohibit the counterparties from accepting additional collateral assets which no longer meet the level referred to in paragraphs 3 and 4;
 - (b) they shall define a schedule by which already accepted collateral is to be replaced over a period of time not exceeding two months;
 - (c) they shall set a credit quality step level that is below the levels set out in paragraphs 3 and 4, which, when exceeded, requires immediate replacement;
 - (d) they shall enable counterparties to increase the haircuts on the relevant collateral over the period set out in point (b).

Article 25

Credit risk assessment by the collateral taker using the Internal Rating Based Approach

1. A counterparty authorised to use the Internal Rating Based (IRB) approach in accordance with Section 6 of Regulation (EU) No 575/2013 may use their internal ratings in order to assess the credit quality of the collateral collected for the purposes of this Regulation.
2. A counterparty using the IRB approach for the purpose of this Regulation in accordance with paragraph 1, shall determine the credit quality step of the collateral based on Table 1 CQS in Annex I as the highest credit quality step corresponding to a probability of default ('PD'), in the sense of point (54) of Article 4(1) of Regulation (EU) No 575/2013, equal or lower than the internal rating.



3. A counterparty using the IRB approach for the purpose of this Regulation in accordance with paragraph 1, shall communicate to the other counterparty the credit quality step associated to the securities that are eligible to be posted as collateral.

Article 26

Eligibility criteria for units or shares in UCITS

1. For the purposes of Article 22, counterparties may use units or shares in UCITS as eligible collateral where all the following conditions are met:
 - (a) the units or shares have a daily public price quote;
 - (b) the UCITS are limited to investing in instruments that are eligible for recognition under Article 22;
 - (c) the UCITS meet the conditions laid down in Article 132(3) of Regulation (EU) 575/2013.

Where a UCITS invests in shares or units of another UCITS, the conditions laid down in paragraph 1 shall apply equally to any such underlying UCITS.

The use of derivative instruments to hedge permitted investments by a UCITS shall not prevent units or shares in that UCITS from being eligible as collateral.

2. For the purposes of paragraph 1, where a UCITS ('the original UCITS') or any of its underlying UCITS are not limited to investing in instruments that are eligible under Article 22, institutions may use units or shares in that UCITS as collateral to an amount equal to the value of the eligible assets held by that UCITS under the assumption that that UCITS or any of its underlying UCITS have invested in non-eligible assets to the maximum extent allowed under their respective mandates.

Where any underlying UCITS has underlying UCITS of its own, institutions may use units or shares in the original UCITS as eligible collateral provided that they apply the methodology in the paragraph 1.

Where non-eligible assets of a UCITS can have a negative value due to liabilities or contingent liabilities resulting from ownership, counterparties shall apply the following steps:

- (a) calculate the total value of the non-eligible assets;
- (b) where the amount obtained from point (a) is negative, subtract the absolute value of that amount from the total value of the eligible assets.

Article 27

Eligibility criteria to avoid wrong way risk

1. The risk management procedures shall ensure that the asset classes referred to in points (f), (g) and (k) to (r) of Article 22(2) also fulfil all of the following criteria:
 - (a) they are not issued by the posting counterparty;
 - (b) they are not issued by entities which are part of the group to which the posting counterparty belongs;



- (c) they are not otherwise subject to significant wrong way risk, as defined in paragraph 1 of Article 291 of Regulation (EU) 575/2013.
2. Points (a), (b) and (c) of paragraph 1 shall apply to the risk exposures arising from third party holders or custodians holding initial margin collected in cash.

Article 28

Concentration limits for initial margin

1. The risk management procedures shall provide that the collateral collected as initial margin in accordance with Article 14 from an individual counterparty meets all of the following conditions:
- (a) the sum of the values of the collateral collected in the form of the asset classes referred to in points (b), (f), (g), (l) and (m) to (r) of Article 22(2) issued by a single issuer or by entities which are part of the same group does not exceed the greater of the following values:
- (i) 15% of the collateral collected from that individual counterparty;
- (ii) EUR 10 million or the equivalent in another currency;
- (b) the sum of the values of the collateral collected in the form of the asset classes referred to in points (o), (p), (q), of Article 22(2), where the asset classes referred to in points (p) and (q) of that Article are issued by institutions as defined in Regulation (EU) No 575/2013 does not exceed the greater of the following values:
- (i) 40% of the collateral collected from that individual counterparty;
- (ii) EUR 10 million or the equivalent in another currency.
- This limit shall also apply to shares in UCITS referred to in point (r) of Article 22(2) where the UCITS is primarily invested in the securities mentioned in this paragraph.
2. The risk management procedures shall provide that the collateral collected as initial margin in accordance with Article 14 from an individual counterparty in excess of EUR 1 billion meets the conditions set out in paragraph 4 where each of the counterparties belong to one of the categories listed in paragraph 3.
3. The categories referred to in paragraph 2 are:
- (a) institutions identified as global systemically important institutions ('G-SIIs') in accordance with Article 131 of Directive 2013/36/EU;
- (b) institutions identified as other systemically important institutions ('O-SIIs') in accordance with Article 131 of Directive 2013/36/EU;
- (c) individual counterparties, for which the total amount of initial margin to be collected by the counterparty itself from an individual counterparty exceeds EUR 1 billion.
4. The conditions referred to in paragraph 2 are:



- (a) the sum of the values of the collateral collected in the form of the asset classes (c), (d), (e), (f), (g), (h), (i), (j), (k) and (l) of Article 22(2) issued by a single issuer or by issuers domiciled in the same country shall not exceed 50% of the collateral collected from that individual counterparty.
 - (b) point (a) shall apply to the risk exposures arising from third party holders or custodians holding initial margin collected in cash.
5. Where G-SIIs or O-SIIs collect initial margin in cash from a single counterparty that is also a G-SII or O-SII, the collecting counterparty shall ensure that not more than 20% of that initial margin is held in cash by a single third party custodian.
6. Where the collateral is collected in the form of an asset class that is the same as the underlying asset class of the OTC derivative contract, the collecting counterparty may not apply the diversification requirements set out in paragraphs 1 to 4.
7. By way of derogation from the frequency set out in Article 14(3), a counterparty referred to in points (a), (b) and (c) of Article 2(10) of Regulation (EU) 648/2012 may assess compliance with the conditions laid down in paragraph 2 with a frequency of at least three months, provided that the amount of initial margin collected from each individual counterparty was at all times below EUR 800 million during the three months preceding the assessment.
8. Where the amount of initial margin collected from any individual counterparty was at least once equal to or exceeded EUR 800 million during the three months preceding a subsequent assessment, a counterparty making use of the derogation referred to in paragraph 7 has to apply the frequency set out in Article 14(3) from that point onwards with the possibility to revert to the lower frequency of paragraph 7 under the conditions set out therein.

SECTION 6

COLLATERAL VALUATION

Article 29

Calculation of the adjusted value of collateral

1. The risk management procedures shall include the application of haircuts to the market value of collected collateral using either the standard methodology referred to in Annex II or using own estimates as referred to in Article 30.
2. In calculating the requirements referred to in Article 30 and Annex II, counterparties may disregard positions in currencies which are subject to a legally binding intergovernmental agreement to limit their variation relative to other currencies covered by the same agreement.

Article 30

Own estimates of the adjusted value of collateral

1. Counterparties may use their own volatility estimates for calculating the haircuts to be applied to collateral where the requirements set out in this Article are met.



2. For debt securities that have a credit assessment from an ECAI, counterparties may use their own volatility estimate for each category of security.
3. In determining relevant categories of securities for the purposes of paragraph 2, counterparties shall take into account the type of issuer of the security, the external credit assessment of the securities, their residual maturity, and their modified duration. Volatility estimates shall be representative of the securities included in the category.
4. The calculation of the adjusted value of the collateral shall be subject to all the conditions set out in Annex III.
5. Counterparties shall update their data sets and calculate haircuts at least once every three months and whenever the level of market prices' volatility changes materially. Procedures shall determine in advance the levels of volatility that trigger a recalculation of the haircuts.
6. The estimation of haircuts shall meet all of the following criteria:
 - (a) a counterparty shall use the volatility estimates in the day-to-day risk management process including in relation to its exposure limits;
 - (b) where the liquidation period used by a counterparty is longer than that referred to in point (b) of paragraph 1 of Annex III for the type of OTC derivative contract in question, that counterparty shall increase its haircuts in accordance with the square root of time formula referred to in paragraph 1 of Annex III;
 - (c) a counterparty shall have in place established procedures for monitoring and ensuring compliance with a documented set of policies, for controlling the operation of its system for the estimation of haircuts and for the integration of such estimates into its risk management process;
 - (d) the system for the estimation of haircuts shall be subject to an internal review that meets all of the requirements of paragraph 7.
7. The review referred to in paragraph 6(d) shall meet all of the following requirements:
 - (a) it shall be carried out regularly within the internal auditing process of the counterparty;
 - (b) the integration of the adjustments into the risk management process of the counterparty shall take place at least once a year;
 - (c) the review shall cover at least the following aspects of the system:
 - (i) the integration of estimated haircuts into daily risk management;
 - (ii) the validation of any significant change in the process for the estimation of haircuts;
 - (iii) the verification of the consistency, timeliness and reliability of data sources used to run the system for the estimation of haircuts, including the reliability of such data sources;
 - (iv) the accuracy and appropriateness of the volatility assumptions.



SECTION 7

OPERATIONAL PROCEDURES AND DOCUMENTATION

Article 31

Operational process for the exchange of collateral

1. Robust risk management procedures shall be in place in order to ensure the timely exchange of collateral for non-centrally cleared OTC derivative contracts. Those risk management procedures shall include:
 - (a) a detailed documentation of policy and procedures with regards to the exchange of collateral for non-centrally cleared OTC derivative contracts and any related limitation or constraint, covering collateral levels, types and eligibility to be reviewed and updated as necessary and at least annually;
 - (b) documented, consistent and robust processes for escalation with counterparties' organisations, authorisation and recording of any exceptions to the existing policy and procedures referred to in point (a);
 - (c) reporting of material exceptions to senior management;
 - (d) agreement of terms with all counterparties in accordance with this Regulation in respect of the operational process for the exchange of collateral, including:
 - (i) the levels and type of collateral required and any segregation arrangements;
 - (ii) the OTC derivative contracts to be included in the calculation of margin;
 - (iii) the procedures for notification, confirmation and adjustment of margin calls and settlement of margin calls;
 - (iv) the procedures for settlement of margin calls in respect of all relevant types of collateral;
 - (v) the methods, timings and responsibilities for calculating margin and valuing collateral.
 - (e) processes for setting collateral levels;
 - (f) procedures to periodically verify the liquidity of the eligible collateral;
 - (g) procedures for timely re-appropriation by the posting counterparty of the collateral in the event of default of the counterparty collecting the collateral.
2. A counterparty using an initial margin model shall be prepared to supply relevant trading documentation referred to in Article 32 to its competent authority at any time.
3. The risk management procedures referred to in paragraph 1 shall be tested on a periodic basis and at least once a year.
4. for any collateral already posted to the collecting counterparty as initial or variation margin may be substituted by other collateral ('alternative collateral'), provided that all of the following conditions are met:



- (a) the substitution is made in accordance with the terms of the agreement between the counterparties;
- (b) the alternative collateral is eligible according to Section 5;
- (c) the value of the alternative collateral after applying any relevant haircut is sufficient to meet all margin requirements.

Article 32

Trading documentation

1. Where counterparties enter into one or multiple OTC derivative contracts, the risk management procedures shall ensure that written trading relationship documentation is executed between them prior to or contemporaneously with entering into non-centrally cleared OTC derivatives transactions. Such documentation shall comprise all material terms governing the trading relationship between the counterparties, including the following:
 - (a) any payment obligations;
 - (b) netting of payments;
 - (c) events of default or other termination events;
 - (d) calculation methods;
 - (e) any netting of obligations upon termination, transfer of rights and obligations;
 - (f) the governing law of the transactions.
2. A counterparty shall perform an independent legal review of the legal enforceability of the bilateral netting arrangements and of compliance with the arrangements in each jurisdiction and set up policies ensuring the continuous assessment of compliance. Such legal review may be conducted by an internal independent unit, or by an external independent third party.
3. The independent legal review referred to in paragraph 2 shall be considered to have been performed for netting agreements that have been recognised in accordance with Article 296 of Regulation (EU) No 575/2013.

Article 33

Segregation of initial margins

1. Collateral collected as initial margin shall be segregated in either or both of the following ways:
 - (a) on the books and records of a third party holder or custodian;
 - (b) via other legally binding arrangements;
 so that the initial margin is protected from the default or insolvency of the collecting counterparty.
2. Collateral collected as initial margin shall meet all the following requirements:



- (a) where collateral is a proprietary asset of the collecting counterparty, it shall be segregated from the other proprietary assets of the collecting counterparty;
 - (b) where collateral is not proprietary asset of the collecting counterparty, it shall be segregated from the proprietary assets of the posting counterparty;
 - (c) it shall be segregated from the proprietary assets of the third-party holder or custodian.
3. Where the collateral is held by the collecting party or by a third party holder or custodian on behalf of the collecting party, the collecting counterparty shall always provide the posting counterparty with the option to segregate its collateral from the assets of other posting counterparties.
4. The segregation arrangements shall ensure that collateral posted as initial margins are available to the posting counterparty in a timely manner in case the collecting counterparty defaults.
5. A counterparty shall perform an independent legal review in order to verify that the segregation arrangements meet the requirements referred to in paragraphs 1 to 4. A counterparty shall provide documentation to its competent authority supporting the compliance of the arrangements in each jurisdiction and set up policies ensuring the continuous assessment of compliance upon request. Such legal review may be conducted by an internal independent unit, or by an external independent third party.
6. By way of derogation from paragraphs 1 and 2, where cash is collected as initial margin, the counterparties shall deposit it with a third party holder or custodian that is not part of the same group as either of the counterparties or with a central bank. The collecting counterparty shall take into account the credit quality of the third party custodian by using a methodology that does not solely or mechanistically rely on external credit quality assessments.

Article 34

Treatment of collected initial margins

1. The collecting counterparty shall not re-hypothecate, re-pledge nor otherwise re-use the collateral collected as initial margin.
2. The requirement laid down in paragraph 1 shall be deemed to be met where a third party holder or custodian reinvests the initial margin received in cash.

CHAPTER II

PROCEDURES FOR THE COUNTERPARTIES AND THE RELEVANT COMPETENT AUTHORITIES WHEN APPLYING EXEMPTIONS FOR INTRAGROUP DERIVATIVE CONTRACTS

Article 35

Procedures for the counterparties and the relevant competent authorities

1. The application or notification from a counterparty to the competent authority pursuant to points (6) to (10) of Article 11 of Regulation (EU) No 648/2012 shall be



deemed to have been received at the time of receipt by the competent authority of all of the following information:

- (a) all the information necessary to assess whether the conditions specified in Article 3 and in points (6) to (10) of Article 11 of Regulation (EU) No 648/2012, as applicable, have been fulfilled;
 - (b) the information and documents referred to in Article 18 of Commission Delegated Regulation (EU) No 149/2013.
2. Where a competent authority determines that further information is required in order to assess whether the conditions referred to in point (a) of paragraph 1 are fulfilled, it shall submit a written request for information to the counterparty.
 3. A decision by a competent authority under Article 11(6) of Regulation (EU) No 648/2012 shall be communicated to the counterparty within three months of receipt of the complete application.
 4. Where a competent authority takes a positive decision under Articles 11(6), 11(8) or 11(10) of Regulation (EU) No 648/2012, it shall communicate that positive decision to the counterparty in writing including all of the following information:
 - (a) whether the exemption is a full exemption or a partial exemption;
 - (b) in the case of a partial exemption, a clear identification of the limitations of the exemption;
 - (c) any additional relevant information.
 5. Where a competent authority takes a negative decision under Articles 11(6), 11(8) or 11(10) of Regulation (EU) No 648/2012 or objects to a notification under Articles 11(7) or 11(9) of that Regulation, it shall communicate its negative decision or objection to the counterparty in writing and shall include all of the following information:
 - (a) the identification of the conditions of Articles 3 and 11 (6) to (10) of Regulation (EU) No 648/2012 that are not fulfilled;
 - (b) a summary of the reasons for considering that such conditions are not fulfilled.

Where one of the competent authorities notified under Article 11(7) of Regulation (EU) No 648/2012 considers that the conditions referred to in point (a) or (b) of the first subparagraph of Article 11(7) of that Regulation are not fulfilled, it shall notify the other competent authority within two months of receipt of the notification by the relevant counterparty.

6. The competent authorities shall notify the non-financial counterparties of the objection within three months of receipt of the notification referred to in paragraph 5.
7. A decision by a competent authority under Article 11(8) of Regulation (EU) No 648/2012 shall be communicated to the counterparty established in the Union within three months of receipt of the complete application.
8. A decision by the competent authority of a financial counterparty among those referred to in Article 11(10) of Regulation (EU) No 648/2012 shall be communicated



- to the competent authority of the non-financial counterparty within two months from the receipt of the complete application for exemption and to the counterparties within three months of receipt of the complete application for exemption.
9. Counterparties that have submitted a notification or received a positive decision according to points (6) to (10) of Article 11 of Regulation (EU) No 648/2012 shall immediately notify the relevant competent authority of any change in circumstance that could affect the fulfilment of the conditions of Article 3 and points (6) to (10) of Article 11 of that Regulation, as applicable. The competent authority may decide to object to the application for the exemption or to withdraw its decision following any change in circumstance that could affect the fulfilment of those conditions.
 10. Where a negative decision or objection is communicated by a competent authority, the relevant counterparty shall submit any other application or notification only if there has been a material change in the circumstances that formed the basis of the competent authority's decision or objection.
 11. The application or notifications referred to in paragraph 1 shall be submitted on the following date, whichever is latest:
 - (a) the date of entry into force of this Regulation;
 - (b) six months before the date of application of the variation margin requirements for the relevant counterparty, as referred to in Article 39(5).

Article 36

Prompt transfer of own funds and repayment of liabilities between the counterparties in intragroup derivatives

The risk management procedures shall ensure the regular monitoring of the exposures arising under intragroup transactions and the timely settlement of the obligations resulting from the intragroup OTC derivative contracts.

CHAPTER III

Applicable criteria for applying exemptions for intragroup derivative contracts

Article 37

Applicable criteria on the legal impediment to the prompt transfer of own funds and repayment of liabilities

A legal impediment to the prompt transfer of own funds or repayment of liabilities between the counterparties as referred to in paragraphs 5 to 10 of Article 11 of Regulation (EU) No 648/2012 shall be deemed to exist where there are current or foreseen restrictions of a legal nature including any of the following:

- (a) currency and exchange controls;
- (b) a regulatory, administrative, legal or contractual framework that prevents mutual financial support or significantly affects the transfer of funds within the group;



- (c) any of the conditions on the early intervention, recovery and resolution as referred to in Directive 2014/59/EU of the European Parliament and of the Council⁸ are met, as a result of which the supervisor foresees an impediment to the prompt transfer of own funds or repayment of liabilities;
- (d) the existence of minority interests that limit decision-making power within entities that form the group;
- (e) the purpose or the legal structure of the counterparty undertaking, as defined in its statutes, instruments of incorporation and internal rules.

Article 38

Applicable criteria on the practical impediments to the prompt transfer of own funds and repayment of liabilities

A practical impediment to the prompt transfer of own funds or repayment of liabilities between the counterparties as referred to in paragraphs 5 to 10 of Article 11 of Regulation (EU) No 648/2012 shall be deemed to exist where there are current restrictions of a practical nature including either of the following:

- (a) insufficient availability of unencumbered or liquid assets to the relevant counterparty when due;
- (b) operational obstacles for such transfers or repayments when due.

CHAPTER IV FINAL PROVISIONS

Article 39

Transitional Provisions

1. The requirements of this Regulation shall apply from 1 September 2016 with the exception of:
 - (a) Articles 35, 36, 37 and 38 which shall apply from the entry into force of this Regulation;
 - (b) Articles 1 (3)(a), 8, 9, 14, 33, 34 and Section 4 which shall apply in accordance with paragraph 2;
 - (c) Article 13 which shall apply in accordance with paragraph 5.
2. The Articles referred to in point (b) of paragraph 1, shall apply as follows:

⁸ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ, L 173, 12.6.2014, p. 190).



- (a) from 1 September 2016 where both counterparties have or belong to groups, each of which has an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 3.0 trillion;
 - (b) from 1 September 2017 where both counterparties have or belong to groups, each of which has an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 2.25 trillion;
 - (c) from 1 September 2018 where both counterparties have or belong to groups, each of which has an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 1.5 trillion;
 - (d) from 1 September 2019 where both counterparties have or belong to groups, each of which has an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 0.75 trillion;
 - (e) from 1 September 2020 where both counterparties have or belong to groups, each of which has an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 8 billion.
3. The aggregate average notional amount referred to in points (a) to (e) of paragraph 2 shall be calculated as the average of the total gross notional amount that meets all of the following conditions:
 - (a) recorded in the last business day of the months March, April and May of the year referred to in each of the points (a) to (e);
 - (b) including all the entities of the group;
 - (c) including all the non-centrally cleared OTC derivative contracts of the group;
 - (d) including all the intragroup non-centrally cleared OTC derivative contracts of the group, counting each one of them once.
4. For the purpose of the calculation of the aggregate notional amount referred to in paragraph 3, investment funds shall be considered distinct entities and treated as separate investment funds, in accordance with Article 8(3).
5. The Articles referred to in paragraph 1(c), shall apply as follows:
 - (a) from 1 September 2016 for all the counterparties referred to in paragraph 2(a);
 - (b) from 1 March 2017 for the other counterparties.
6. By way of derogation from paragraphs 2 and 5, in respect of contracts referred to in point (a) of Article 7, the requirements set out under paragraph 5 shall apply on one of the following dates, whichever is earlier:
 - (a) 31 December 2018;
 - (b) the entry into force of Commission Delegated Act referred to in Article 4(2) of Directive 2014/65/EU specifying some technical elements related to the definition of financial instruments with regard to physically settled foreign exchange forwards.



7. Articles 13 and 14 shall apply from [please insert date: 3 years after the date of entry into force of this Regulation] for all non-centrally OTC derivatives on single-stock equity options and index options.
8. By way of derogation from paragraphs 1 and 5, where the conditions of paragraph 9 are met, the requirements set out under points (b) and (c) of paragraph 1 shall take effect on either of the following dates:
 - (a) [please insert date: 3 years after the date of entry into force of this Regulation] where no equivalence decision has been adopted pursuant to Article 13(2) of Regulation (EU) No 648/2012 for the purposes of Article 11(3) of that Regulation in respect of the relevant third country;
 - (b) the later of the following dates where an equivalence decision has been adopted pursuant to Article 13(2) of Regulation (EU) No 648/2012 for the purposes of Article 11(3) of that Regulation in respect of the relevant third country:
 - (i) 60 days after the date of entry into force of the decision adopted pursuant to Article 13(2) of Regulation (EU) No 648/2012 for the purposes of Article 11(3) of that Regulation in respect of the relevant third country;
 - (ii) the date when the requirements set out under points (b) and (c) of paragraph 1 take effect.
9. The derogation referred to in paragraph 8 shall only apply where all of the following conditions are met:
 - (a) the counterparty established in a third country is either a financial counterparty or a non-financial counterparty;
 - (b) the counterparty established in the Union is one of the following:
 - (i) a financial counterparty, a non-financial counterparty, a financial holding company, a financial institution or an ancillary services undertaking subject to appropriate prudential requirements and the counterparty referred to in point (a) is a financial counterparty;
 - (ii) either a financial counterparty or a non-financial counterparty and the counterparty referred to in point (a) is a non-financial counterparty;
 - (c) both counterparties are included in the same consolidation on a full basis in accordance to Article 3(3) of Regulation (EU) No 648/2012;
 - (d) both counterparties are subject to appropriate centralised risk evaluation, measurement and control procedures;
 - (e) the requirements of Articles 35, 36, 37 and 38 are met.
10. By way of derogation from paragraph 1, where a Union counterparty enters into an OTC derivative contract with an entity of the same group domiciled in the Union or in a third country, the requirements on the exchange of initial margin set out under point (b) of paragraph 1 shall take effect on 1 March 2017.



Article 40
Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President
On behalf of the President



Brussels, **XXX**
[...](2013) **XXX** draft

ANNEXES 1 to 4

ANNEXES

supplementing Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories of the European Parliament and of the Council with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a CCP



ANNEXES
supplementing Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories of the European Parliament and of the Council with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a CCP

ANNEX I

Mapping of PD to Credit quality steps for the purposes of Article 25(2)

1. An internal rating with a PD equal to or lower than the value in Table 1 of shall be associated to the corresponding credit quality step.

Table 1

Credit Quality Step	Probability of default, as defined in Article 4(54) of Regulation (EU) 575/2013 lower than or equal to:
1	0.10%
2	0.25%
3	1%
4	7.5%



ANNEX II

Standard haircuts to the market value of collateral for the purposes of Article 29

1. The market value of the collateral shall be adjusted as follows:

$$C_{\text{value}} = C \cdot (1 - H_C - H_{\text{FX}})$$

where:

C = the market value of the collateral;

H_C = the haircut appropriate to the collateral, as calculated under paragraph 2;

H_{FX} = the haircut appropriate to currency mismatch, as calculated under paragraph 6.

2. Counterparties shall apply at least the haircuts provided in the following Tables 2 and 3:

Table 2
Haircuts for long term credit quality assessments

Credit quality step with which the credit assessment of the debt security is associated	Residual maturity	Haircuts for debt securities issued by entities described in Article 22 (2) (c) to (e) and (h) to (k), in (%)	Haircuts for debt securities issued by entities described in Article 22 (2) (f), (g), (l) to (n) in (%)	Haircuts for securitisation positions meeting the criteria in Article 22 (2) (o) in %
1	≤ 1 year	0.5	1	2
	>1 ≤ 5	2	4	8
	> 5	4	8	16
2-3	≤ 1 year	1	2	4
	>1 ≤ 5	3	6	12
	> 5	6	12	24
4 or below	≤ 1 year	15	N/A	N/A
	>1 ≤ 5	15	N/A	N/A
	> 5	15	N/A	N/A



Table 3
Haircuts for short term credit quality assessments

Credit quality step with which the credit assessment of a short term debt security is associated	Haircuts for debt securities issued by entities described in Article 22(2) (c) and (j) in (%)	Haircuts for debt securities issued by entities described in Article 22(2) (m) in (%)	Haircuts for securitisation positions and meeting the criteria in Article 22(2) (o) in (%)
1	0.5	1	2
2-3 or below	1	2	4

3. Equities in main indices, bonds convertible to equities in main indices and gold shall have a haircut of 15%.
4. For eligible units in UCITS the haircut is the weighted average of the haircuts that would apply to the assets in which the fund is invested.
5. Cash variation margin shall be subject to a haircut of 0%.
6. For the purpose of exchanging variation margin, a haircut of 8% shall apply to all non-cash collaterals posted in a currency other than those agreed in an individual derivative contract, the relevant governing master netting agreement or the relevant credit support annex.
7. For the purpose of exchanging initial margin, a haircut of 8% shall apply to all cash and non-cash collaterals posted in a currency other than the currency in which the payments in case of early termination or default have to be made in accordance with the single derivative contract, the relevant governing master netting agreement or the relevant credit support annex ('termination currency'). Each of the counterparties may choose a different termination currency. Where the agreement does not identify a termination currency, the haircut shall apply to the market value of all the assets posted as collateral.



ANNEX III

Own estimates of the haircuts to the market value of collateral for the purposes of Article 30

1. The calculation of the adjusted value of the collateral shall meet all of the following criteria:
 - (a) counterparties shall base the calculation on a 99th percentile, one-tailed confidence interval;
 - (b) counterparties shall base the calculation on a liquidation period of at least 10 business days.
 - (c) counterparties shall calculate the haircuts by scaling up the daily revaluation haircuts, using the following square-root-of time formula:

$$H = H_M \cdot \sqrt{\frac{N_R + (T_M - 1)}{T_M}}$$

where:

H = the haircut to be applied;

H_M = the haircut where there is daily revaluation;

N_R = the actual number of business days between revaluations;

T_M = the liquidation period for the type of transaction in question.

- (d) counterparties shall take into account the lesser liquidity of low quality assets. They shall adjust the liquidation period upwards in cases where there are doubts concerning the liquidity of the collateral. They shall also identify where historical data may understate potential volatility. Such cases shall be dealt with by means of a stress scenario;
- (e) the length of the historical observation period institutions use for calculating haircuts shall be at least one year. For counterparties that use a weighting scheme or other methods for the historical observation period, the length of the effective observation period shall be at least one year.
- (f) the market value of the collateral shall be adjusted as follows:

$$C_{\text{value}} = C \cdot (1 - H)$$

where:

C = the market value of the collateral;

H = the haircut as calculated in point (c) above.

2. Cash variation margin may be subject to a haircut of 0%.



ANNEX IV

Standardised Method for the calculation of initial margin for the purposes of Article 15

1. The notional amounts or underlying values, as applicable, of the OTC derivative contracts in a netting set shall be multiplied by the percentages in the following Table 1:

Table 1

Category	Add-on factor
Credit: 0–2 year residual maturity	2%
Credit: 2–5 year residual maturity	5%
Credit 5+ year residual maturity	10%
Commodity	15%
Equity	15%
Foreign exchange	6%
Interest rate: 0-2 year residual maturity	1%
Interest rate: 2-5 year residual maturity	2%
Interest rate: 5+ year residual maturity	4%
Other	15%

2. The gross initial margin of a netting set shall be calculated as the sum of the products referred to in paragraph 1 for all OTC derivative contracts in the netting set.
3. The following treatment shall be applied to contracts which fall within more than one category:
 - (a) where a relevant risk factor for an OTC derivative contract can be clearly identified, contracts shall be assigned to the category corresponding to that risk factor;
 - (b) where the condition referred to in point (a) is not met, contracts shall be assigned to the category with the highest add-on factor among the relevant categories;
 - (c) the initial margin requirements for a netting set shall be calculated in accordance with the following formula:

Net initial margin = 0.4 * Gross initial margin + 0.6 * NGR * Gross initial margin.

where:

- (i) net initial margin refers to the reduced figure for initial margin requirements for all OTC derivative contracts with a given counterparty included in a netting set;
- (ii) NGR refers to the net-to-gross ratio calculated as the quotient of the net replacement cost of a netting set with a given counterparty in the numerator, and the gross replacement cost of that netting set in the denominator;



- (d) for the purposes of point (c), the net replacement cost of a netting set shall be the bigger between zero and the sum of current market values of all OTC derivative contracts in the netting set;
- (e) for the purposes of point (c), the gross replacement cost of a netting set shall be the sum of the current market values of all OTC derivative contracts calculated in accordance with Article 11(2) of Regulation (EU) No 648/2012 and Articles 16 and 17 of Commission Delegated Regulation No 149/2013 with positive values in the netting set;
- (f) a netted notional amount may be computed before applying the add-ons referred to in paragraph 1 between contracts that are of opposite direction and are identical in terms of all contractual features except their notional amount.



4. Accompanying documents

4.1 Draft cost-benefit analysis

4.1.1 Problem definition

1. This section identifies problems to be addressed by the draft RTS. The core problem that the RTS aim to address is the lack of a harmonised regulatory framework for margin requirements for non-centrally cleared derivatives and associated problems including high systemic risk, regulatory arbitrage and an uneven playing field in the EU market for OTC derivatives. Specifically it is noted that:
 - a) The high volume of non-centrally cleared derivatives¹ poses high systemic risk in the EU market as well as in the rest of the world².
 - b) If the margin requirements for non-centrally cleared derivatives vary across the Member States, then the regulatory framework will give a competitive advantage to financial institutions that operate in the low-margin jurisdictions (resulting in an uneven playing field for institutions in the EU). This would also incentivise institutions that initially operate in high-margin jurisdictions to relocate their business activities to another jurisdiction where the margin requirements are low (regulatory arbitrage).
2. These problems prevent the effective and efficient operation not only of the market for non-centrally cleared derivatives but also of the internal market.
3. Section 2.1.4 presents an analysis of the alternative technical options that can effectively address these problems.

4.1.2 Objectives

4. The general and operational objectives of the EMIR, as noted in the recitals of the EMIR, are to respond to the risks emerging from the interconnectedness between institutions operating in the OTC derivative markets by:
 - a) reducing counterparty credit risk, and
 - b) establishing robust risk management.
5. The objective of the current RTS is to establish a robust regulatory framework by:

¹ See Section 4.1.5, where the key statistics in relation to the baseline are presented.

² For example in the countries that are covered by the scope of BCBS-IO스코.



- a) improving prudential regulation so that non-centrally cleared derivatives are bilaterally collateralised and subject to either margin or capital requirements,
 - b) harmonising regulatory practice on non-centrally cleared derivatives across the Member States, and
 - c) aligning the EU regulatory framework with international practice.
6. Article 11 of the EMIR outlines:
- a) the framework for risk-management procedures for contracts for non-centrally cleared derivatives,
 - b) the overall procedures for intragroup exemptions that national competent authorities must follow, and
 - c) the criteria for the identification of practical and legal impediment to the prompt transfer of funds between counterparties.
7. However, this article does not specify what these procedures and criteria should be. As a result, the provisions may lead to variations in the interpretation of these criteria and procedures and a lack of harmonisation in margin requirements across the EU.
8. Article 11(15) of the EMIR gives the ESAs power to issue RTS to promote harmonisation in risk-management procedures, procedures for exemptions and criteria for identifying legal and practical impediment to the prompt transfer of own funds and repayment liabilities between counterparties.
9. Specification of the rules on the abovementioned provisions is a crucial aspect of the market for non-centrally cleared derivatives. The objective is to mitigate the high risk that the market for non-centrally cleared derivatives currently carries, by complementing the provisions under Article 11 of the EMIR, and ultimately to contribute to the effective and efficient functioning of the internal market.

4.1.3 Baseline

10. The quantitative analysis in Section 4.1.5 shows the estimated value of aggregate non-centrally cleared activity that is captured by the scope of the current RTS for major European banks. Currently, the estimated value in terms of the total gross notional outstanding amount for non-centrally cleared derivative activities is about EUR 146 trillion. This figure is expected to decrease to about EUR 74.9 trillion (or by 49%) after the implementation of the central clearing obligation, which will require about half of these transactions to be subject to mandatory central clearing. In other words, after the implementation of the margin requirements, about 49% of the OTC derivative market will be captured by the current RTS, and the remaining 51% will be cleared centrally.



11. Similar figures that are based on a larger sample and cover countries outside the EU (e.g. the US and Japan) show that the policy impact in the EU will be similar to the development of the international market for OTC derivatives.
12. In terms of initial margin the estimated value of total initial margin currently collected among financial institutions is about EUR 40 billion in the EU. The figure is about 40% of the global value.

4.1.4 Assessment of the technical options

13. The current section analyses the major technical options that are considered under each section of the current RTS. The assessment of the technical options presents the evidence and the logic behind the choice of a particular policy that shapes the current RTS, including:
 - a) physically settled foreign exchange swaps and forwards, and currency swaps;
 - b) scope of applicability of the initial margin requirements;
 - c) covered bonds;
 - d) eligibility and treatment of collateral;
 - e) credit quality assessment;
 - f) concentration limits;
 - g) phase-in of initial margin requirements;
 - h) procedures concerning intragroup transactions.

Physically settled foreign exchange swaps and forwards, and currency swaps

14. The assessment relates to the scope of derivative instruments to which the margin requirements apply. The regulation covers all derivatives that are not centrally cleared, with the exception of derivatives in certain types of transactions.
15. The current options relate to the exclusion of foreign exchange forwards and swaps from the scope of the margin requirements due to their unique characteristics (e.g. product availability) and due to the particular market practices involved (e.g. requirements with regard to product delivery).

Option 1: exemption from the requirement to collect initial margin for physically settled foreign exchange swaps and forwards, and currency swaps

16. Physically settled foreign exchange swaps and forwards are the derivative instruments by which the underlying financial products (i.e. foreign currency) are physically delivered in exchange for a specific payment. The physical existence and the availability of the underlying financial instrument decrease counterparty risk.



17. However, the physical settlement characteristics do not minimise counterparty risk arising from unforeseen events such as counterparty default.

Option 2: no exemption from the requirement to collect initial margin for physically settled foreign exchange swaps and forwards, and currency swaps

18. An initial margin requirement for non-centrally cleared physically settled foreign exchange swaps and forwards is expected to minimise the risk associated with counterparty default. This is true particularly for contracts with long maturities, where the uncertainty is greater.
19. However, initial margin requirements will result in additional costs for the industry, which may in turn downsize the market for physically settled foreign exchange swaps and forwards. This is true particularly when the international market is taken into account, in particular EU trade with the US market and intra-EU trade across jurisdictions with different currencies.
20. Preferred option: the first option (exemption from IM) is the preferred option for the following reasons:
- a) The BCBS-IOSCO framework specifies that certain physically settled foreign exchange products and swaps should be exempt from the exchange of initial margin, with the intention that the risks associated with the exemption will be considered by the monitoring group established in 2014.
 - b) Given the interconnectedness of the market and international practice, in particular in the US market, an initial margin requirement for physically settled foreign exchange swaps and forwards would put the EU at a comparative disadvantage vis-à-vis other players.
 - c) Therefore, to reflect the international dimension of the foreign exchange markets and to maintain international consistency between jurisdictions, it will be beneficial if the technical standards are consistent with the BCBS-IOSCO framework.

Scope of applicability of the initial margin requirements

21. The assessment relates to the scope of the RTS. It discusses the threshold for the size of the counterparties in terms of gross notional outstanding amounts of OTC derivatives in order to establish which entities should be included in the scope of the current RTS.

Option 1: the RTS would apply to all entities undertaking OTC derivatives transactions

22. This option does not set a minimum threshold to identify entities that can be exempted from the margin requirements. It sets uniform and comprehensive risk-management requirements for participants in the OTC derivative market. The approach would be effective in achieving the objective of reducing systemic risk in the OTC derivative market.



23. However, the uniform application of margin requirements violates the proportionality principle. The ESA recognises the significant change in market practice and potential costs associated with these requirements. This is also acknowledged in the BCBS-IOSCO framework. These costs have the potential to fall disproportionately on smaller market participants, and, in extremis, discourage the use of derivative markets, in particular for risk-reducing activities such as hedging.

Option 2: the RTS would apply to all entities undertaking OTC derivatives transactions, subject to a minimum level

24. In line with international principles, this option introduces a threshold value of EUR 8 billion for gross notional outstanding amounts of OTC derivatives. Entities with aggregated notional outstanding amounts under this threshold are not subject to the initial margin requirements.
25. Preferred option: the second option is the preferred option since it respects the proportionality principle and is in line with international practice.

Covered bonds

26. Covered bonds are debt securities backed by a cover pool of predominantly mortgages or public-sector loans serving as collateral. Derivatives can be used in cover pools to hedge interest rate and currency risks, for instance with the purpose of issuing covered bonds in currency denominations other than that of the underlying collateral. Bilateral collateral exchange, as mandated by the EMIR, would require the cover pool to provide collateral to its derivative counterparty. This would give the derivative counterparty a preferential claim to the assets in the cover pool over the covered bondholders, which is incompatible with the senior rights of covered bondholders usually prescribed by existing covered bonds across Europe.

27. In this respect, recital 24 of the EMIR provides that:

‘When developing draft regulatory technical standards to specify the arrangements required for the accurate and appropriate exchange of collateral to manage risks associated with uncleared trades, ESMA should take due account of impediments faced by covered bond issuers or cover pools in providing collateral in a number of Union jurisdictions. ESMA should also take into account the fact that preferential claims given to covered bond issuers counterparties on the covered bond issuer’s assets provides equivalent protection against counterparty credit risk.’

Alternative 1: one-way margin requirement

28. Under this first alternative, the cover pool is exempted from posting and collecting collateral in the form of initial margin and from posting variation margin to its derivative counterparty if not previously collected.



29. This alternative relies on specific risk mitigants embedded in covered bond programmes to provide the derivative counterparty with a certain level of protection as an alternative to the exchange of collateral. These risk mitigants include the derivative counterparty benefiting from the appropriate segregation of the assets in the cover pool from the issuer's insolvency estate and a minimum level of legal over-collateralisation.
30. Specifically the ESA's consider that the following conditions must be met:
- a) the derivative is not terminated in case of a resolution or insolvency-related default of the covered bond issuer³;
 - b) the derivative counterparty ranks (at least) pari passu with the covered bondholders⁴;
 - c) the derivative is recorded in the cover pool of the covered bond programme in accordance with national covered bond legislation and is used only to hedge the interest rate, or currency mismatches of the cover pool;
 - d) the netting set does not include derivatives unrelated to the covered bond programme;
 - e) the covered bond programme meets the requirements of Article 129 of the CRR;
 - f) the covered bond programme is subject to a regulatory⁵ collateralisation requirement of at least 102%⁶.
31. In cases where the conditions of Alternative 1 are not met, the ESAs have considered the following alternative.

Alternative 2: collateral provider

32. Under this second alternative, the cover pool is not exempt from posting collateral to its derivative counterparty. Instead, this alternative relies on the interposition of a third-party collateral provider between the cover pool/covered bond issuer and its derivative counterparty to address the legal impediment faced by the cover pool when posting collateral.

³ For the cover pool to be eligible, most European jurisdictions require that the payments on the derivatives cannot be accelerated in case of the covered bond issuer's default. Otherwise, the covered bondholders will lose the benefit of the protection provided by the hedging of the covered bond issuer's insolvency.

⁴ Under most European covered bond regimes, the claims of the derivative counterparty can rank equally with, but not take priority over, the claims of the covered bondholders.

⁵ Voluntary over-collateralisation is not taken into account due to the lack of restrictions preventing the issuer from suddenly reducing it. In the worst-case scenario, the issuer could reduce over-collateralisation to the legally required amount shortly before going into default.

⁶ A minimum collateralisation of at least 102% in respect of the covered bonds in circulation is required in certain jurisdictions.



33. Under this arrangement, the third party, as a collateral provider, acts as a guarantor for the derivative counterparty. In return, the third party receives a claim on the assets in the cover pool (ranking pari passu or below the covered bondholders) and a fee paid by the covered bond issuer/cover pool.
34. There is no need to explicitly take into account the use of a third-party collateral provider, as there is currently no provision preventing a counterparty from using a third-party provider to post the collateral, as long as the collateral is available to the counterparty in the event that the covered bond issuers default.
35. It is noted that there appears to be significant scope for market-based solutions that will preserve risk mitigation, which is an overall principle across the technical standards.

Timing for the collateral exchange

36. The BCBS-IOSCO framework does not require a daily collection of collateral (for either VM or IM) although it is required that a regular calculation and exchange takes place. The current industry practice on the exchange of margin varies across entities and types of trades. Variation margin is often exchanged among banks and larger financial institutions. Often, but not always, VM is exchanged in cash. IM is rarely exchanged except with respect to hedge funds or counterparties with lower credit quality. It is therefore difficult to rely on the current practices when laying down the provisions on the timing of the collateral exchange for OTC derivatives.
37. According to final and proposed rules outside the EU, different approaches have been pursued by various Regulators for the timing of margin exchange. Some clearly opted for the margin exchange to be executed at T+1, while some flexibility is allowed for the choice of 'T' for cross-border trades over different time zones. Others require an exchange 'without delay' or within few business days of calculation of IM obligations.
38. There is a common understanding that the margin calculation can be performed early in the morning of the following business day. The simplicity of the ISDA SIMM model (the most likely candidate for the calculation of IM) allows straightforward calculations. As explained later on, posting available collateral can also be performed quickly.
39. Considerations should be made that valuation can only take place after close of trading in the US not only because a trade in EU or Asia may refer to an American exchange, but also because global firms' operational centres, receiving the margin call, may be located in any one of Asia, Europe and the US.
40. VM has to be calculated daily. The RTS provides a list of conditions that determine when IM has to be recalculated, but in practice also IM has to be recalculated daily for most of the netting sets. The RTS allow for more time (in practice, one additional day) for the exchange of margins in cross-border netting sets over different time zones. This applies to VM and IM



and applies to all the trades in that netting set, new or existing trades. This is in line with the current practice for the calculation of VM in case of trades with Asian counterparties.

41. Once there is enough time for calculation and in whichever way the time zone issue is addressed, collateral has to be pledged or transferred. The ability to meet a T+1 call (including collateral pledge or transfer), however, should not be confused with the settlement of securities. In fact, non-cash collateral does not need to follow the settlement cycle (typically based on a delivery-versus-payment system) but it is either a pledge or a free-of-payment title transfer. Major custodians commonly perform these operations on a same-day basis and virtually instantaneously. This is the case for securities held at that custodian or for transfers across major custodians, because the process around the collateral transfer is already a common practice that does not require any change of custodians' internal processes. Constraints can arise where smaller counterparties decide to rely on local and less sophisticated custodians.
42. As a consequence, it is clear why some jurisdiction does not account for the full settlement cycle of the securities posted as initial margin where others do allow for this additional time.
43. Industry stakeholders' comments in response to the second consultation paper were varied. Although all respondents expressed the need to have more time for posting collateral, the motivations and the time frame suggested varies from 'at least T+3' (ISDA), the 'T+5' of the Japanese Banking Association up to the 'T+7' of some large non-financial counterparties.
44. Custodians and banks were consulted on the need of additional time for posting initial margin. Major custodians confirmed they can perform, as they already do, this type of operations immediately also in a cross border context and across major custodians without changing their internal processes. Banks, on the other hand, recognised that if collateral is available, they can post it immediately. However, banks also claim that the technology is not that advanced yet to perform the portfolio reconciliation and margin calculation just 'pushing a button', although this is done for variation margin.
45. Banks also claim that typically they do not keep collateral aside to face margin calls but they repo it. Moreover, banks also would like to be able to post the collateral of the desired quality to counterparties after collateral transformation. In both situations, for obtaining the securities back from a repo and for the collateral transformation, banks asked to have a certain number of additional days (after T+1) for the posting of initial margin; the number of days should be related to the settlement cycle of the securities.
46. The next sections detail pros and disadvantages of the two alternative approaches described therein.

Options on margin exchange: advantages and drawbacks



47. The BCBS-IOSCO margin framework for OTC derivatives have three main objectives:
- Reducing systemic risk via limiting the interconnectedness among counterparties;
 - Incentivise central clearing;
 - International consistency of the margin rules.
48. The last objective, in particular, aims to avoid regulatory arbitrage because these activities can be easily relocated to another jurisdiction.
49. This section highlights pros and cons of the two alternative approaches on the timing for the margin exchange:
- Option 1: initial and variation margin shall be posted at T+1 (which can be T+2 in a cross border context); or**
- Option 2: initial and variation margin shall be posted at T+1 (which can be T+2 in a cross border context) plus a number of days equals to the length of the settlement cycle of the securities.**
50. To note that the current version of the RTS (as the two Consultation Papers) is drafted in accordance with option a) with some additional flexibility for the exchange of VM.

Reducing Systemic risk

51. Keeping those general objectives in mind, it comes without saying that once variation and initial margins are exchanged on a regular basis, both options substantially reduce systemic risk where Option 1 would be more effective.
52. Requiring a T+1 posting of IM would not allow counterparties to transform collateral or to post collateral after obtaining back eligible collateral that was unavailable because used for a repo. This may require counterparties that decide not to set aside high-quality collateral to face margin calls to double fund the collaterals (e.g. posting cash) for the time they need to obtain back the securities. In any case, a counterparty would be able to meet requirement under Option 1 because either the posting party has the securities or the cash from the repo. Therefore, it should be able at any time to post one or the other. Posting cash IM is also a viable alternative, although more expensive, also because Regulators seem to agree on the fact that cash IM should not be segregated. Since smaller counterparties do not enter aggressively in repo transactions; therefore this is more an issue for larger institutions.
53. A disadvantage of Option 2 is that the clients would end up collecting the lowest quality collateral (to the extent allowed in the RTS and in the bilateral agreement) from their counterparties which in turn would again increase systemic risk.



54. It should be recognised that allowing additional time for portfolio reconciliation and the call to be calculated and posted would help limit disputes and therefore reduce operational risk.

Incentives to central clearing

55. Margins to central counterparties are posted on a T+1 basis and therefore Option 2 would not incentivise central clearing. However, at this juncture it is not possible to conclude whether both options offer enough incentives to central clearing.

International consistency of the margin rules

56. Different approaches on the timing for the margin collection may increase market fragmentation and, potentially, regulatory arbitrage.
57. This approach may also limit the ability of certain financial institutions to act globally, posing particular difficulties for transactions either in one direction, dealing with the US, or in the other, dealing with counterparties located in Asia or emerging markets. By this point of view, none of the two options prevails, unless more weight is given to the US market.

Other considerations

58. The T+1 requirement may result in additional costs with respect to Option 2.
59. Smaller counterparties (i.e. below the EUR 8 billion threshold) are exempted from IM. Counterparties slightly above the threshold will be in the scope of IM only in 2020 and therefore have time to set up internal systems.
60. All these counterparties may also decide to rely on external consultant for the management of derivatives, as non-financial counterparties often do, or to rely on the calculations provided by the investment bank they have as counterparty.
61. Financial counterparties below the EUR 8 bn threshold are not subject to IM but are still subject to VM. These counterparties may decide to post securities (likely government bonds) instead of cash because they do not have the liquidity to meet margin calls in cash. For these situations is hard to see how Option 2 would be of much help. For example, insurance companies or pension schemes already have securities at a custodian that can be pledge as collateral without the need of any transformation or delay.
62. Based on this analysis, the ESA are of the opinion that Option 1 is should be the preferred one.

Eligibility and treatment of collateral

63. The assessment specifies the type of collateral that can be used when posting margins bilaterally for non-centrally cleared derivatives. Specifically, the objective of the policy is to



ensure that the characteristics of the collateral are sufficiently liquid and of sufficiently high credit quality.

Option 1: to specify a list of eligible collateral based on the list from the international standards and further detailed qualitative requirements

64. This option gives market participants leeway to agree on eligible collateral and sets a framework to facilitate the review of these agreements. The option can be easily applied by all market participants and ensures the highest degree of consistency and comparability across all counterparties. The option is expected to minimise the operational cost for the supervisory authorities, since no further assessment of the adequacy of accepted collateral is necessary.
65. This framework could rely on existing classifications, such as the eligible financial collateral in the credit risk mitigation framework of the CRR. This would ensure consistency in the framework and provide overall clarity.
66. However, this approach will to some extent rely on additional liquidity and credit criteria, such as external ratings, to ensure consistency. This may risk providing a less harmonised implementation if conditions are not clearly specified. However, it is also noted that credit and liquidity risk assessment is an area subject to significant market fluctuations; therefore, some flexibility will be needed, regardless of the approach adopted.

Option 2: to provide qualitative requirements that are linked to the requirements set out for collateral posted to a CCP

67. Under this option, the counterparty would be allowed to define its own list of eligible financial collateral based on a set of qualitative minimum requirements provided in the RTS.
68. The approach is flexible and easy to adapt. It allows the use of a wide range of collateral as long as it provides sufficient protection against counterparty default. Under this approach, market forces decide on the eligibility of items as collateral.
69. With qualitative requirements, counterparties have the option of using their own assessment (e.g. of credit risk) instead of relying on external ratings. However, the approach does not harmonise the practice and allows counterparties considerable discretion in deciding on eligible collateral.
70. This is true particularly since the scope of the margin requirements for non-centrally cleared derivatives covers both financial and non-financial counterparties. This could lead to the collecting or posting of collateral that is not highly liquid and cannot be converted into cash rapidly and with minimal price impact.
71. The policy would entail high operational costs for national competent authorities. The competent authorities would have to ensure consistency amongst the individual market



participants and assess the adequacy of each market participant's implementation of the qualitative criteria. The competent authorities would have to approve the eligibility criteria and revise them as part of their supervisory activity.

72. This technical option would also create costs for the industry. Counterparties would have to demonstrate explicitly to the competent authorities that the conditions had been fulfilled and that the conditions were comparable to the approach for CCPs in the technical standards of the EMIR.

Option 3: a framework linked to market-based indicators similar to the one under development for the Liquidity Coverage Ratio (LCR), adopting the definition of liquid assets used for the liquidity framework

73. The purpose of the liquidity buffer under the liquidity framework is to raise cash by selling the assets outright or entering into secured funding transactions. The horizon of the LCR is 30 days, which is slightly longer than a normal margin period. However, much emphasis is placed on both the liquidity and the credit aspects in the definition of liquid assets. There appears to be a strong similarity to eligible collateral for margin requirements, since the assets/collateral in both cases need to be able to be sold off in the market within a relatively short interval. Alignment with an LCR approach that is founded on market-based indicators is therefore a credible option.
74. However, the liquidity framework is currently not finalised and may not be finalised before the finalisation of the RTS, which leaves a period of uncertainty. Furthermore, the LCR proposal is aimed at institutions, whereas the scope here is broader, as it will also include non-institutions. It may also be argued that, given that the scope of application concerns the relationship between two counterparties, which is significantly smaller than the scope of the liquidity risk profile of an institution, a broader set of collateral should be allowed.
75. Preferred option: a list of eligible asset classes limited by qualitative requirements is the preferred option because it more effectively addresses the problems relating to harmonisation and creating a level playing field in the market. The option is less costly and achieves a balance between flexibility and harmonisation. However, it raises the issue of specifying especially the credit quality in greater detail, bearing in mind the requirements of the CRA 3 regulation, which encourages the removal of mechanistic reliance on external ratings. This aspect is discussed in greater detail below.

Credit quality assessment

76. The policy objective is to provide a transparent and harmonised approach for counterparties without an approved internal model for risk assessment. This approach should be easily applicable and traceable by the relevant supervisory authority whilst ensuring that the accepted collateral is of appropriate credit quality.



Option 1: the RTS could provide only a very high-level definition of high credit quality (e.g. ‘investment grade’)

77. This technical option allows the use of a wide range of collateral as long as it provides sufficient protection against default by the counterparty. Market developments may suddenly render items on the list unsuitable as collateral. With qualitative requirements, counterparties have the option of using their own assessment (e.g. of credit risk) instead of relying on external ratings.
78. Adopting this approach, at least without requiring the counterparties to demonstrate to the competent authorities that the requirement is met, could leave the counterparties with a large amount of discretion. This could lead to the collection or posting of collateral that cannot be converted into cash rapidly and with minimal price impact. Requiring the counterparties to explicitly demonstrate to the competent authority that the criteria have been fulfilled (comparable to the approach for CCPs) will also most likely lead to a non-harmonised approach as the scope of the margin requirements for non-centrally cleared derivatives is extremely broad, covering financial and non-financial counterparties. An approach that works for a limited number of CCPs is more difficult for this very broad range of counterparties.

Option 2: the RTS could identify types of collateral where minimum Credit Quality Steps (CQS) would be required, thereby indirectly referring to ratings of external credit assessment institutions

79. This approach is, in part, similar to what is laid down in the CRR. In the case of deterioration in the quality of assets already accepted as collateral that leads to the non-eligibility of this collateral, the draft RTS also allow for a ‘grace period’ to replace this collateral.
80. The option provides an effective alternative for counterparties without an approved internal model. This would ensure transparency and allow for smaller market participants and non-banks to undertake their own assessments. The inclusion of a grace period would mitigate cliff effects by giving counterparties time to replace the collateral.
81. The institutions will need to rely on external credit assessments provided by ECAs.
82. Preferred option: Option 2 is the preferred option as it provides an operational framework that also mitigates mechanistic reliance on ratings. However, to mitigate mechanistic reliance, the use of approved IRB models is allowed as an alternative, just as potential cliff effects are mitigated with the introduction of so-called ‘grace periods’, where counterparties are given time to exchange collateral no longer eligible after rating downgrades.

Concentration limits

83. The policy objective is to ensure that the collateral taker is able to realise sufficient value from the collateral to replace the OTC contracts associated with a defaulted counterparty.



Option 1: no concentration limit

84. Concentration limits make it more difficult for counterparties to find suitable collateral. They also place an additional operational burden on counterparties as the limits have to be monitored and collateral might occasionally have to be replaced in order not to breach the thresholds. Regulators incur additional costs as they have to check whether counterparties are complying with the restrictions.
85. However, this process of appropriating the collateral and entering a new contract might take a number of days. Without concentration limits, the initial and variation margins collected might be highly concentrated and not hold their value in a period of significant market stress. The collecting counterparty might also have difficulties in exiting a large position.

Option 2: concentration limits for exposures from collected margins that represent a significant proportion of the overall exposures of the collecting counterparty

86. Ideally, this option would achieve the advantages of Option 1 while avoiding unnecessary burdens.
87. Option 2 may result in insufficient protection if the threshold is set too high.

Option 3: concentration limits for margins irrespective of position size

88. This requirement ensures a minimum level of diversification for the collected collateral. It also reduces potential problems arising from having to liquidate a large position. The restrictions arising from concentration limits under Option 3 are more predictable for both counterparties than under Option 2.
89. Option 3 makes it more difficult to find suitable collateral than Option 1. Compared with this option, it also places an additional operational burden on counterparties. Option 3 might force the collection of diversified collateral even if the initial margin in total were small compared with the collecting counterparty's overall credit exposure. A disadvantage is that smaller counterparties may face difficulties or impediments in posting collateral different from local sovereign debt securities.
90. Preferred option: given the considerations above, these draft RTS propose a variant of Option 3 as the preferred option. The concentration limits in relation to sovereign debt securities are applied only to systemically important financial institutions or to parties collecting more than EUR 1 billion from a single counterparty.

Phase-in of initial margin requirements

91. The assessment covers the approach to transitional requirements. The policy objective is to specify the phase-in requirements for the current RTS.



Option 1: to adopt the approach of the international standards that implement a phase-in period of four years, starting with the largest market participants from 1 September 2016

92. The approach gives smaller participants a longer transitional period, i.e. more time to put into place all the necessary processes and systems. Additionally, by adopting the approach of the international standards, the policy takes into account the proportionality principle and creates a level playing field.
93. This approach would favour smaller players in terms of costs, but would also leave smaller entities exposed to counterparty risk during the transitional period.

Option 2: not to consider a phase-in schedule

94. An advantage is that there would not be any competitive advantage for smaller participants.
95. However, this option would put smaller participants at a disadvantage compared with institutions in third countries.
96. Preferred option: given the considerations above, these draft RTS propose Option 1 as the preferred option. This will, furthermore, align with internationally agreed standards.

Procedures concerning intragroup transactions

When is the application for intragroup transactions (IGTs) deemed to have been received by the competent authority?

Option 1: the application is deemed to have been received when it is deemed complete by the competent authority. This option consists of including in the RTS the possibility for the competent authority to ask for more information.

97. The EMIR stipulates, in Article 11(6) to 11(10), that counterparties shall submit applications or notifications to their respective competent authorities. Depending on the nature of the counterparties (financial counterparties, non-financial counterparties or third country entities), the exemption will be subject to either a decision or a potential objection by the competent authorities.
98. Advantages: this option adds flexibility to the intragroup exemption procedures. Instead of refusing or objecting to an exemption on the grounds that the competent authority does not have the necessary information to verify that the relevant conditions have been fulfilled, the competent authority will have the option of going back to the applicant and providing more time for the applicant to submit a fuller explanation, which should be to the benefit of counterparties seeking exemption.
99. Another advantage is that the timeline within which the competent authorities are required to notify the counterparties of the outcome of the request for exemption will only start once the application or notification is deemed to be complete. Several requests for



information may be sent, providing both the competent authorities and the counterparties with opportunities to reassess the files and complete the application.

100. Disadvantages: the main disadvantages are issues relating to timing and legal certainty. When counterparties apply for exemption, they will not be able to determine the time required to grant the exemption until their application is deemed complete. This may be particularly problematic under Article 11(6), 11(8) and 11(10), in accordance with which counterparties can only start using the exemption after the decision has been taken by the competent authorities. The risk is that there is no time limit for completing the application.

Option 2: the application is deemed to have been received upon the initial receipt of the application sent by the counterparty to the competent authority. This option consists of not including in the RTS the possibility for the competent authority to ask for more information.

101. The advantages and disadvantages are the opposite of those of Option 1.
102. Preferred option: given the considerations above, these draft RTS propose Option 1 as the preferred option.

Procedure to be followed under Article 11(7)

Option 1: the length of the objection period is set at three months and the objection must be communicated to the other competent authority before it is communicated to the counterparties

103. Article 11(7) specifies the procedure to be followed when two counterparties to an intragroup transaction are non-financial counterparties (NFCs) within the meaning of Article 2(9) of the EMIR.
104. Under Article 11(7), each NFC shall notify its competent authority of its intention to apply the exemption, and the exemption is valid unless 'either of the competent authorities does not agree upon fulfilment of the conditions' mentioned in the article. Therefore, both competent authorities have the option of objecting, which, if exercised, would prevent the counterparties from using the exemption.
105. Option 1 proposes specifying how the competent authority which chooses to object must communicate this objection to the counterparties and to the other competent authority. More specifically, it requires that (1) the competent authority which chooses to object notifies the other competent authority within two months of receipt of the application and (2) each competent authority notifies its counterparty of the objection within three months of receipt of the application.
106. If the procedure is not defined, the following situation could arise: for an intragroup transaction between a counterparty established in country A, and a counterparty established in country B, the exemption is objected to in country A and is in country B. It is



unclear from Article 11(7) whether the objecting competent authority is obliged to inform the other competent authority, let alone the other counterparty. It could therefore be the case that, for the same intragroup transaction, the counterparty established in country A considers itself exempted while the counterparty established in country B does not, which may create a dispute between the counterparties.

107. In addition, the timeline within which the competent authorities may object is not defined in Article 11(7), whereas it is set at three months in Article 11(9) concerning the possibility for competent authorities to object to exemptions for intragroup transactions between an NFC and a counterparty established in a third country. Therefore, Option 1 seeks to achieve similar treatment for NFCs whose request is objected to, irrespective of whether the other counterparty is established in the EU or in a third country. Setting the non-objection period at three months provides an NFC applying under Article 11(7) with certainty about the period of time during which its exemption may be objected to and ensures consistency with Article 11(9).
108. Finally, Option 1 foresees a period of one month (between the notification of the objection to the other competent authority and the notification of the objection to the counterparties) for the two competent authorities to reach an agreement in the event that only one of the two intends to object. This one-month period may avoid disputes between competent authorities taking place after the counterparties have started to make use of the exemption.
109. A disadvantage of this option is that it entails additional costs for the competent authorities as they are required to notify the other competent authority which may disagree. However, this should foster cooperation between competent authorities.

Option 2: the procedure to be followed under Article 11(7) is not further specified

110. The advantages and disadvantages are the opposite of those of Option 1.
111. Preferred option: given the considerations above, these draft RTS propose Option 1 as the preferred option.

Procedure to be followed under Article 11(8)

Option 1: to set a maximum period of three months for the competent authority to notify the counterparty of its decision regarding the exemption

112. Article 11(8) specifies the procedure to be followed when the one counterparty to an intragroup transaction is a financial counterparty (FC) within the meaning of Article 2(8) of the EMIR and the other counterparty is established in a third country.
113. Under Article 11(8), an IGT is exempted on the basis of a positive decision of the competent authority of the FC.



114. Option 1 requires the competent authority of the FC to communicate its decision to the FC within three months of receipt of the application.
115. Advantages: under Article 11(8), the counterparties are required to wait until the decision is made to make use of the exemption. There is no a priori exemption, unlike in cases where the competent authorities merely have the option of objecting to the use of the exemption. Therefore, it is crucial for the counterparties to have a fixed timeline within which their request for exemption is granted or refused.
116. In addition, while the timeline within which the competent authority shall notify the counterparty of its decision is not defined in Article 11(8), it is set at 30 calendar days in Article 11(6) concerning intragroup transactions between two financial counterparties. Setting the non-objection period at three months provides an FC applying under Article 11(8) with certainty about the period of time during which its exemption shall be granted or refused. It also ensures consistency with Article 11(6), although a longer time period (3 months instead of 30 calendar days) is justified by the fact that the other counterparty is established in a third country, which may complicate the assessment to be made by the competent authority.
117. Disadvantage: it could be argued that the absence of a defined period of time within which the competent authority has to notify the counterparty of its decision was an intention of Article 11(8) and therefore Option 1 would contradict the initial intention of the text. In practice, this is unlikely to be the case, in view of the legal uncertainty created by the absence of a defined time period as described above.

Option 2: not to further specify the procedure to be followed under Article 11(8)

118. The advantages and disadvantages are the opposite of those of Option 1.
119. Preferred option: given the considerations above, these draft RTS propose Option 1 as the preferred option.

Procedure to be followed under Article 11(9)

Option 1: not to further specify the procedure to be followed under Article 11(9)

120. Article 11(9) specifies the procedure to be followed when a counterparty to an intragroup transaction is an NFC within the meaning of Article 2(9) of the EMIR and the other counterparty is established in a third country.
121. Under Article 11(9), an IGT is exempted unless the competent authority of the NFC does not agree on the fulfilment of the conditions defined in the article within three months of the date of notification.
122. Under Option 1, no further specification would be added to the RTS.



123. Advantages: the timeline for the competent authority to object is already defined in Article 11(9). Furthermore, the other competent authority involved in the process a counterparty established in a third country, and the EMIR does not foresee a competent authority playing a role in granting or refusing an exemption. Therefore, it does not seem necessary to further specify the procedure to reach a similar outcome to those of the other cases mentioned in Article 11(6) to 11(10).
124. Disadvantages: it could be argued that the competent authority of the counterparty established in a third country should, at a minimum, be consulted or informed of the outcome of an application for exemption. However, this would be outside the mandate defined in Article 11(15)(c), which requires the ESAs to specify the procedures for the counterparties and the relevant competent authorities to be followed when applying exemptions under Article 11(6) to 11(10). The definition of 'competent authorities' provided in Article 2(13) only includes the competent authorities designated by Member States.

Option 2: to further specify the procedure to be followed under Article 11(9)

125. The advantages and disadvantages are the opposite of those of Option 1.
126. Preferred option: given the considerations above, these draft RTS propose Option 1 as the preferred option.

Procedure to be followed under Article 11(10)

Option 1: to set a maximum period of three months for the competent authority to notify the counterparty of its decision regarding the exemption

127. Article 11(10) specifies the procedure to be followed when one counterparty to an intragroup transaction is an FC within the meaning of Article 2(8) of the EMIR and the other counterparty is an NFC within the meaning of Article 2(9) of the EMIR.
128. Under Article 11(10), an IGT is exempted on the basis of a positive decision of the competent authority of the FC, under the condition that the competent authority of the NFC does not object.
129. Option 1 requires that (1) the competent authority of the FC informs the competent authority of the NFC within two months of receipt of the application and (2) the competent authority of the FC notifies the FC of the decision within three months of receipt of the application.
130. Under Article 11(10), the counterparties are required to wait until the decision is made to make use of the exemption. There is no a priori exemption, unlike in cases where the competent authorities merely have the option of objecting to the use of the exemption. Therefore, it is crucial for the counterparties to have a fixed timeline within which their request for exemption is granted or refused.



131. While the timeline within which the competent authority shall notify the counterparty of its decision is not defined in Article 11(10), it is set at 30 calendar days in Article 11(6) concerning intragroup transactions between two FCs. Setting the period at three months provides an FC applying under Article 11(10) with certainty about the period of time during which its exemption shall be granted or refused. It also ensures consistency with Article 11(6), although a longer time period (3 months instead of 30 calendar days) is justified by the fact that the other counterparty is an NFC.
132. Article 11(10) requires the competent authority of the FC to notify the other competent authority of its decision and provides the latter with the option of objecting to the decision of the former. Option 1 proposes the establishment of a timeline within which those communications should be made, to ensure that the FC is made aware of the final decision no later than three months after the submission of its application. Therefore, the competent authority of the FC should notify the other competent authority of its decision within two months, leaving one month for the two authorities to agree on the final decision to be communicated to the FC within three months.
133. A disadvantage of this approach would be that the main cost of this option would be borne by the competent authority of the FC as it would need to be ready to communicate its decision to the other competent authority within two months of receipt of the application.

Option 2: not to further specify the procedure to be followed under Article 11(10)

134. The advantages and disadvantages are the opposite of those of Option 1.
135. Preferred option: given the considerations above, these draft RTS propose Option 1 as the preferred option.

Procedure to be followed after an exemption has been granted

Option 1: to require counterparties benefitting from an exemption to inform the competent authority in the event of a change that could affect the fulfilment of the conditions under which the exemption has been granted

136. An exemption from the requirements of Article 11(3) is granted on the basis of a number of conditions stipulated in Article 3 and in Article 11(6) to 11(10). It may be the case that, at a certain point in time, a counterparty has been granted an exemption and, at later point in time, there is a change (e.g. in the risk-management procedures of the counterparty) affecting the fulfilment of the conditions under which the exemption has been granted. This change could mean that if the counterparty were to submit another application after the change had occurred, the exemption would not be granted. By requiring the counterparties benefitting from an exemption to inform the competent authority in the event of a change that could affect the fulfilment of the conditions under which the exemption has been granted, Option 1 ensures equal treatment between all counterparties. Furthermore, it ensures that the competent authority is comfortable at all times that the conditions under which the exemption has been granted continue to be



fulfilled, as well as ensuring that it is able to reassess the exemption after such a change has occurred.

137. A disadvantage of this option is that it entails additional costs for both the counterparty and the competent authority, as the exemption cannot be considered as having been granted once and for all. It requires counterparties to monitor changes that may affect the fulfilment of the conditions under which the exemption has been granted. It requires competent authorities to reassess the conditions upon receipt of a notification of those changes.

Option 2: not to further specify the procedure to be followed after an exemption has been granted

138. The advantages and disadvantages are the opposite of those of Option 1.
139. Preferred option: given the considerations above, these draft RTS propose Option 1 as the preferred option.

How should practical and legal impediments be defined?

Option 1: define specific cases in which practical and legal impediments are envisaged

140. This option has the following advantages:
- a) limiting legal uncertainty for counterparties applying for the exemption;
 - b) providing guidance to the competent authorities on the criteria for granting the exemption;
 - c) limiting disputes or divergent assessments between competent authorities.
141. A disadvantage is that this approach might be seen as too specific, limiting significantly the cases in which the exemption can be granted. However, it should be noted that it was the specific intention of the legislator when adopting the EMIR to apply this exemption in a restrictive manner. This is the reason for all the different procedures to be followed depending on the counterparties involved and for the inclusion of the reference to practical and legal impediments, with a mandate to ESMA to further specify what those practical and legal impediments are.

Option 2: define in a very broad manner what practical legal and impediments might be

142. The advantages and disadvantages are the opposite of those of Option 1. In addition, this option would not respect in full the mandate given to ESMA to develop technical standards.
143. Preferred option: given the considerations above, these draft RTS propose Option 1 as the preferred option.



Should restrictions stemming from insolvency, resolution or similar regimes be included in the legal impediments?

Option 1: including the restrictions

144. This option has the advantage of specifying one particular case of legal impediment, with the advantages and disadvantages described in the previous section. In addition, these restrictions are the typical restrictions impeding the proper transfer of funds between entities of the same group.
145. If one entity within a group does not have access to the funds necessary to liquidate its exposure with another entity of the same group that has entered into insolvency and an IGT exemption is granted, the first entity would have an uncollateralised exposure with an entity of the same group and would face all the risks stemming from the default of the second entity, which is exactly the situation that the bilateral margin requirements are intended to avoid’.
146. However, different insolvency rules affect IGTs and many of those rules limit the prompt transfer of funds, from an operational or legal perspective. If applied in a restrictive manner, reference to insolvency proceedings might leave a very limited number of transactions benefitting from the exemption.

Option 2: excluding the restrictions

147. The advantages and disadvantages are the opposite of those of Option 1 (including the restrictions).
148. Preferred option: given the considerations above, these draft RTS propose Option 1 as the preferred option.

4.1.5 Quantitative analysis

149. This section describes the baseline for the RTS in the EU market for non-centrally cleared derivatives. The statistics are based on the most recent comparable data. Describing the baseline, i.e. the current situation in the EU market, helps the reader to understand the magnitude of the current problem and the potential improvements in the market that the technical options under the current RTS are intended to achieve.

4.1.6 Introduction and main findings

150. The descriptive statistics partially complement the arguments presented in Section 2.1.1, ‘Problem definition’, Section 2.1.1, ‘Baseline’, and Section 2.1.3, ‘Assessment of technical options’, and provide insights on:
- a) the value of non-centrally cleared derivatives in the EU market;



- b) the value of OTC derivatives that are cleared bilaterally under the current RTS and those that fall under the central clearing mechanism;
 - c) the impact of the threshold regime on the EU market for non-centrally cleared derivatives; and
 - d) the effect of the phase-in requirements on the total notional amount of derivatives.
151. The BCBS-IOSCO quantitative impact study on margins (Basel-QIS) launched a quantitative survey in July 2012 before the final proposal for margin requirements for non-centrally cleared derivatives to assess the liquidity costs of margin requirements for non-centrally cleared OTC derivatives. The results were published together with the revised version of the international standards⁷ (the second consultative document).
152. This section aims to give an overview of the liquidity costs that are generated by the margin requirements in the EU market. It is believed that the data available will be sufficient for the purposes of this impact assessment, considering that the further collection of data would represent a significant burden for counterparties.
153. The ESAs have engaged with industry experts and stakeholders to monitor the initiatives of the market participants and the extent to which they will influence the impact of this regulation, most notably the introduction of common internal models with a widespread application.
154. Furthermore, an overview of the initial phase of the transitional provisions shows the coverage of the non-centrally cleared OTC derivative markets during the transitional period, giving a rough indication of the number of counterparties.
155. The assessment has been undertaken on the assumption that the figures provided by the European contributors, despite their limited number, were a reasonably good representation of the liquidity costs across the EU. Furthermore, the implementation of the EUR 50 million threshold impacted heavily on the overall initial margin requirements. The BCBS-IOSCO quantitative impact study was conducted on the assumption that the threshold was available at counterparty level, but the final framework only allows it at consolidated group level.
156. This analysis shows that:
- a) looking both at notional amounts and at the initial margin requirements, European institutions make up around half of the overall sample;
 - b) the results for the EU concerning the proportion of OTC derivatives expected to be subject to central clearing and the levels of initial margins estimated under the internal models are broadly in line with the results of the BCBS-IOSCO findings; and

⁷ [Margin requirements for non-centrally cleared derivatives – Second consultative document](#), issued by BCBS and IOSCO in February 2013.



- c) the overall estimate of initial margin requirements for the EU ranges from EUR 200 billion to EUR 420 billion. The details of the calculation of these estimates are reported in Section 4.1.8. The following sections elaborate on all of these aspects in greater detail.

157. The ESAs will, however, continue to follow the work of the expert group that the BCBS and IOSCO set up to monitor the implementation of the margin framework in the various jurisdictions. Therefore, any potential changes in the overall impact of this reform will be noted.

4.1.7 Methodology and assumptions

158. For the QIS, the BCBS and IOSCO collected information with a reference date of 30 June 2012. Nonetheless, some of the respondents provided the most recent data available. For this analysis, the ESAs asked the national competent authorities that are also members of the BCBS or IOSCO to disclose the same data sets reported to the BIS for its exercise. Therefore, the global and European results should be comparable. For this analysis, the data sample comprises 20 institutions from 6 jurisdictions⁸ in the EU, in comparison with 39 respondents (of which 36 were banks or insurers) from 10 jurisdictions to the global QIS. The data were reviewed by national supervisors in September 2012 to ensure quality, accuracy and consistency⁹.

159. For this analysis, the ESAs followed roughly the same approach used by the BCBS and IOSCO in their analysis. Most of the uncertainty with regard to these results is because the assumptions of the original survey do not fit the final framework perfectly, in particular:

- a) This study is based on two calculation methods, namely the standard schedule and internal estimates of the initial margins; the possible introduction of widely used third party models is not taken into account.
- b) The estimates delivered for the QIS were based on the assumption of the first consultative document¹⁰ that the threshold could apply at counterparty level; the current draft RTS prescribe that the EUR 50 million threshold can be implemented only at group level.
- c) The results of the global QIS survey disclosed in the second consultative document were based on the assumption that no netting would be allowed in the standard model (the 'standard schedule' in the terminology used by BCBS-IOSCO). However, the final draft RTS assume that using the standardised method, netting benefits can

⁸ Fifteen banks, two insurers, one in the utility sector, one non-financial and one classified as 'other', from France, Germany, Italy, the Netherlands, Spain and the United Kingdom.

⁹ In addition to the data collected during the survey, other sources and references were used, such as the FSB progress report on OTC derivative reform, the BIS official statistics and the data on EU banks provided by SNL Financial.

¹⁰ [Margin requirements for non-centrally-cleared derivatives – consultative document](#), issued by BCBS and IOSCO on 6 July 2012.



be captured by applying the net-to-gross ratio (NGR). Firstly, this analysis cannot really be adjusted for that. Secondly, this means that the estimates relating to the standardised model can be interpreted as an upper limit.

- d) The same correction factors are applied to rescale the data from the FSB estimates and the global QIS estimates to take into account differences in the sample of data providers. These adjustments may not perfectly fit the conditions of the European market.

160. For example, the overall non-centrally cleared derivative activity in the EU can be estimated by comparison with the results of the BCBS-IOSCO QIS.

4.1.8 Summary of the results

161. Making an appropriate comparison with the QIS conducted by BCBS-IOSCO is a non-trivial exercise for which a number of considerations need to be taken into account. Firstly, the data presented by BCBS-IOSCO underwent a data cleansing procedure that took into account double reporting, i.e. two counterparties reporting the same trade, and adjustments for the fact that the full sample did not cover all banks. This complicates an outright comparison, as the same procedures cannot be consistently applied to the EU sample.

162. Consequently, a number of assumptions have to be made, in particular that the European markets mirror to a large extent the conditions in the global derivative markets. This assumption does not appear to be particularly controversial given the global nature of the derivative markets. Any scaling in the BCBS-IOSCO quantitative impact study is consequently also reflected in the European analysis. However, this does introduce some elements of estimation error.

163. Tables 1 and 2 provide an idea of the proportion of European respondents in the BCBS-IOSCO sample.

Table 1: European and global derivative activity according to underlying asset classes (in EUR billion). These results include centrally and non-centrally cleared derivatives.

Respondents	Foreign exchange	Interest rate	Credit	Equity	Commodity	Other	Current total gross notional outstanding
EU	26 182	107 029	8 912	3 208	478	132	145 939
BCBS-	54 958	230 136	24 265	6 596	2 027	515	318 497

164. The overall size of the EU OTC market, prior to the introduction of centralised clearing, is around EUR 146 billion among the participants in the EU sample, which covers the largest European counterparties. Table 1 shows that the EU counterparties make up 46% of the overall QIS sample and that the majority of EU exposures stem from foreign exchange and

¹¹ Compare with Table 2, row 1, p. 29 of the second consultative document.



interest rate derivatives. The total proportion is slightly higher than the figures presented in other surveys investigating the European derivative market, probably reflecting an over-representation of European institutions in the BCBS-IOSCO QIS.

165. However, the above figures are affected by a number of issues, as some contracts have been double-counted, as counterparties have individually reported their overall activity. Therefore, trades that both counterparties have reported will have been included twice. This is difficult to adjust for, given that it requires details of the specific counterparties, so the unadjusted numbers are presented and provide an upper limit. However, adjustments have been made to account for the differences in sample size and the size of the overall derivative market.

Table 2: QIS data for EU countries: non-centrally cleared derivative activity after central clearing takes effect (in EUR billion).

Respondents	Foreign exchange	Interest rate	Credit	Equity	Commodity	Other	Total gross notional outstanding
EU	21 447	48 338	3 392	1 469	233	42	74 920
BCBS-IOSCO ¹² (adjusted)	47 863	107 209	12 132	2 908	1 212	409	171 733

166. The notional amount of derivative contracts, presented on a gross basis, shows that potentially EUR 75 trillion of derivatives could fall under the scope of the current RTS. However, in practice, the amount will be significantly lower, as contracts between the large counterparties in the sample have been counted twice, not all counterparties will be above the EUR 8 billion threshold applying from 2019 and physically settled foreign exchange contracts will not be subject to initial margins. Consequently, the overall potential for non-centrally cleared contracts is expected to be substantially lower.

4.1.9 Estimates for the European market

167. In this section, the estimates based on the European sample are compared with the results published in the second consultative document.
168. The estimates based on the European sample are labelled 'EU'. In all the tables below figures are reported in EUR billion and rounded to the nearest billion for readability.

Table 3: QIS data for EU countries: non-centrally cleared derivative activity before and after central clearing takes effect (in EUR billion)

Respondents		Foreign exchange	Interest rate	Credit	Equity	Commodity	Other	Total gross notional outstanding
EU	Before	26 181	107 029	8 912	3 208	478	132	145 939

¹² Table 3, p. 30 of the second consultative document.



Respondents		Foreign exchange	Interest rate	Credit	Equity	Commodity	Other	Total gross notional outstanding
	After	21 447	48 338	3 392	1 469	233	42	74 920
	Reduction	18%	55%	62%	54%	51%	68%	49%
	Before	54 958	230 136	24 265	6 596	2 027	515	318 497
BCBS-IOSCO ¹³	After	47 863	107 209	12 132	2 908	1 212	409	171 733
	Reduction	13%	53%	50%	56%	40%	21%	46%

169. Table 3 summarises the previous tables, presenting a breakdown of the derivatives that are expected to be centrally cleared and those that are expected to be non-centrally cleared as gross notional amounts. The last row in the table shows that the estimated reduction in the total gross notional outstanding amount after mandatory clearing enters into force is about 49%.

170. Once an estimate of the overall non-centrally cleared derivative activity is available, a comparison can be carried out between the current practice concerning the exchange of initial margins and the amount of initial margins collected after the full implementation of the margin framework. This is based on the simplifying assumption that the overall activity in 2019, the end of the phase-in period, and the data used for this analysis remain similar.

171. In line with the supervisory guidance on foreign exchange transactions,¹⁴ these draft RTS prescribe minimum regulation for the exchange of variation margins but not for initial margins relating to physically settled FX forwards and swaps (and a similar treatment of cross-currency swaps). Table 4 gives an overview of the activity relating to these kinds of derivatives and compares the EU estimates with the BCBS-IOSCO estimates.

Table 4: Gross notional outstanding amounts (EUR billion) of foreign exchange OTC derivatives (after CCP clearing) subject to these RTS.

Respondents	Foreign exchange swaps and forwards			
	Maturity < 1 month	Maturity between 1 and 6 months	Maturity between 6 months and 1 year	FX derivatives after removing swaps and forwards included in the other columns
EU	2 247	3 548	1 252	14 401
BCBS-IOSCO ¹⁵	8 225	12 510	4 212	47 863

172. It should be noted that Table 4 refers to non-centrally cleared transactions after mandatory clearing. The figures represent a significant amount, yet a relatively small proportion of all

¹³ Table 3, p. 30 of the second consultative document.

¹⁴ [Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions](#), issued by BCBS in February 2013.

¹⁵ Table 6, p. 33 of the second consultative document.



derivatives subject to margin requirements. It should be noted that, under this proposal, physically settled FX forwards and swaps are subject to a variation margin but not to an initial margin.

173. With regard to existing practices, only very limited initial margins are exchanged today, as illustrated in Table 5.

Table 5: Comparison between estimated and provided initial margin amount under the current practice (EUR billion)

Respondents	Total notional outstanding	Initial margin posted	Initial margin collected
EU	145 939	2	37
BCBS-IOSCO ¹⁶	318 497	6	95

174. The exchange of variation margins seems to be common practice among financial institutions but the exchange of initial margins is rare. Initial margins are currently collected under very specific circumstances and only with respect to certain counterparties. Therefore, the estimate of approximately EUR 100 billion on a global basis and less than EUR 40 billion in the EU for initial margins currently collected is in line with expectations.

175. The introduction of the EUR 50 million threshold (the threshold) has a substantial impact on the overall amount of initial margin required. Data are available only on the assumption that the threshold is applied at counterparty level. These draft RTS prescribe that the threshold can be applied only to the total amount of initial margin required when calculated at consolidated group level.

176. The BCBS and IOSCO report the final results as an estimate of the effects that the introduction of the threshold would have on top of the possibility of allowing netting among asset classes. These results are shown in Table 6 and compared with the EU estimates in the following table. The netting effect, although not negligible, is limited to around 8–14%. The last column is obtained by multiplying the estimates based on the QIS sample by 1.3, i.e. the assumption is that the Basel-QIS sample covers around 75% of the global market.

Table 6: Initial margin requirements under the threshold regime, global estimates

Initial margin requirements			
Threshold level (EUR million)	QIS-sample No netting across asset classes (EUR billion)	QIS-sample Netting across asset classes (EUR billion)	Rescaled to global market ¹⁷ No netting (EUR billion)

¹⁶ Table 4a, p. 31 of the second consultative document.

¹⁷ Rescaled to entire global market: second column (no netting) multiplied by 1.3 = 1/75%.



Initial margin requirements				
BCBS-IOSCO ¹⁸	0	1 271	1 095	1 652
	50	558	513	725

177. The results of the BCBS and IOSCO survey show that the overall impact, i.e. the amount of initial margin required once the framework enters fully into force, varies between EUR 1.7 trillion (threshold set to 0) and EUR 0.7 trillion (threshold set to EUR 50 million).¹⁹

178. With the same assumptions, a similar range can be estimated specifically for the EU, based on the European sample. To avoid double counting, the second and third columns were estimated using only the margins collected.

Table 7: Initial margin requirements under the threshold regime, European estimates

Initial margin requirements				
	Threshold level (EUR million)	European sample No netting across asset classes (EUR billion)	European sample Netting across asset classes (EUR billion)	Rescaled to EU market ²⁰ No netting (EUR billion)
EU	0	323	260	420
	50	155	116	201

4.1.10 Scheduled implementation in the European Union (phase-in)

179. EBA evaluated the phase-in requirements using available public data. Data were extracted from SNL Financial reports for year-end 2012. The data sample covers 143 banks from 25 different European countries, representing a total notional amount of EUR 233 874 billion.

180. In the sample, the number of banks subject to initial margin requirements during the phase-in described in the final article of the draft RTS, assuming unchanged derivative activity, will be relatively limited during the first four years. However, it should also be noted that Table 8 refers only to banks and not to other counterparties and therefore only provides a lower limit for the counterparties subject to the requirements.

181. However, it should also be noted that the EUR 3 trillion threshold for the first period does not exactly identify the amount of transactions that will be subject to initial margin requirements in the first phase. This is due to the fact that counterparties exceeding the

¹⁸ Table 5, p. 32 of the second consultative document.

¹⁹ Second consultative document, p. 33.

²⁰ Rescaled to entire EU market: second column (no netting) multiplied by 1.3 =1/75%.



EUR 3 trillion threshold will be subject to initial margin requirements only if their counterparty also meets the same condition. In other words, the exchange of collateral for initial margin will be required only if both counterparties are above the threshold. The ESAs estimate that fewer than half of the contracts in question will actually meet this condition as of September 2016.

Table 8: Phase-in thresholds for initial margin requirements (EUR billion)

Phase-in dates	Thresholds	Number of institutions above the threshold
1 September 2016	3 000	12
1 September 2017	2 250	13
1 September 2018	1 500	14
1 September 2019	750	17
1 September 2020	8	59

182. In terms of number of institutions, and not necessarily in terms of the amount of margin to be collected, the largest implementation burden will be at the end of the phase-in period.



4.2 Feedback on the public consultation

The feedback on the public consultations is available as a separate file at the [regulatory page of the RTS](#).