Initial Margin Requirements for Uncleared Derivatives Fact Sheet

BNP PARIBAS

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All in-scope entities will have to exchange initial margin (IM) for eligible uncleared derivative contracts entered into after the relevant phase-in dates. The following factsheet gives an overview of Regulatory Initial Margin and answers the most frequent questions[1].

BACKGROUND

The requirement to exchange initial margin arises from the G20's response to the economic and financial crisis that began in 2007 and required that:

- All standardised OTC derivatives should be traded on exchanges or electronic platforms, where appropriate and cleared through central counterparties (CCPs)
- Non-centrally cleared derivatives contracts should be subject to higher capital requirements

SCOPE

Which entities are in-scope?

Entities will need to assess themselves whether they are in-scope or not. All entities that are already in scope for variation margin and are expected to exceed the relevant IM threshold should be considered as being in-scope.

The threshold under EU EMIR is determined by reference to the outstanding aggregate average notional amount (AANA) of uncleared OTC derivatives for March, April and May prior to the implementation date which is now the 1st Jan of each year going forward. This should be calculated at counterparty group level. These calculations can be complex and in order to allow sufficient time for contractual negotiations (and other preparations) you should consider estimating the AANA several months in advance of the go-live date. Please also allow sufficient time for custodians to onboard you and to activate your account.

Both parties to the transactions are impacted. Be aware that depending on where you are located and where your trades are booked, regulations in multiple regimes may apply – for instance, those of the EU (European Market infrastructure regulation (EMIR)), the UK, the US, Australia, Canada Hong Kong, Japan, Singapore, Switzerland etc. You should discuss this with your professional advisers.

What are the eligible products?

Generally, the rules apply globally to all uncleared OTC derivative transactions, although there are some jurisdictional differences in relation to issues such as the treatment of equity options.

Under EU EMIR, Entities may agree not to collect IM on physically-settled foreign exchange forwards and swaps, or the principal in relation to cross-currency swaps. There are also temporary exemptions under EU EMIR for IM in relation to single-stock equity options and index options.

Regulatory Initial Margin

Timelines

1 September 2016 onwards

Gradual phase-in for initial margin requirements for groups whose aggregate month-end average notional amount of non-centrally cleared derivatives for March, April, and May of the respective year exceeds:

- 2016/17: €3 trillion
- 2017: €2.25 trillion
- 2018: €1.5 trillion
- 2019: €0.75 trillion
- 2021: €50 billion
- 2022: €8 billion

Then 1st Jan each year following the annual AANA calculation period for EMIR

Further information

If you wish to discuss further, please contact the BNP Paribas European Regulatory Reform team gminitialmarginclientrequests@uk.bnpparibas.com

[1] Please note that the focus of this communication is EU EMIR, that is to say, Regulation EU 648/2012 as amended and updated as of the date of this communication.

Summary of the main exemptions:

<table>
<tr><th colspan="2">Instrument Type</th><th>US Prudential Rules</th><th>Europe</th><th>Hong Kong</th><th>Japan</th><th>Australia</th><th>Singapore</th></tr>
<tr><td rowspan="4">FX</td><td>FX spot</td><td colspan="6">Exempted</td></tr>
<tr><td>Physically settled FX swaps</td><td>Exempted</td><td>Exempted from IM (VM still applies for some counterparts)</td><td colspan="4">Exempted</td></tr>
<tr><td>Physically settled FX Forwards</td><td>Exempted</td><td>Exempted from IM (VM still applies for some counterparts)</td><td colspan="4">Exempted</td></tr>
<tr><td>Principal payments on cross-currency swaps</td><td colspan="6">Principal exchanges are exempted from IM, other factors (e.g. interest coupons) are subject to IM</td></tr>
<tr><td rowspan="4">Securities</td><td>Option based on securities</td><td>Exempted</td><td>Exempted until Jan 2026</td><td>Exempted until Jan 2026</td><td colspan="2">Not exempted</td><td>Exempted</td></tr>
<tr><td>Option based on broad index</td><td>Exempted</td><td>Exempted until Jan 2026</td><td>Exempted until Jan 2026</td><td colspan="2">Not exempted</td><td>Exempted</td></tr>
<tr><td>Forward based on securities*</td><td>Exempted</td><td colspan="4">Not exempted</td><td>Exempted</td></tr>
<tr><td>Forward based on broad index</td><td>Exempted</td><td colspan="4">Not exempted</td><td>Exempted</td></tr>
<tr><td>Commodities</td><td>Physically settled forwards</td><td>Exempted</td><td>Exempted (subject to certain conditions)</td><td colspan="2">Exempted</td><td>Exempted (subject to certain conditions)</td><td>Exempted (subject to certain conditions)</td></tr>
</table>

Note: UST forwards are considered a swap and are therefore **in scope for IM (and Variable Margin (VM)), unless they are intended to be physically settled in which case they are out of scope under US Rules*

Conditions under which margin has to be exchanged

IM will be required only if both counterparties are eligible. Key points to note are:

- An in-scope entity is not required to post or receive initial margin until a threshold of EUR 50 million is reached (at group level) with its counterparty (again, at group level). Typically, an entity's group will distribute this threshold amount across their group entities which enter into OTC derivatives with a counterparty and other members of that counterparty's group. Once that threshold as stated for a counterparty pair is breached, eligible collateral[2] with a value equal to such excess over the threshold will have to be transferred in a regulatorily-compliant manner. This will be achieved by a transfer into a segregated pledge account with a third party custodian.

- Counterparties can agree between them a minimum transfer amount **(MTA)** for the exchange of initial margin and variation margin which **cannot be greater in the aggregate than €500,000** or the equivalent amount in another currency (at LEI level)**.** However, if the total collateral amount owed to the collateral taker exceeds the MTA, the collateral taker shall collect the full total collateral amount, without deduction of the MTA. Counterparties can agree on separate MTAs for IM and VM, provided that the sum does not exceed €500,000

- Only new in-scope transactions are subject to the requirement after the respective phase-in date. Legacy transactions are generally exempted, unless there are changes to the trade economics e.g. an increase in notional.

What is the EU EMIR non-netting jurisdiction exemption?

Under EU EMIR, there are specific exemptions to the requirement to provide initial margin and variation margin in relation to OTC derivative transactions with counterparties in a third country where (i)the required segregation of initial margin cannot be achieved and/or the (ii) netting agreement or exchange of collateral agreement cannot be enforced with certainty at all times. This is not an automatic exemption and is based on the monitoring of applicable legal opinions. There is also a maximum amount of OTC derivatives, calculated at the level of the BNP Paribas group, which can benefit from this exemption and is subject to internal monitoring.

[2] Regulatory haircuts also apply

What is the timeline for the regulatory Initial Margin requirement?

The initial margin requirement has been phased in over a number of stages since 2016, the large waves have all now passed. The last large wave was 1st Sept 2022, the AANA threshold is shown below which is to be applied going forward:

From:	US/CFTC (USD)	CA (CAD)	EU (EMIR) (EUR)	JP (JPY)	AU (AUD)	HK (HKD)	KR (KRW)	SG (SGD)
2022	8bn	12bn	8bn	1.1tr	12bn	60bn	10 tr	13bn

However, it is the responsibility of clients to check annually if they exceed the AANA for that year. if exceeded, under EU EMIR they will be in scope from 1st Jan of the following year. So, for example, if an in-scope entity breaches the threshold by reference to its group AANA for March, April and May 2024, that group will come into scope for Regulatory Initial Margin under EU EMIR as from 1st January 2025.

Earlier phases are summarised below:

From	Threshold (AANA)
December 2016 / February 2017	€3 trillion
September 1 2017	€2.25 trillion
September 1 2018	€1.5 trillion
September 1 2019	€0.75 trillion
September 1 2021	€50 billion

All of the group's non-centrally cleared derivatives, including foreign exchange forwards, swaps and currency swaps, shall be included in the AANA calculation

Please note: The BNP Paribas group has been subject to regulatory initial margin requirements under relevant regimes since 1st September 2016.

ELIGIBILITY AND TREATMENT OF COLLATERAL

What are the main collateral management principles?

There are specific collateral standards under the rules under different regimes, but they share the same general principles. The EU requirements are set out below as a guide:

- Assets posted as collateral should be highly liquid and, after accounting for an appropriate haircut, be able to hold their value in a time of financial stress (as noted in the BCBS-IOSCO document entitled "Margin requirements for non-centrally cleared derivatives" revised March 2015)

- Segregation: Collateral collected as initial margin shall be segregated from proprietary assets of the collecting counterparty, on the books and records of a third party holder or custodian, or via other legally effective arrangements (no segregation is required for variation margin)

- The collecting counterparty shall always provide the posting counterparty with the option to segregate its collateral from the assets of other posting counterparties (individual segregation)

- Re-hypothecation: The collecting counterparty shall not re-hypothecate, re-pledge nor otherwise re-use the collateral collected as initial margin

How to contact us

If you have any other comments or questions, please contact us at gminitialmarginclientrequests@uk.bnpparibas.com or your usual relationship or sales contact.