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For Immediate Release

ISDA Publishes New Academic Paper on Margin Requirements for Non-cleared Derivatives Market

MIAMI, April 25, 2018 – The International Swaps and Derivatives Association, Inc. (ISDA) has published a new academic paper that analyzes the regulatory initial margin framework for the non-cleared derivatives market. The academic paper, sponsored by ISDA, was written by Rama Cont, Chair of Mathematical Finance at Imperial College London.

The paper examines the rationale for the 10-day liquidity horizon applied under the initial margin rules for non-cleared trades, and assesses whether it is appropriate. The 10-day period is double the five days set for cleared trades.

The research argues that using a fixed liquidation horizon of 10 days is not realistic, and does not take the liquidity characteristics of the assets or the size of the position into account. Instead, the paper recommends that the liquidation horizon should depend on the size of the position relative to the market depth of the asset. It also argues that IM should not be based on the exposure of the initial position over the entire liquidation horizon, but on the exposure over the initial period required to set up the hedge, plus the exposure to the hedged position over the remainder of the liquidation horizon.

"The clearing of standardized derivatives was an explicit regulatory objective, but regulators also recognized the importance of a healthy non-cleared market to allow end users to precisely hedge bespoke risks. Now is the time to assess the risk-appropriateness of the regulatory framework, and whether the margin treatment for non-cleared trades is resulting in higher than necessary costs for end users," said Scott O'Malia, ISDA Chief Executive.

"The framework for calculating initial margin requirements has been imported from existing practices for cleared derivatives, except that regulators have increased the margin period of risk, presumably because there is a perception that non-cleared derivatives are intrinsically harder to close out or unwind if one counterparty defaults. Our study questions the rationale for this approach, and advocates an alternative that takes into account the default management process, as well as the size and complexity of trades," said Professor Cont.

Click here to read the full paper.

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About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 900 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter @ISDA.