Margin Approaches - The Relationship between Independent Amount and Initial Margin

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How to Determine Margin Call amounts when considering Independent Amounts and Initial Margin

This overview details the considerations to document and determine margin calls for independent amounts ("IA") and segregated regulatory initial margin ("IM"). It explains the three standard approaches included in the "next generation" initial margin documents published by ISDA in 2018 and 2019. In some cases the approach can reduce the amount of IA to be posted to reflect IM.

Definitions of key considerations

IM Trades: Transactions that are in scope for the regimes applicable to the parties trading relationship, entered into on or after the applicable Reg IM compliance date. *(Full list of in scope products can be found here)*

Life Cycle Events: Transactions that are in scope for the applicable regimes, entered into before the applicable regulatory IM compliance date, but brought into scope for IM compliance due to a trade lifecycle event after that date. *(Trade life cycle event guidance can be found here)*

VM: (Variation Margin) Variable margin payment collected to cover daily mark to market exposure on trades defined under documentation, but these will likely include trades entered into before and after the applicable regulatory IM compliance date.

IA: Independent Amount. This is bilaterally agreed between the parties and can be determined in several ways (e.g. percentage of notional amount, fixed IA amount, or any other methodology or approach).
  ➢ Segregation not necessary but may apply if agreed bilaterally
  ➢ If IA is determined by reference to trades, then the documentation will define in-scope trades, but these will likely include trades entered into before and after the applicable IM compliance date

IM: Regulatory calculation (SIMM/GRID)
  ➢ Collateral must be segregated as per uncleared margin rules.
  ➢ Trades in scope: IM Trades, including Lifecycle Events

IM Threshold: Maximum permitted regulatory IM threshold (USD 50 million or equivalent in other currencies). For simplicity, we assume in this paper that the parties always specify the maximum allowed threshold, but there could be reasons why the parties might specify a smaller threshold, in particular if the maximum permitted threshold needs to be shared among multiple accounts or affiliates. For a fuller discussion, see "Non-Cleared Initial Margin: By the Numbers", available here.

There are three standard approaches to consider which elections are made within the following documents:
- ➢ ISDA 2018 Credit Support Annex for Initial Margin (IM)
- ➢ ISDA 2018 Credit Support Deed for Initial Margin (IM)
- ➢ ISDA 2019 Bank Custodian Collateral Transfer Agreement for Initial Margin
- ➢ ISDA Clearstream Collateral Transfer Agreement (2019)
- ➢ ISDA Euroclear Collateral Transfer Agreement (2019)

A full summary of ISDA Initial margin documentation can be found here

1. Distinct Approach

Post two distinct independent flows with no offsets:
- ➢ IA required as defined in existing documentation between the parties
- ➢ IM required under IM document in respect of the IM trades

Result: Two separate margin flows under their two respective agreements without offsetting.

2. Allocated Approach

Posting two flows allocated across IA and IM with offsetting opportunity for IA only:
- ➢ The amount of IA required can be reduced by the amount due under the IM document (if any), floored at zero.
- ➢ This is achieved by an agreement in the IM document to amend the existing documentation so that the IA can be reduced by the IM posted.

Result: If the total amount of IA is larger than the IM, then the IA will be reduced by the amount of IM to be posted. Any IA still required to be transferred will be governed by the terms of the existing documentation. This will result in two separate flows where both IA and IM are required to be posted.

3. Greater of Approach

Posting one flow combined for both IA and IM, which is the larger of either amount.

- ➢ The IA amount is defined under existing documentation.
- ➢ The IM amount is defined under a new IM document in respect of new trades subject to regulatory IM.
- ➢ One margin flow being the greater of the two amounts above, is posted under the IM document. The IM document amends the IA documentation to achieve this outcome.

Result: Obligations for both IA and IM will be satisfied by delivery under the terms of the IM document. This means that all IA and IM will be subject to terms that comply with the IM regulations applicable to the parties' relationship, including segregation requirements, eligible collateral and haircuts.

Margin call calculation

Distinct Approach - Post two distinct independent flows with no offsets:
- ➢ Segregated Margin Call: Max (0, IM - IM Threshold)
- ➢ Non-segregated Margin Call: VM + IA

Allocated Approach – Assuming IA is not segregated and IM is segregated
- ➢ Segregated Margin Call: Max (0, IM - IM Threshold)
- ➢ Non-segregated Margin Call: VM + Excess IA

  - ○ Excess IA = Max (0, IA – Max (0, IM – IM Threshold))

Greater of Approach - IA and IM segregated in the same account
- ➢ Segregated Margin Call: Max (0, IA, IM - IM Threshold)
- ➢ Non-segregated Margin Call: VM

The following tables provide four examples of the various margin approaches:

Please note: The examples for the Distinct Approach and Allocated Approach below assume that IA is not segregated and is netted with VM.

DISTINCT MARGIN APPROACH	Example 1		Example 2	
Post two distinct independent flows with no offsets.	VM	55	VM	55
	IA	95	IA	95
	IM	45	IM	65
Note: IA is a fixed amount for these use cases	IM Threshold	50	IM Threshold	50
	Segregated margin call (45 minus 50 floored at 0)	0	**Segregated margin call (65 minus 50 floored at 0)**	15
	(No call not breaching IM Threshold)		(Amount above IM Threshold)	
	Non segregated margin call (55 plus 95)	150	**Non segregated margin call (55 plus 95)**	150
	(Net of VM and IA)		(Net of VM and IA)	
ALLOCATED MARGIN APPROACH	**Example 1**		**Example 2**	
Posting two flows allocated across IA and IM with potential reduction in IA.	VM	55	VM	55
	IA	95	IA	95
	IM	45	IM	65
	IM Threshold	50	IM Threshold	50
	Segregated margin call (45 minus 50 floored at 0)	0	**Segregated margin call (65 minus 50 floored at 0)**	15
	(No call not breaching IM Threshold)		(Amount above IM Threshold)	
	Non segregated margin call (55 plus the greater of 95-0 and 0)	150	**Non segregated margin call (55 plus the greater of 95-15 and 0)**	135
	(Net of VM and IA)		(Net of VM and IA reduced by IM)	
GREATER OF MARGIN APPROACH	**Example 1**		**Example 2**	
Posting one flow combined for both IA and IM which is the larger of either amount.	VM	55	VM	55
	IA	95	IA	95
	IM	45	IM	65
	IM Threshold	50	IM Threshold	50
	Segregated margin call (greater of 95 and 45-50 floored at 0)	95	**Segregated margin call (greater of 95 and 65-50 floored at 0)**	95
	(IA is larger than the amount of IM to be posted)		(IA is larger than the amount of IM to be posted)	
	Non segregated margin call (55)	55	**Non segregated margin call (55)**	55
	(VM only)		(VM only)	

DISTINCT MARGIN APPROACH	Example 3			Example 4	
				Demonstrates a negative VM	
Post two distinct independent flows	VM	55		VM	-55
with no offsets.	IA	95		IA	95
	IM	185		IM	70
Note: IA is a fixed amount for these use cases	IM Threshold	50		IM Threshold	50
	Segregated margin call (185 minus 50 floored at 0)	135		**Segregated margin call (70 minus 50 floored at 0)**	20
	(Amount above IM Threshold)			(Amount above IM Threshold)	
	Non segregated margin call (55 plus 95)	150		**Non segregated margin call (-55 plus 95)**	40
	(Net of VM and IA)			(Net of VM and IA)	
ALLOCATED MARGIN APPROACH	**Example 3**			**Example 4**	
				Demonstrates a negative VM	
Posting two flows allocated across IA	VM	55		VM	-55
and IM with potential reduction in IA.	IA	95		IA	95
	IM	185		IM	70
	IM Threshold	50		IM Threshold	50
	Segregated margin call (185 minus 50 floored at 0)	135		**Segregated margin call (70 minus 50 floored at 0)**	20
	(Amount above IM Threshold)			(Amount above IM Threshold)	
	Non segregated margin call (55 plus the greater of 95-135 and 0)	55		**Non segregated margin call (-55 plus the greater of 95-20 and 0)**	20
	(VM only, IA reduced to zero by IM)			(Net of VM and IA reduced by IM)	
GREATER OF MARGIN APPROACH	**Example 3**			**Example 4**	
				Demonstrates a negative VM	
Posting one flow combined for both IA and	VM	55		VM	-55
IM which is the larger of either amount.	IA	95		IA	95
	IM	185		IM	70
	IM Threshold	50		IM Threshold	50
	Segregated margin call (greater of 95 and 185-50 floored at 0)	135		**Segregated margin call (greater of 95 and 70-50 floored at 0)**	95
	(The amount of IM to be posted is larger than IA)			(IA is larger than the amount of IM to be posted)	
	Non segregated margin call (55)	55		**Non segregated margin call (-55)**	-55
	(VM only)			(VM only)	