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Initial Margin for UK Pension Schemes – how to be SMARTEST

Pension schemes are coming into scope of the Initial Margin (IM) rules applicable to uncleared OTC derivatives. You need to be checking now if these rules are going to affect you and, if so, how you are going to prepare for them.

Remember, the pension scheme exemption from the clearing obligation for OTC derivatives does not extend to Initial Margin, so you will have to assess whether you are impacted. This note will help you find the **SMARTEST** way to start your preparations.

S	Scope You need to assess whether you are in scope for IM. This will depend on the gross notional amount (see AANA) of uncleared OTC derivatives that you and your group have. Include all trades and all group companies. If you are above EUR50bn, then you are in scope for Phase 5 (ie you need to be IM ready by September 2020). A total above EUR8bn puts you in the frame for Phase 6 (Sept 2021). Then you need to find out which of your counterparties are also in scope.
M	Monitoring Being in scope for IM is one thing, but it doesn't mean that you will have to post margin. You can use the Threshold to reduce the amount you have to post, and it may mean that you don't have to repaper for IM at all right now. But you will want to agree with your counterparties how you are going to monitor your exposure (eg by using SIMM) so that you avoid inadvertent breaches of the rules.
A	AANA (or Aggregate Average Notional Amount). This is the value that strictly determines if you are in Scope . Calculate your average month-end notionals of uncleared derivatives in March, April and May 2020. In practice, you will have to decide if you are in scope much earlier than this.
R	Regimes You will be subject to the EU regime (EMIR), but your counterparty may well need to impose terms to ensure you are compliant with other regimes (eg the US rules). So you can't just ignore the other IM regimes around the world.
T	Threshold This is the lifesaver for IM if you would only be posting small amounts. You can have up to EUR50m of exposure before you have to post. But terms and conditions apply!
E	Eligible collateral Probably the hardest bit of IM is deciding what assets you are willing to post and to collect and then (a) checking that they are eligible across all applicable Regimes and (b) expressing them in a form and language that your Triparty custodian can understand. Not as easy as it sounds!
S	SIMM Whilst the rules set out a basic formula (called "grid") for calculating your IM exposure, using valuation models can dramatically reduce this. SIMM (Standard Initial Margin Model) is an ISDA published methodology that is widely used. You need a licence and it will take time to implement it (if you don't already have it) – so it is something to think about at an early stage.
T	Triparty v Third Party custody platforms One of the features of IM is that you will need to appoint a custodian to hold the Eligible collateral that you post (and so will your counterparty). In Triparty services your custodian will value assets and move collateral in and out of your pledged account automatically. Third party custodian services are passive so you will have to monitor your and your counterparty's posting to make sure it is enough.

For more information about Initial Margin, how it may affect you and how to prepare, please contact us.



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