



Best Practice Spotlight:

Non-netted Margin Call Workflow

In the collateralized OTC derivatives market, margin calls, interest statements and collateral substitutions have been delivered via various media, predominantly email. AcadiaSoft is replacing these communications with standard electronic collateral messages – communicated through its MarginSphere service (“MarginSphere”) – and working with market participants to integrate these messages into their workflows. AcadiaSoft’s Best Practices Group (“BPG”) plays an important role in this automation effort by identifying the challenges that have broad impact and defining the best practices required to achieve the most consistent messaging possible across the industry.

A key automation challenge that has been a focus of the BPG is how the industry should handle Non-netted Margin Call Workflows. The purpose of this document is to describe the best practices supporting these workflows.

NON-NETTED MARGIN CALL WORKFLOW OVERVIEW

The ISDA CSA agreement is commonly used to govern the use of credit support (collateral) in securing derivatives transactions. The CSA stipulates the treatment of independent amounts (“IA”) as either netted against Variation Margin (“VM”) or as non-netted, the latter requiring the posting of IA to the secured party regardless of the VM requirement. When combined with a collateral account control agreement, collateral can be held separately at a third party custodian.

When it comes to issuing margin calls for non-netted agreements, it is clear when one party of the agreement has to call for either (and just one of) IA or VM that a single call is made. In fact, the call would be the same whether the account permitted netting or not. However, when one party needs to call for both IA and VM on a non-netted agreement, questions have arisen on whether one or two calls are made and, in either case, what information is included within the call(s). This is the problem that is being addressed by this best practice.

For the purposes of defining non-netting workflow best practice, two different scenarios are considered:

1. **Non-Netted, Separate Collateral Balances**—The IA collateral balance must be distinct and held in a separate account as a result of IA segregation or independent credit support terms for IA and VM.
2. **Non-Netted, Combined Collateral Balance**—IA and VM collateral are both held in an account at the secured party or a custodian.

Differing views have surfaced on how to best handle both non-netted scenarios. Integrating counterparty systems with electronic messaging without a standard non-netting call workflow will increase development and support costs, add to the complexity of the messaging standard and reduce historical transparency for control functions (including regulatory entities).

As the existing ISDA documents, including “[Standards for the Electronic Exchange of OTC Derivative Margin Calls](#)” published in November 2009, do not specifically address processing at this level, the purpose of this effort was to provide the necessary detail to support electronic messaging for non-netted calls via MarginSphere.

BEST PRACTICE: SEPERATE IA AND VM COLLATERAL BALANCES

Most margining systems will view IA and VM calls as separate workflow items when separate collateral balances for IA and VM have to be maintained. This will generally be the case whenever IA-specific segregation is employed or when IA



and VM have certain independent credit support terms negotiated. Separate calls should be issued for IA and VM when this is the case.

IA-Specific Segregation

One or two CSAs can be used to establish IA segregation relationships. Accordingly, one or two AcadiaSoft agreement IDs can be used to support IA segregation. If two agreement IDs are used (one for IA and one for VM) a single call workflow should apply for each respective agreement.

If only one agreement ID is used, IA and VM calls should be made separately using the respective call type. When multiple calls are issued under a single agreement, a call completeness indicator should be included with each call for a given valuation date (i.e. call 1 of 1, call 1 of 2, call 2 of 2). This is necessary as a minority of systems may not see segregated IA and VM as separate workflows.

Independent Credit Support Terms

In some cases, credit support terms like Rounding and Minimum Transfer Amount (MTA) terms may be negotiated as independent for IA and VM under a single agreement. When this happens, collateral balances must be held separately so the terms can be applied to the unique deltas between IA and VM requirements and their respective collateral balances. Similar to IA segregation, separate calls should be made for IA and VM and a completeness indicator should be used. *In all non-netting, separate collateral balance cases:*

- Separate pledges should be used to meet the requirements for IA and VM
- When VM exposure swings from the favor of party A to the favor of party B, a single call should be issued by Party B with return and deliver amounts populated in the call message.
- When IA and VM requirements are in opposite directions, each counterparty should issue one call for IA or VM as appropriate.

BEST PRACTICE: NON-NETTED, COMBINED COLLATERAL BALANCE

When combined collateral balances are used for non-netting agreements, the majority of margining systems will see the combined IA/VM requirement as a single workflow item. As such, a one call model should be employed when a combined collateral balance can be used. Combined collateral balances will generally be used when applicable credit support terms are not independent for IA and VM and the IA collateral is not segregated from VM collateral.

In all non-netting, combined collateral balance cases:

- A single pledge can be used to meet the requirements for IA and VM
- A single call should be issued that specifies the IA and VM components of the total call requirement.
- Applicable credit support terms should be applied to the total call requirement
- When IA and VM requirements exist in opposite directions, each counterparty should issue one call for IA or VM as appropriate.

ACADIASOFT IMPLICATIONS

The Best Practices outlined above are largely supported by MarginSphere today – and with a small number of enhancements will be fully supported.

When the CSA does not permit netting and separate collateral balances must be maintained, a separate call should be sent out for IA and VM on MarginSphere. In this case, margin call fields should be populated as any other call with the following stipulations:

1. For the Initial Margin call:



- a. The margin call should specify a Call Type (callType XML) of Initial. The Total Call Amount field (totalCallAmount XML) should be populated with an amount equal to the Net Initial Margin Amount. This GUI inputs for this our illustrated below.

– *Call Details* –

Valuation Date:	10/10/2011
Currency:	GBP
Call Type:	Initial
Total Call Amount:	1,000,000.00

- b. Only the Initial Margin details should be provided – the Variation margin fields should not be populated. The Net Required Amount field (initialNetRequiredAmount XML) should equal the Total Call Amount in the Call Details. The MarginSphere GUI illustration is below.

– *Variance / Initial Margin* –

	Variation Margin	Initial Margin
Exposure:		10,000,000.00
Collateral Value:		9,000,000.00
Pending Collateral:		0.00
Net Required Amount:		1,000,000.00

2. For the Variation Margin call:

- a. The margin call should specify a Call Type (callType XML) of Variation. The Total Call Amount field (totalCallAmount XML) should be populated with an amount equal to the Net Variation Margin Amount. This GUI inputs for this our illustrated below.

– *Call Details* –

Valuation Date:	10/10/2011
Currency:	GBP
Call Type:	Variation
Total Call Amount:	1,000,000.00

- b. Only the Variation Margin details should be provided – the Initial margin fields should not be populated. The Net Required Amount field (initialNetRequiredAmount XML) should equal the Total Call Amount in the Call Details. The MarginSphere GUI illustration is below.



– ▾ Variance / Initial Margin

	Variation Margin	Initial Margin
Exposure:	2,000,000.00	
Collateral Value:	1,000,000.00	
Pending Collateral:	0.00	
Net Required Amount:	1,000,000.00	

3. A new completeness indicator should be populated with 1:2 (for one of two) or 2:2 (for two of two). This completeness indicator is currently being scheduled for a future MarginSphere release.

If collateral is held in a single collateral account, then a single call that sums IA and VM in a total amount and then, using fields in the message, provides the breakdown of the IA and VM sub totals for the call. In this case, margin call fields should be populated as any other call with the following stipulations:

1. Call details should specify a new call type of Consolidated (callType XML) and the Total Call Amount field (totalCallAmount XML) should be populated with the IA amount.

– Call Details

Valuation Date:	10/10/2011
Currency:	GBP
Call Type:	Consolidated
Total Call Amount:	1,000,000.00

2. The Variation/Initial Margin breakdown should be populated with both Variation and Initial Margin information and the sum of the two Net Required Amount fields (variationNetRequiredAmount and initialNetRequiredAmount XML) should equal the Total Call Amount in the Call Details.

– ▾ Variance / Initial Margin

	Variation Margin	Initial Margin
Exposure:	2,000,000.00	1,000,000.00
Collateral Value:	1,300,000.00	700,000.00
Pending Collateral:	0.00	0.00
Net Required Amount:	700,000.00	300,000.00



NON NETTED WORKFLOW EXAMPLES

The following examples have been created to help clarify how Non Netted Workflows would work in practice. They include a single workflow where an agreement is not to be netted but collateral is held in a single account. In addition, there are two examples provided for Non-Netted flows where two separate collateral balances are maintained – one for a segregated account and a second for a non-segregated account but where separate terms have been negotiated for IA and VM. These examples are detailed below.

Scenario 1: Non-Netted (Combined Collateral Balance)	
Both IA and VM collateral are held in the same account at the secured party or a custodian. MTA and Rounding are applied in aggregate to IA + VM exposure.	
VM Requirement	1,555,000
IA Requirement	1,025,000
Total Requirement	2,580,000
Actual Collateral	300,000
Pending Collateral	150,000
Total Collateral	450,000
Credit Support Amount	2,080,000
Rounding Amount	50,000
Minimum Transfer	150,000
Total Call Amount	2,150,000

Scenario 2: Non-Netted, Segregated IA Collateral Balance (Separate Collateral Balances)			
IA is held in a segregated account. Rounding and MTA identical for IA and VM, but applied independently to IA and VM Credit Support Amounts.			
IM		VM	
VM Requirement	1,555,000	VM Requirement	1,555,000
IA Requirement	1,025,000	IA Requirement	1,025,000
Total Requirement	2,580,000	Total Requirement	2,580,000
Actual Collateral	150,000	Actual Collateral	150,000
Pending Collateral	150,000	Pending Collateral	0
Total Collateral	300,000	Total Collateral	150,000
Credit Support Amount	725,000	Credit Support Amount	1,405,000
IA Rounding Amount	50,000	VM Rounding Amount	50,000
IA Minimum Transfer Amount	150,000	VM Minimum Transfer Amount	150,000
IA Call Amount	750,000	VM Call Amount	1,450,000



Scenario 3: Non-Netted, Independent Rounding and MTA Terms (Separate Collateral Balances)			
Different Rounding and MTA terms have been negotiated for IA and VM. Separate collateral balances must be maintained to derive the call amounts.			
IM		VM	
VM Requirement	1,555,000	VM Requirement	1,555,000
IA Requirement	1,025,000	IA Requirement	1,025,000
Total Requirement	2,580,000	Total Requirement	2,580,000
Actual Collateral	150,000	Actual Collateral	150,000
Pending Collateral	150,000	Pending Collateral	0
Total Collateral	300,000	Total Collateral	150,000
Credit Support Amount	725,000	Credit Support Amount	1,405,000
IA Rounding Amount	50,000	VM Rounding Amount	100,000
IA Minimum Transfer Amount	150,000	VM Minimum Transfer Amount	250,000
IA Call Amount	750,000	VM Call Amount	1,500,000

Non-Netted Calls – At a Glance

- Non-netted, Combined Balance– One Call
- Non-netted, Separate Balance – Two calls
- Be mindful of:
 - Apply only when party calls for both IM and VM
 - When two calls, indicate completeness
 - When one call, populate IM and VM amounts

About AcadiaSoft, Inc.

AcadiaSoft, Inc. offers a unified collateral management workflow environment that streamlines communications between dealers and investment managers in the global OTC derivatives market. It allows market participants to communicate vital information on exposures, commitments and adjustments between counterparties in a complete, verifiable and secure manner. Designed for both sell-side and buy-side, the platform provides a simple solution to the complex issues associated with collateral management workflow thereby reducing operational risk, saving time and resources and improving transparency.

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