Introduction

The following is meant to be a general overview of how phase 1 firms have organized themselves from an operations and organizational perspective around the new IM margin and reconciliation processes.

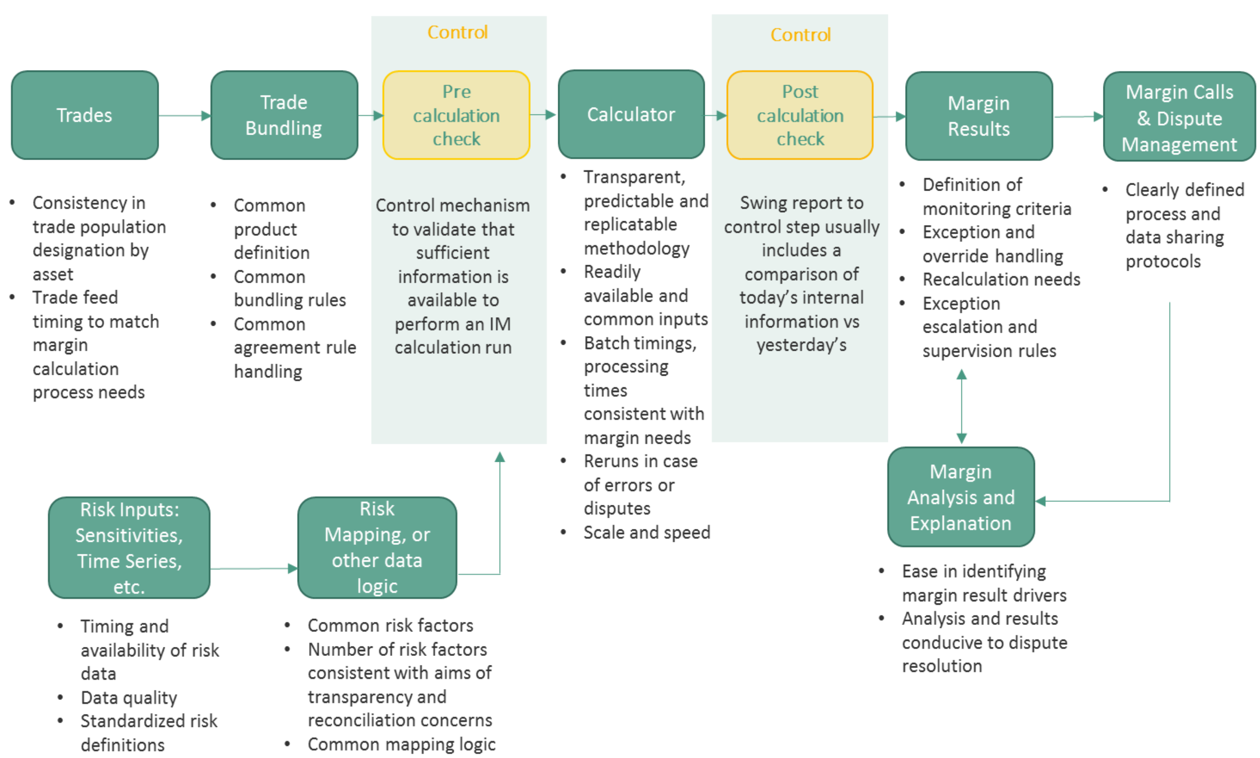
Trade & Sensitivity Processing

Generally speaking, while acknowledging the differences in reconciling trade level pv's which are additive at a portfolio level on the VM side vs the expression of risk down to a sensitivity level on the IM side - there are similarities to the VM reconciliation process but also some important differences to point out.

Pre-IM Calculation

From a pre-IM calculation perspective, similar to the VM process, most firms have in place a control mechanism that ensures on a regular basis that the appropriate information has been received prior to initiating an IM exposure calculation.

Have all trade and sensitivity feeds been received with the expected SLA? If not, when will I receive them? How complete are they? Do I need to revert back to yesterday's data to calculate IM in time to make my margin call cut-off time? From a policy perspective, how long will I tolerate a fallback to stale risk before I escalate to senior management? These are the types of activities and statistics that are monitored by the IM Calc Control Team.



Post IM Calculation

Once the pre-calc control process has validated that sufficient information is available to perform an IM calculation run – IM exposure is calculated and the next step in the validation & control process takes place. This Post IM calculation control step usually includes a comparison of today's internal information vs yesterday's. This report is sometimes referred to as a swing report. In this step, the control team is generally looking for trade feed or processing errors that may cause large swings in IM exposure and or trade count differences.

Margin Call Calculation

Once the control team has validated the data is of sufficient quality to stand as the record of IM exposure to be include in the calculation of IM margin – an "IM margin call run" is initiated and an IM Margin Requirement calculation is performed. If no issues are observed during the "run" – margin calls and statements are sent to clients.

Simultaneous Submission of IM Data, Trades & Sensitivities and Margin Calls to AcadiaSoft

At the same time that margin calls are released to clients either via AcadiaSoft or email, firms send their trades and sensitivities to AcadiaSoft. As Best Practice, Acadiasoft suggests that firms provide their data before 9AM GMT each day.

Reviewing IM Reconciliation Results

Once reconciliation results are available, firms begin the work of reviewing results and working on resolving differences.

Operational Break - Unmatched Trades

The existing port rec team is most commonly responsible for researching operational breaks such as unmatched trades. These individuals have the most practical experience in resolving unmatched trade breaks and they also have access to the internal and external confirmation tools to complete their investigation and determine who is right or wrong.

Operational Break - Miss-Matched Portfolios

One new type of IM break that a firm's port rec team is responsible for is an unmatched trade that results from one firm booking the trade in the legacy portfolio and the other firm booking the trade in the post compliance date portfolio. As firms fine tune their trade mapping process, there could be some noise in the trade allocation process until software code is updated to route trades to the correct legacy or post compliance date portfolio.

Matched Trades

Firms have assembled a new team to work on matched trades with IM differences. These individuals are either in market or collateral risk and maintain some quantitative skills. This team of "SIMM Analysists" is responsible for investigating and liaising with the appropriate front or middle office personnel to resolve differences on matched trades.

Missing Risk

Once common IM difference associated with matched trades is missing risk. In this example, one firm may have included in their calculation - risk that another firm has mistakenly excluded. It is at this point in the process that both firms may agree to reveal to each other, sensitivities below the Net Sensitivity level. Once the SIMM Analyst team confirms the counterparty approach to calculating risk – they then liaise with their own internal middle office to understand how the trade risk has been calculated and whether anything has been improperly excluded on the firm's side.

Other common IM issues associated with Matched trades includes asset class and ISIN mapping differences.

Model Differences

Once the SIMM Analyst team has worked with the counterparty and their own internal middle office to resolve missing risk or asset class or ISIN mapping issues – differences may still remain on the IM amounts associated with a matched trade. In this instance, the remaining amount is likely driven by modelling differences.

When model differences are observed, firms generally set some gating threshold that the difference needs to exceed, either on a percentage, whole dollar amount or from a persistence perspective, before it is escalated internally to the Valuation Control team.