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# UMR Global Benchmarking Session

March 2020



# Foreword



Since hosting this digital meeting and commissioning this report IOSCO and BCBS have made the decision to delay Phase 5 & 6 of the Uncleared Margin Rules until 2021 and 2022 respectively. While buy side firms now have an extended time to prepare for the changes they will inevitably have to make, their resources are being stretched more than ever as attention and resource has turned to business continuity while remote working conditions and volatility will effect timeframes for all number of projects.

The Finance Hive is confident this report offers a relevant, detailed snapshot into buy side thought process at a time where UMR was more pressing than it is now, and as such considered it a useful tool for those in the industry looking to use the additional time available to them to get ahead, and make better-informed decisions to make their UMR journey easier for all effected business functions



# Introduction

Finance Hive members have been telling us for over a year that understanding the Uncleared Margin Rules (UMR) for FX Derivatives was a key priority for their organisation. From April 2019 to March 2020 over 200 buy side joined roundtable discussions to discuss UMR; and Clearing as a potential route to compliance. In addition, The Finance Hive facilitated numerous 1-1 meetings for buy side and recommended partners of The Hive to brainstorm and benchmark around implications, solutions and most importantly opportunities that were brought to light by the rules.

In December 2019 the frequency and urgency of these conversations hit a fever-pitch and we received numerous requests from members to hold a meeting where they would be able to discuss how UMR was affecting their roles, firms and the industry at large. There was also considerable appetite to join forces and work on laying out a framework for how FX Clearing could be used to drive efficiencies to their FX execution, or at least understand how the market would develop.

A physical iteration of that meeting is yet to happen. Instead, as a result of the Covid-19 pandemic, The Finance Hive hosted over 50 of our buy side members and recommended partners to join a remote virtual benchmarking discussion to get a first glimpse at how their direct peers were preparing for the incoming regime.







# Conversation Summary

The buy side joining the meeting came into the morning in three broad camps. The first comprised of representatives joining from firms who anticipated or knew they had accounts that would be captured by phase 5, falling under the September 2021 deadline with over \$50bn of outstanding notional. The second comprised of those captured by or expected to be captured by phase 6, falling into the September 2022 deadline with over \$8bn outstanding notional. The third group featured buy side who were not directly impacted by UMR but were keen to learn about its implication on the FX market as a whole, how they might be indirectly effected and learn more about the benefits that FX Clearing could offer.

**Among these groups there was a range of levels of understanding and knowledge around the topics that were discussed but following their individual breakout groups, all of the buy side came out with a better idea of:**

- What falls in scope of UMR, how they could know if and when they were captured, and what their first steps should be once they did
- The implications of UMR on FX execution
- The benefits technology and processes triggered by UMR could have beyond dealing with the regulation itself.
- The primary approach their peers were considering taking towards UMR and why they thought this was the best way forward for their firm
- The pitfalls that need to be avoided when implementing these changes
- Tips on building effective working groups that address the concerns of all parts of the business and end-investors

Of the three camps outlined above, the majority fell into firms captured by phase 5 and looking to get ahead of the curve and plan out their route to compliance well in advance.

The buy side agreed that the first piece required to solve the UMR puzzle involved reaching out to clients as early as possible to get an understanding of how they were effected and to maintain those channels of communication as internal decisions were being made. Most buy side had allready completed or were making significant progress with this initial step.





# Conversation Summary



A key focus of the conversations was how other buy side planned to calculate Initial Margin and decide which calculation method to use. It was identified that among firms captured by phase 1-4 the SIMM model was preferred, and this was the case amongst the majority of buy side that had made a decision. The SIMM model offered the opportunity to incorporate netting in a more effective manner and offered the buy side the opportunity to better predict movements in liquidity.

However, the GRID model could provide an option to calculate initial margin for those buy side who did not want to create and a quantitative model. GRID was also seen as the better option for buy side who were less keen to rely on third parties to perform their IM calculations.

Buy side were keen to understand how UMR and the more widely practiced FX Clearing would affect their execution. The management of initial margin, and the tools to track and optimise it, provides an opportunity to calculate best-execution beyond best price and factor in margining costs into counterparty selection. However, to be able to consider this, buy side would need to invest in developing a far more complex best execution framework and build or buy tools that can help them measure against it.

With regards to clearing, it was raised that a pricing differential in the NDF market is there anecdotally but not explicitly yet. However, it was impossible to rule it out in the future, and actually seems quite likely as more buy side moved towards clearing. This is something buy side need to monitor and stay wary of.

The majority of buy side in the boardrooms still preferred to remain operating bilaterally as their primary approach to UMR, with clearing as a close second. It was acknowledged that there seemed to be some momentum towards clearing in the market as it was maturing and more of the benefits became obvious to the buy side. However, the biggest challenge is still creating an operational infrastructure that can support the workflow and being able to justify the costs that are involved.

Many participants were looking for reassurance that they were all having the same UMR concerns and challenges. The roundtables very much offered this level of reassurance that all buy side were in the same boat and feeling the same pain. It was identified that UMR brings many challenges, some legal, some operational, some risk related and some regarding vendor management; but collateral and custodian management were themes that penetrated all boardrooms. Being able to involve stakeholders from all of these different business functions along with traders and portfolio managers in internal decision making was considered vital to avoiding any unnecessary UMR headaches.



# Key Takeaways

- We were reviewing FX clearing. We are comfortable with operating bilaterally at the moment; but considering consensus we might have another look.
- There is an obvious momentum shift towards FX Clearing.
- It is good to reaffirm the general feeling around SIMM vs GRID.
- Advice is to converge towards SIMM, but it seems that there is still a strong chance that GRID model will play significant role.
- Margin optimisation tools might be best suited to fit into PM workflow rather than the trading desk
- It would seem PB's are at various stages of being able to compress trades, and it was advised to reach out to as many as possible
- UMR may drive the buy side to redefine best execution to include operational efficiencies
- When calculating your outstanding notional you should consider multiple dates and see how both models work; but be mindful of the risks of mixing and matching across funds.
- The tide is turning towards FX Clearing, but significant operational challenges still exist on the way
- One of the biggest challenges is putting an operational infrastructure in place that can facilitate FX Clearing.
- Cleared market hasn't really embraced FX as of yet. FX is very important to us and we would like to see a move towards Clearing
- We need to look at Clearing opportunities across FX and the other asset classes that we work in
- It was useful to better understand some of the indicators that we should consider when thinking about Clearing
- The key issue is around segregated clients
- There is not an out of the box solution available
- Communicating with clients and understanding how each one is affected is vital
- Liquidity has not been affected... Yet...
- You can create value from the unintended consequences of UMR through pre-trade analysis tools
- Managing custodian relationships and understanding what collateral you need to post is incredibly burdensome
- UMR will make best execution frameworks far more complex as margining differentials may outweigh price differences between brokers
- Most buy side are feeling the same pain and are stuck in the same boat with UMR
- Most funds impacted in 2021 for the majority of participants.
- Buy Side are looking closely at their AANA calculations to see if they are able to use clearing to fall under the thresholds
- A pricing differential in the NDF market is there anecdotally but not explicitly yet. This is likely come in time and buy side should be wary of this
- Some venues are key to the ecosystem and will be a great help. Other venues need to be pushed by the buy side to think more about embracing Clearing
- Pricing of swaps/forwards V's futures is key when thinking about how you might adapt your investment style for UMR.
- It is going to be a long journey ahead for the buy-side.
- Interesting to see how the Prime Brokerage market will evolve if everyone moves towards clearing. It might make it harder for us to use them.



# Top Tips from our recommended partners



## Cassini

Our tip would be to not use the UMR delay to suspend your UMR preparedness projects. Rather, use this as an opportunity to fully evaluate the impact of collateral and liquidity across the business and ensure that you put in place strong tools to understand and mitigate the effect of ISDA SIMM and cleared margin on your portfolios, including looking at maximizing the efficiency of your margin trading and collateral deployment.



## Eurex

In order for buy side to reduce their exposure, they should consider connectivity to existing FX clearing solutions (e.g. NDF clearing, Futures) and chose a clearing house that offers the widest product access (listed and OTC) so that the same connectivity can be leveraged for other products should there be a need to put hedge products for clearing or optimization.



## Phil Hermon, FX Products, CME Group

I'd encourage the buy side to take a holistic look at their FX activity across a range of quantitative and qualitative factors before making any decisions. This will allow them to identify the optimal solution for them. For example, they should not just be looking at the Initial Margin differences between ISDA SIMM and OTC cleared for a portion of their book. Instead, they should consider the access to liquidity, bid-ask spread, counterparty credit risk, Initial Margin requirements, freeing up of lines and operational processes by considering bilateral FX v cleared OTC v Listed FX. This should be done across the full spectrum of Forwards, NDFs, Options and Swaps.



## FX Connect/ TradeNexus

It cannot be underestimated how much third-party providers can help in the UMR process. We advise that buy side should harness the resources and expertise providers have available and ensure you are accessing all of their insights by inviting them to pitch to you. They can help educate your team and move the thought process along.



## LCH

We would urge participants to think about how they can optimise margin through the use of clearing houses. This will help ensure further savings, in addition to confirming they are well positioned for UMR compliance and any shift in pricing.



# Next Steps

The health and wellbeing of Finance Hive members and partners will always be our number one priority for the duration of the Coronavirus outbreak, and we will continue to monitor the public health emergency as it develops. Now more than ever, we understand the importance of learning and participating in peer-group discussion. In light of this we will continue to act as facilitators of buy side-to-buy side discussion, whether this be through physical meetings, small and focused digital networking and problem-solving groups, or editorial content.

UMR, FX Clearing and their impact on the FX landscape is an issue of huge importance to our members, and as a result we have several initiatives planned to help you on the way to compliance and understand the implications on the trading desk.



## ROUNDTABLE MEETING: Finance Hive Spotlight: UMR & Clearing (January)

In January we will gather the buy side in person for a private, invite only series of roundtables, to give you an opportunity to hear from peers how their UMR journey has progressed, which challenges they have overcome on the way and preparations they are putting in place to prepare for future bumps in the road.

### Topics to be discussed:

- Integrating and streamlining clearing
- What flow falls in scope of UMR?
- Execution benefits of FX Clearing
- Margin Optimisation, Counterparty Selection and Best Execution
- FX Futures: Compliance and Liquidity
- FX Clearing: Minimising disruption to execution and workflow

## UMR POLLEN GROUPS

Pollen is The Finance Hive's peer group experience. This curated peer group of 6-12 career contemporaries forges deep connection, camaraderie, and support. Pollen groups are curated to put together individuals with shared business strategies or investment priorities, within comparable industry verticals. This means members can benefit from a tailor-made soundboard of peers to help make faster decisions and avoid expensive mistakes. Each Pollen group will have a dedicated Hive Network Manager; a private Whatsapp group so they can engage in real time; and will convene quarterly to confidentially work through challenges. Pollen groups are reviewed after 11 months as changing priorities mean Hive members will need a new source of pollen. We will be in touch shortly to invite you to specific pollen groups.

## GLOBAL PULSE: UMR

Global Pulse is The Finance Hive's proprietary research initiative. Seamlessly blending quantitative analysis of real-time business priorities and objectives, with colourful on the record commentary from Industry leaders, Pulse provides a reliable, evidenced benchmarking opportunity available when you need it and where you need it. We have been surveying our members globally for the past two months on their current UMR outlook and will be collating these responses into a global analysis of buy side plans of action and build a collective voice on the most vital clarification/action points the collective buy side need from regulators, clearing houses and other service providers.