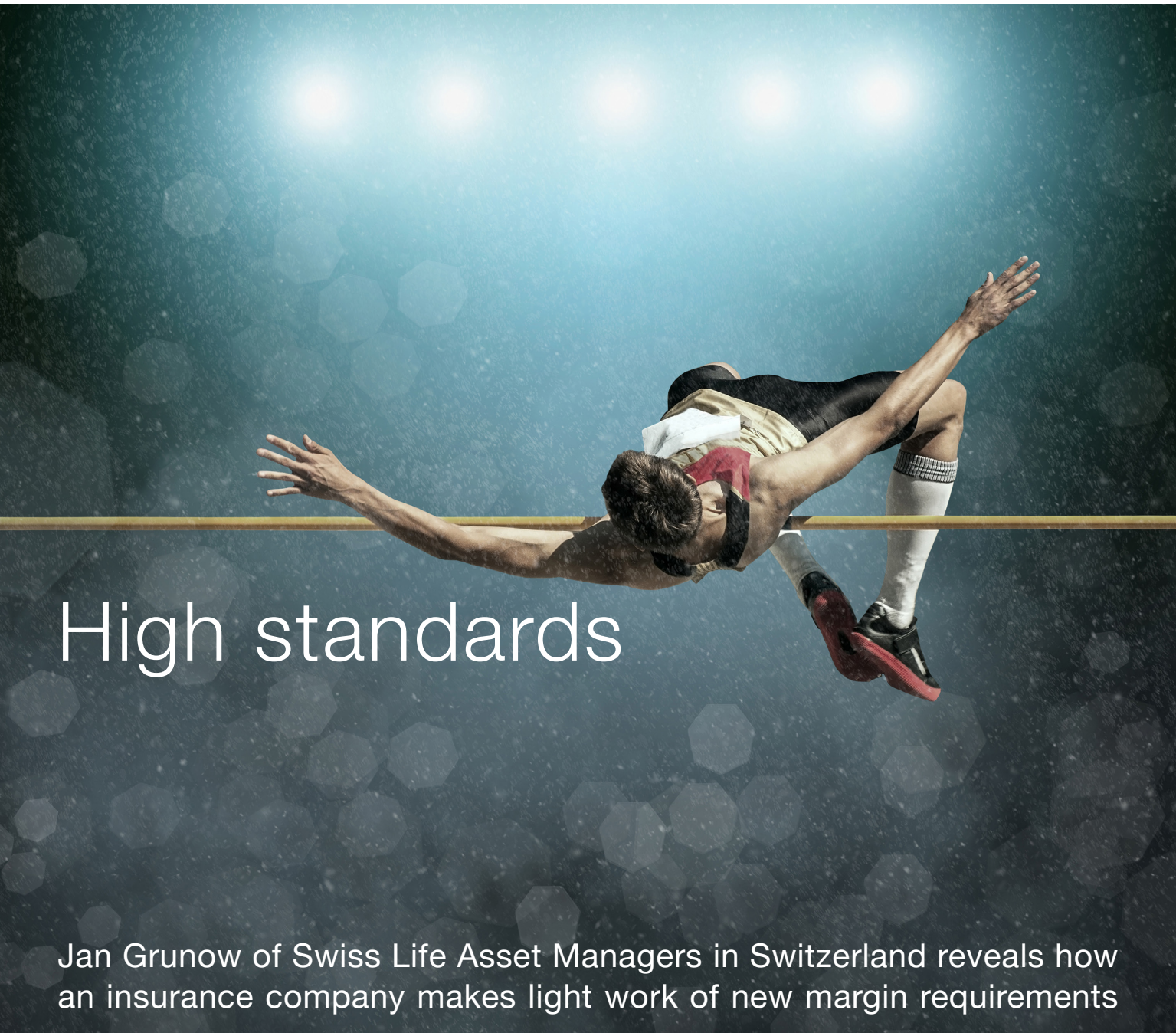


High standards

Jan Grunow of Swiss Life Asset Managers in Switzerland reveals how an insurance company makes light work of new margin requirements

Historically, how much collateralising has Swiss Life AM had to do?

Swiss Life Asset Managers (AM) has quite a long tradition of daily cash collateral exchange to level out valuation changes in over-the-counter (OTC) derivatives positions. The use of OTC derivatives is important for Swiss Life AM to hedge the assets of the insurance company Swiss Life Ltd and Swiss Life funds. We mainly use interest rate and currency derivatives and occasionally credit derivatives.

Until the financial crisis in 2008, Swiss Life AM was content with a weekly variation margin exchange process. Since then we have switched to daily valuation and collateral exchange. The value of the cash collateral exchanged daily can be massive, as was the case on 15 January 2015 when the Swiss National Bank announced it would discontinue the minimum exchange rate of CHF 1.20 against the euro. To a lesser degree, we also have experience in posting initial margins in connection with OTC currency derivatives. These margins were posted in the form of securities to the foreign exchange prime brokers but were adjusted at wider time intervals.

Is mandatory clearing for OTC derivatives a big culture shock for Swiss Life AM?

As Swiss Life AM was already familiar with the concept of central clearing for exchange-traded derivatives, the culture shock was not that big. As the Swiss insurance company holds a lot of eligible collateral on its balance sheet, the availability of initial margin is not the problem. Our biggest challenge is to find clearing solutions that meet our own risk management standards and are compliant with Swiss law and the regulations applicable to insurance companies. Swiss insurance regulation sets high standards regarding the posting

of initial margins from insurance assets. The initial margin is part of the policyholder's assets and must be ring-fenced at all times to cover any offsetting claims against the insurance company.

This requirement is not that easy to meet as most of the central counterparties (CCPs) and clearing brokers operate outside Switzerland under insolvency laws that are neither mutually accepted nor harmonised. We have intensively screened solutions over the past few years that would allow us to post the initial margin directly into a securities account at the CCP held at an independent Swiss custodian, such as the local central securities depository. However, it is only recently that a ray of hope has appeared on the horizon: some CCPs are working intensely on direct clearing or at least on full custodial segregation models.

With mandatory clearing for OTC derivatives coming in stages, how have you planned and prepared for implementation?

It was a very cumbersome process, as we started early with the conceptual work and quickly realised that the legislator, regulator and even the industry were not ready to let us make too much progress. We focused first on our own funds in Luxembourg and implemented a standard clearing model for them. Being ahead of the legal mandatory clearing deadline, we were able to work with our partners free of time pressure and share our initial experiences of the new process.

We are currently focusing on onboarding the Swiss insurance mandate by organising the new ISA direct clearing setup of Eurex Clearing. As a basic clearing member, we can post the required initial margin directly to the CCP and thus avoid any collateral transfer risk via a clearing broker. This also gives us the advantage of our OTC derivative positions not being part of the clearing broker's balance sheet and therefore not causing any capital costs from the clearing agent. The direct clearing model will provide us with a very robust and compliant option.

In terms of concept, clearing appears to be a good idea. But how confident are you that it will make markets safer in practice?

Swiss Life AM still has some mixed feelings about the clearing obligation for OTC derivatives. The fact that the clearinghouses have stable and proven risk management processes, which guarantee a smooth process in the event of counterparty defaults is a definite plus point. This is highly important for the stability of the financial markets and therefore in the interests of everyone. On the other hand, we may see a concentration process in the CCP and clearing broker market, which will potentially raise systemic risks again. The largest CCP attracts more and more business for liquidity reasons, whereas new CCPs in particular find it hard to get a larger stake of the overall clearing business. That is why the clearing brokers do not show huge interest in onboarding smaller clients and smaller CCPs.

This cannot be in the interests of the financial industry and its ambition to increase stability. We hope that the regulatory regime and industry adopt a pragmatic approach to their further development without losing the original goal of making the OTC markets more stable and secure.

How do you ensure that you manage collateral as efficiently as possible?

Most of our derivatives-intensive asset management mandates have sufficient eligible securities to be posted as initial margin for the CCPs. For the Swiss insurance company, we strive for a single securities account at our Swiss CSD SIX SIS, which holds eligible securities for different collateral purposes, such as repo or derivatives business.

The SIX SIS fully-automated triparty collateral management service selects the securities in our long-box and makes sure the instructed collateral value is covered at all times with eligible securities. This enables us to concentrate eligible security collateral in a single account and delegate the selection and transfer of the single securities from the accounts of the collateral taker to SIX SIS as our third-party collateral manager. In this model, we keep full responsibility for the valuation of derivatives and interaction with counterparties. We just optimise the selection and handling of the securities collateral. **SLT**



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