THE GUIDE TO

INITIAL MARGIN AANA CALCULATIONS

TONIC CLOUD MARGIN

CloudMargin & Tonic Regulation Guide

What is AANA?

AANA (Average Aggregated Notional Amount) is a gross notional calculation across all uncleared OTC trades per firm, for a three-month regulatory calculation period, to determine the Initial Margin phase that firm is in-scope for.

Background

The original tidal wave of phase 5 groups - 1,100 based on ISDA's estimates - is now split across phases 5 and 6:

- **Phase 5** went live in **Sept-2021**, but now with an increased AANA threshold of **$/€50 billion**

- **Phase 6** will go-live in **Sept-2022**, using the original phase 5 AANA threshold of **$/€8 billion**

- No change was made for **phase 4**, which went live in **Sept-19** with its original AANA threshold of **$/€750 billion**

AANA calculations are now ***hugely important for smaller firms.*** The final phases are huge tidal waves compared to the previous phases, catching unprecedented volumes of mainly buy-side firms.

AANA calculations are required to confirm which phase each firm's parent group, or funds, are in-scope for.

The truth is that AANA calculations will be getting plenty of attention from now on. This guide gives more information on the details of the calculations and steps required to ensure you are in compliance.

Timeline and details

			New in-scope party estimates		
	Go-live date	AANA ($/)	New groups	New relationships	Relationships > 50mn threshold
Phase 4	Sept 2019	750bn	19	Unknown	
Phase 5	Sept 2021	50bn	314	3,616	28-41%
Phase 6	Sept 2022	8bn	775	5,443	15-23%

* Phase 5 and 6 estimates taken from ISDA analysis

How should firms calculate their AANA?

The high-level AANA calculation methodology sounds pretty simple:

The gross aggregation of notional for all in-scope OTC trades ***under the same group*** over a three-month period, then divided by a prescribed number of days to give a notional average.

AANA Challenges

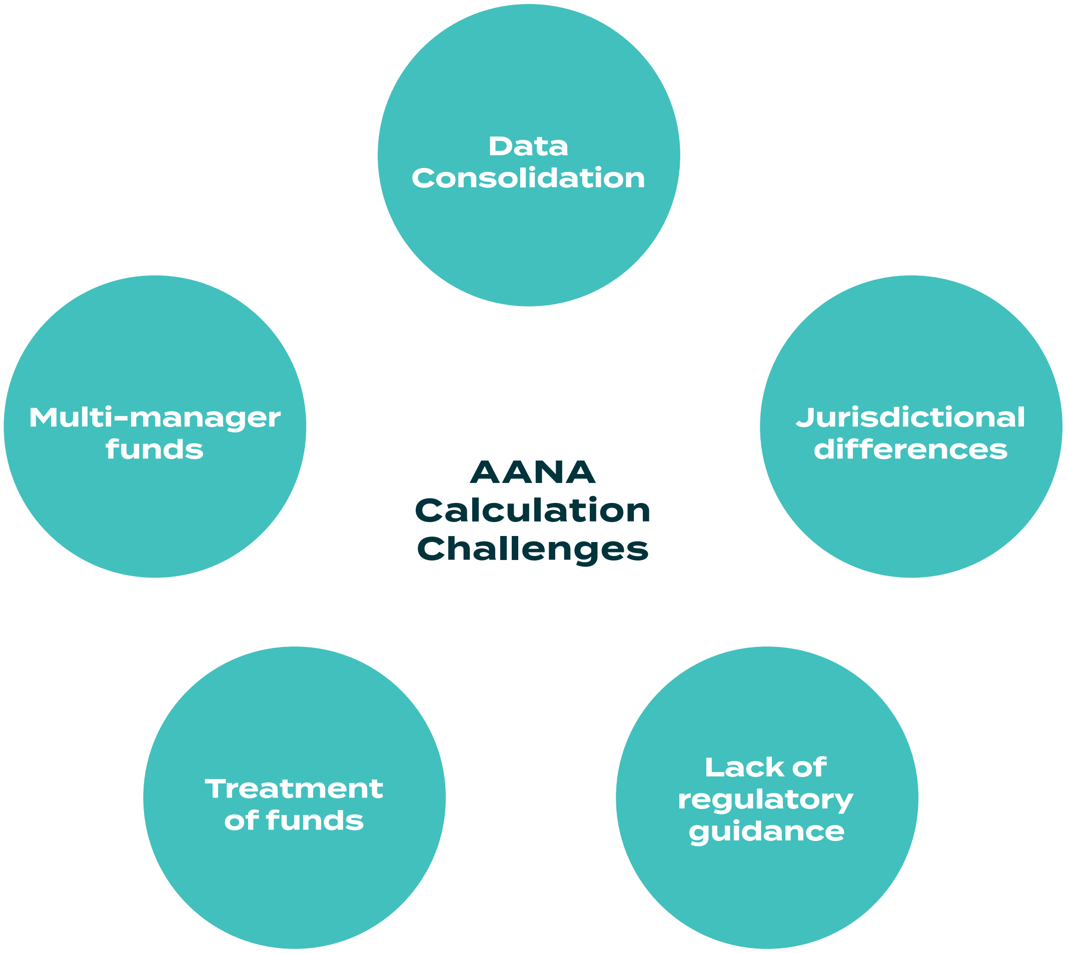
The calculation itself is not so difficult, but there are many challenges that make AANA more complex that it appears.

Let’s take a deeper look into each of these challenges.

- **Data consolidation:** Incomplete or inaccurate data can make it tough to pull the required trade data together. Likewise silo’d data from multiple sources can be a challenge to normalise into a single format before successfully aggregating i.e. from multiple IT systems, or multiple entities under the same group.

- **Jurisdictional differences:** The reality is that different jurisdictions do have different AANA calculations, with differences existing for calculation period, methodology and product scope. Firms will need to perform separate AANA calculations per jurisdiction, including for their counterparties’ jurisdictions, to define which phase they are in-scope.

- **Lack of regulatory guidance:** There are some product types that are trickier than others to calculate the gross notional for, as it’s not always clear which notional should be used (products with multiple notional legs, amortising notionals, etc) . There is also no explicit regulatory guidance for AANA calculations per product type, which can make firms feel uncertain about whether they are calculating correctly.



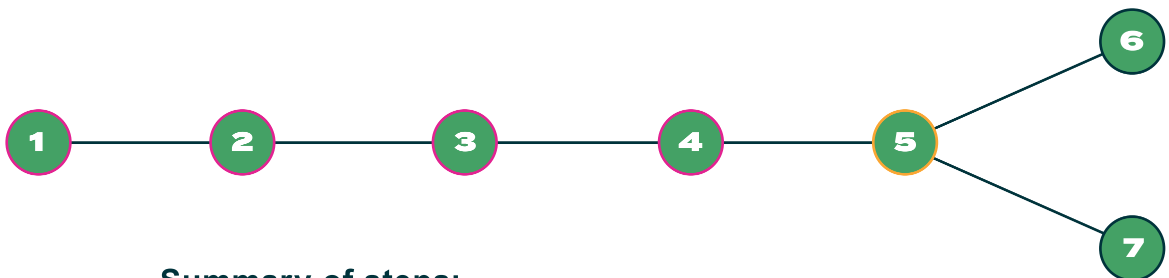
- **Treatment of funds:** If you are the principle owner of a fund, be aware that some funds will be treated as independent entities for their AANA calculations. Under EU rules this includes funds classified as UCITS, or AIFs managed by AIFMs. However, if a fund does not meet the 'independent' classifications then it may be treated as part of the overall parent group, which typically means a far larger AANA result. Understanding the treatment of funds for each of your firm's jurisdiction(s) will be key to confirming your Initial Margin phase.

- **Multi-manager funds:** For multi-manager funds the AANA can only be accurately calculated via the consolidation of trading across all managers for that fund. Each fund manager will not have sight of the fund's trading under the other fund managers, so will not be able to provide a complete AANA calculation. Instead AANA for multi-manager funds will typically fall back to the principal fund owner, who should have that complete trading view.

Seven steps to calculating AANA

There are some good industry resources already out there that define the mechanics of the AANA calculation. So we won't try to recreate the wheel here, but what we will do is break down the key steps for firms to follow. These steps are often not so clear and easily misunderstood.

With that in mind, here we walk through the key steps required before, during and after a firm's AANA calculation.



Summary of steps:

Steps 1-4 are about preparation for the calculation itself. Step 5 details out the actual AANA calculation itself. And steps 6 and 7 describe what to do with either outcome of the calculation - below or above threshold.

1. Confirm your jurisdiction(s)

2. Confirm whether you are an in-scope entity

3. Confirm your AANA calculation period

4. When should we perform AANA calculation(s)?

5. Calculate AANA

6. AANA is above the threshold? Move quick, use time wisely

7. AANA is below €/$8billion? Continue to calculate

Below we go through a deep dive of each step:

1. Confirm your jurisdiction(s)

Jurisdictional AANA calculation methodologies can differ, as you'll see in steps 3 and 5. There have even been examples in previous phases of in-scope firms exceeding the AANA calculation in one jurisdiction but not another, due to calculation and FX rate differences.

Firms are often regulated in ***multiple jurisdictions***, so will need to perform an AANA calculation ***per jurisdiction***.

Likewise firms should also be performing AANA calculations as per their counterparties' jurisdictional rules, which can also pull them into scope.

2. Confirm whether you are an in-scope entity

Simplistically, if your group/entity/fund was in-scope for Variation Margin then you'll likely be a potential in-scope party for Initial Margin.

There are jurisdictional differences in entity scope. The US rules typically only apply directly to Swap Dealers (SDs) and Major Swap Participants (MSPs) and indirectly to Financial End Users (FEUs).

The EU rules catch a broader scope of groups and apply to Financial counterparties (FCs) and Non-Financial counterparties exceeding the clearing thresholds (NFC+), which are defined here.

Even firms outside of regulated jurisdictions are often brought into scope via their counterparties, who do need to comply with the Initial Margin rules.

3. Confirm your AANA calculation period

You didn't expect all jurisdictions to have the same calculation period did you?

See here for ISDA's useful artefact outlining the different AANA calculation methodologies per jurisdiction.

The good news is that for ***Phase 6***, Sept-22, the majority of jurisdictions use the three-month AANA calculation period of March to May 2022.

However, the US Prudential AANA calculation period remains an outlier and continues to use June to August 2021.

Some firms will therefore have two regulatory calculation periods, based on the jurisdictions that they - and their counterparties - are regulated under.

4. When should we perform AANA calculation(s)?

AANA calculations should be run by all firms that are potentially in-scope ***now, if not done already.***

This can be done by using a proxy three-month period to mirror the regulatory period.

We'd strongly advise firms to then replicate that AANA calculation at a regular ongoing frequency (i.e. monthly), to ensure the early identification of any trade portfolio changes that may move your firm from one phase to another.

If an in-scope firm does wait to perform their AANA until the end of May of the year they might be captured, then they'd be leaving themselves with ***only 3 months*** until the 1st Sept go-live date. Three months to deliver what could be a front-to-back change programme that would normally take ***18 months+*** for firms due to exchange collateral….hopefully there won't be many firms following this approach!

5. Calculate AANA

In terms of the mechanics of the calculation, the simplest place to start is the industry resources that already exist.

For ***US AANA calculations***, see ISDA's helpful resource **here**.

For ***EU AANA calculations***, and the differences between EU and US calculations, see Acadia's resource **here**.

Further considerations

Product type

There are product-level ambiguities that exist for the AANA calculation, mainly because the regulations do not stipulate the calculation methodology at product type-level.

We've described a couple of the key problem areas below, but be warned that there are more!

Physically-settled FX - Physically-settled FX are in-scope for the AANA calculation for all jurisdictions, despite the fact that they're out of scope for margin exchange. Make sense? Probably not, but the rules are rules and we can safely assume physical FX won't be removed from the AANA calculation now.

Equity options - These can be problematic due to different cross-jurisdictional treatment. They're permanently out of scope under US rules (they're treated as securities). Within EU rules, and at time of writing, IM and VM do not apply to single-stock equity options or index options until 4 January 2024. Just to make matters worse, equity options have always been in-scope for some other jurisdictions (e.g. Japan, Australia).

Fund

As mentioned before, it is critical for principal owners of funds to understand how each of their funds is treated for AANA within each in-scope jurisdiction.

For a fund to calculate its AANA independently, outside of the parent group, it will have to meet certain criteria. That criteria will change per jurisdiction. For example, under EU rules funds will have independent AANA calculations if they are defined as UCITS, or AIFs managed by AIFMs.

However, if a fund does not meet the 'independent' classifications then it may be treated as part of the overall parent group.

These are key factors that firms should understand as early as possible, as the treatment of an independent fund versus the parent group may determine the compliance phase.

6. AANA above threshold? Move quick, efficiently

There's no time to waste for firms breaching threshold.

Once firms have confirmed they are in-scope they will need to move fast to kick-off early tasks such as educating all internal stakeholders, setting up the programme, finding a programme sponsor and identifying relevant resources and expertise.

It is also important to inform your Dealer counterparties that your firm is in-scope. The ISDA resource embedded within step 5 above contains the best ways to self-disclose to your counterparties.

Newly in-scope firms have a steep learning curve to educate themselves on the front-to-back changes that will impact them. There are helpful resources out there for these firms, including **Tonic's free Initial Margin Health check**, which gives firms access to our specialists to guide them through the key IM rules, changes, challenges and solutions.

In terms of delivery scope, BCBS/IOSCO's March-2019 guidance means that ***only those firms with exposure breaching the exchange threshold (€/$50mill at group-to-group level) will need to deliver the full set of custodian, operational and legal changes.*** See the first of our two related posts here for an overview of the BCBS/IOSCO guidance and its impact.

Based on BCBS/IOSCO's guidance, a **Threshold Breach Assessment** is a critical first step for all in-scope firms to confirm their compliance scope and plans.

The outcome of a Threshold Breach Assessment is the creation of forecast SIMM and Grid exposure calculations across all of a firm's relationships. These can then be used to assess if and when exchange threshold breaches will take place. Only then will a firm be able to confidently plan out its compliance tasks, including those operational readiness activities.

7. AANA below €/$8 billion? Continue to calculate

A scenario for some firms is that they will run an ***early proxy AANA calculation*** which comes in below the €8bill threshold.

This feels like good news, as the firm seems to be out of scope. However, the firm has not performed the calculation for the ***regulatory calculation period***. Each firm must therefore repeat the calculation between March to May to confirm whether they are in or out of scope.

Another key point is that, from the first proxy calculation onwards, each firm should continue to calculate on ***a regular, ongoing basis*** to track any changes in trading and therefore their AANA calculation results. We know firms that have suddenly breached an AANA Phase threshold, due to a quick change in their uncleared trading, leading to a very rushed and hectic IM programme to get ready.

In parallel, firms may try to future-proof themselves from breaching the AANA threshold, maybe via portfolio compression or a change in trading strategy (e.g. more voluntary clearing).

Those firms unable to successfully reduce their uncleared trading, or with an anticipated future increase in trading volumes, will be well-advised to progress full-speed with their IM programme.

What's clear is that firms should be incredibly careful before they down tools and assume no action is required.

Confirmed as out of scope for Phase 6? Don't forget that even if a firm stays below the 8 billion AANA threshold for Phase 6, they will come in-scope in subsequent years if their gross notional rises above the 8 billion so ***firms will need to continue this process each year.***

Need help with your AANA?

We hope this guide set you on a good path with AANA. If you would like more help calculating AANA and establishing efficient strategies based on your AANA calculation result, CloudMargin and Tonic provide a comprehensive service to help you through each of these steps.

Learn more at **go.cloudmargin.com/aana-service** or contact us to speak to an expert at **cloudmargin.com/speak-to-an-expert**

TONIC CLOUD MARGIN

CENTRALISE. CONNECT. AUTOMATE. OPTIMISE.