OTC Derivatives Reporting Requirements under EMIR

FINCAD

Financial institutions use FINCAD's F3 technology to overcome regulatory challenges, and to display leadership in their processes and controls to their customers, regulators, and shareholders.

Clearing, Collateral, Valuation, and Validation

The European Market Infrastructure Regulation (EMIR) imposes trading, valuation and risk requirements on OTC derivatives.

The efforts to mitigate the potential risks specified in EMIR are impacting financial institutions. As a result, there have been significant changes in how derivatives are used and the related processes and workflows.

With respect to derivatives, there has been a steady roll-out of EMIR-related expectations surrounding processes for valuation, collateral and risk in the name of transparency and reducing systemic risk. This has led to a significant increase in the amount of reporting that is required by derivatives market participants.

FINCAD's F3 helps firms to meet process and reporting goals in all areas of the derivatives workflow, including valuation, collateral, margining and monitoring.

Enhanced Derivatives Reporting Processes and Controls

At its core, EMIR requires firms to adopt detailed valuation policies and procedures and to define permanent and independent risk management functions. When evaluating business workflows, the optimal solution for many firms is to centrally manage regulatory components.

FINCAD's F3 meets this need by scaling both computation and resources, and by efficiently allowing the sharing of data and results across the organization.

Model Validation

An important component of EMIR is model validation, especially with respect to Level 3 products (derivatives for which market-observable pricing inputs are not available). In other words a model must be setup to value the derivative.

This is in comparison to Level 1 and 2 products where market observable inputs do exist to easily arrive at an agreed upon valuation.

For level 3 products, the organization must provide comprehensive model and product validation. As part of the verification process of the model, an independent valuation becomes critical, especially for complex derivatives.

As more complex derivatives are also likely not to be centrally cleared, this will increase the need to ensure the model being used is robust.

F3 helps teams perform both mark to market and mark to model calculations independently of their counterparty and trading desk—providing an additional line of defense for the organization.

F3 enables model validation teams to build, validate, and monitor model assumptions for comprehensive model validation procedures for all derivative types, from simple to the most exotic instrument.

Margin Calculations for Non-cleared OTC Derivatives

Another key component of EMIR states that wherever possible, derivatives should be centrally cleared. For those derivatives that cannot be centrally cleared, margin will need to be calculated and posted.

The margin calculations requirements for non-cleared OTC derivatives are, as yet, not fully defined, and may vary depending on geographies, supported instrument types, and regulatory nuances, adding a level of complexity to margin management. The management of margin is important for optimizing both risk and return.

F3 can help by providing a flexible framework for calculating and verifying initial and variation margin—especially for uncleared OTC derivatives.

F3 is able to effectively manage margin calculations across different clearing rules, instrument types and currencies.

Additionally, trading teams can use F3's distributed calculation and scaling technology to obtain pre-trade margin calculations and make informed trading decisions.

Powerful Multi-curve Construction

Curve construction taking into account eligible collateral across different currencies can be a complex task.

The cornerstone of valuation is curve-building, and F3 offers best-of-breed analytics by incorporating its proprietary curve-building technology.

This highly flexible framework is self-consistent, arbitrage-free, and supports multiple curves and currencies.

It enables you to efficiently build curves from any market instrument (e.g. single currency fixed-float swaps, tenor basis swaps, and cross-currency basis swaps) using a variety of discounting models (e.g. OIS, multi-currency CSA, Libor + funding spread, etc.) depending on collateralization.

Scenario Analysis

F3 is a sophisticated technology that can perform any market risk scenario on virtually any financial instrument or portfolio, including hybrids and exotic payoffs.

User-defined scenarios for single or multiple risk factors can be run in isolation, or VaR and Expected Shortfall can be derived from loss distributions arising from applying large-volume scenarios.

New Risk Management Standards

Given the changing regulatory landscape, organizations will continually augment their risk management procedures, not only to ensure adherence to the regulation but to also attain a competitive advantage. F3 provides the framework to handle these evolving needs.

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Contact Sales or Support Toll-Free:

USA/Canada 1 800 304 0702 **Europe** 00 800 304 07020 **Email** info@fincad.com