



MAYER | BROWN

# 5<sup>th</sup> OTC Derivatives Seminar

Executing New Market Standards in 2019 and 2020

Frankfurt – 26 June 2019

# Welcome from Our Speakers



**Chris Arnold**  
Partner, Derivatives &  
Structured Products  
carnold@mayerbrown.com  
**LONDON**  
T +44 20 3130 3610



**Henrik Beneke**  
Syndikusrechtsanwalt  
LB Baden-Württemberg  
henrik.beneke@lbbw.de  
**STUTT GART**  
T +49 711 12 7746 26



**Curtis A. Doty**  
Partner, Banking & Finance  
cdoty@mayerbrown.com  
**NEW YORK**  
T +1 212 506 2224



**Matt Kluchenek**  
Partner, Banking & Finance  
mkluchenek@mayerbrown.com  
**CHICAGO**  
T +1 312 701 8798



**Ed Parker**  
Partner, Derivates &  
Structured Products  
eparker@mayerbrown.com  
**LONDON**  
T +44 20 3130 3922



**Dr. Patrick Scholl**  
Partner, Banking & Finance  
pscholl@mayerbrown.com  
**FRANKFURT**  
T +49 69 7941 1060

# Agenda

## TOPIC

**Global benchmark developments, their implementation in OTC derivatives and hedging risks to the cash markets**

**The upcoming market changes for interest derivatives and changes to 2014 ISDA Credit Derivatives Definitions**

**Initial Margin implementation for Phase V entities and key legal and documentation execution aspects (Part 1)**

## COFFEE BREAK

**Initial Margin implementation for Phase V entities and key legal and documentation execution aspects (Part 2)**

**Pre- and post-Brexit changes to derivative documentation; German and other EU law alternatives; new developments on additional provisions used in new Brexit related German law master agreements**

**EMIR Refit**

**Special US focus on market, regulatory and enforcement experiences relevant for German market participants**

## DRINKS AND HORS D'OEUVRES

## SPEAKERS

Curtis A. Doty, Mayer Brown New York  
Patrick Scholl, Mayer Brown Frankfurt

Chris Arnold, Mayer Brown London  
Patrick Scholl, Mayer Brown Frankfurt

Ed Parker, Mayer Brown London

Henrik Beneke, Landesbank Baden-Württemberg

Patrick Scholl, Mayer Brown Frankfurt  
Ed Parker, Mayer Brown London

Chris Arnold, Mayer Brown London

Matthew F. Kluchenek, Mayer Brown London

*Curtis A. Doty, Mayer Brown New York*

*Patrick Scholl, Mayer Brown Frankfurt*

# **Global Benchmark Developments, their Implementation in OTC Derivatives and Hedging Risks to the Cash Markets**

# U.S. approach to the LIBOR Discontinuance Problem

- Alternative Reference Rates Committee (ARRC) convened by the Federal Reserve Bank of New York and the Board of Governors of the Federal Reserve System
  - Charged with coming up with a reference rate to replace LIBOR
  - Charged with coming up with a plan to implement the transition to the new reference rate
- Private sector
- No regulatory or supervisory authority
- ARRC initially focused on derivatives

# Identification of SOFR

- June 2017: The ARRC recommends the secured overnight financing rate (SOFR)
  - The interest rate on overnight loans that use U.S. government obligations as collateral
  - Based on actual transactions in a huge market
- April 2018: Fed starts quoting SOFR

# Overnight, term and forward-looking term rates

- USD-SOFR-COMPOUND (Supplement 57 to 2006 ISDA Definitions)
  - Compounded (i.e., geometrical) average of SOFR for each U.S. Government Securities Business Day in the Calculation Period
  - An “in arrears” term rate – not known with certainty until after the last USGSBD of the Calculation Period
  - Fallbacks if there is a SOFR Index Cessation Event
- SOFR Overnight Index Swap (OIS) Rate (as defined in FASB ASU 2018-16):
  - “The fixed rate on a U.S. dollar, constant-notional interest rate swap that has its variable-rate leg referenced to SOFR (an overnight rate) with no additional spread over SOFR on that variable-rate leg. That fixed rate is the derived rate that would result in the swap having a zero fair value at inception ...”
  - Known in advance, but dependent on a trading market in SOFR OIS swaps (or listed derivatives)

# The fundamental conundrum of LIBOR transition

- Some users of non-derivative products (e.g., loans) may have a strong preference for forward-looking term rates, but ...
- In derivatives markets, the bulk of liquidity needs to be in the RFRs, not FLTRs. Otherwise, in regulators' view, we'll have reproduced the original problem with IBORs – a thinly traded benchmark supporting a massive superstructure
  - See FSB, *Interest rate benchmark reform – overnight risk-free rates and term rates* (July 2018)
  - ISDA consultation on IBOR fallbacks did not include FLTRs among the choices for an adjusted RFR

# Status quo for derivatives

- Fallbacks under 2006 ISDA Definitions for USD-LIBOR (if rate does not appear on screen):
  - rate at which USD deposits are offered by the Reference Banks at approximately 11:00 am, London time, ... to prime banks in the London interbank market for a period of the Designated Maturity ...
  - if fewer than 2 quotations, then the Calculation Agent looks to quotations of major banks in New York City for loans in USD to leading European banks
  - no further fallbacks if quotes for these interbank loans are not available
- What happens when fallbacks run out?
  - New York common law on gap-filling, frustration, impossibility, force majeure, etc.

# Interaction with ISDA benchmarks supplement and protocol

- EU Benchmarks Regulation Article 28(2): Supervised entities (other than an administrator) that use a benchmark must produce and maintain robust written plans setting out the actions that they would take in the event that a benchmark ***materially changes*** or ***ceases to be provided***.
- ISDA Benchmarks Supplement and Protocol were designed to facilitate compliance. How does the Benchmarks Supplement interact with IBOR fallbacks?
  - 2006 ISDA Definitions Benchmarks Annex provides for “Priority Fallbacks”
  - if the definition of a benchmark includes a concept defined or otherwise described as an “index cessation event”, then any fallback specified to apply upon the occurrence of such an event will be a “Priority Fallback”
  - if Priority Fallbacks fail, Alternative Continuation Fallbacks (and, failing these, no fault termination rights) apply
  - Priority Fallbacks do not apply if an Administrator/Benchmark Event occurs that does not constitute an “index cessation event”

# ISDA consultation on IBOR fallbacks for 2006 ISDA Definitions (July 2018) and Report (December 2018) for non-USD IBORs

- Under planned amendments, floating rate options will be revised to include fallbacks that will be **triggered upon the permanent discontinuation** of the related IBORs, as evidenced by a public statement by the administrator of the IBOR or the administrator's regulatory supervisor
- ISDA is developing fallbacks based on a **compounded setting in arrears rate** and the **historical mean/median approach to the spread adjustment** for all of the benchmarks covered in the consultation
- ISDA is currently working with experts on technical issues and spread adjustment calculation methodology, which it plans to submit for public sector antitrust review

# ISDA letter to the Official Sector Steering Group of the FSB (April 2019)

Outlines 2019 milestones:

- Supplement to the 2006 ISDA Definitions to include fallbacks that would apply upon cessation of key IBORS (including USD, GBP, CHF, JPY and EUR LIBOR)
- Supplemental consultation covering USD LIBOR and focused on the compounded setting in arrears rate and the historical mean/median approach for the spread adjustment
- ISDA will select a vendor for publishing the term adjusted reference rate and spread adjustment for each IBOR – avoids disputes over calculations
- A consultation on the preferred approach for addressing pre-cessation issues in LIBOR and other IBOR derivative contracts, including in the context of a regulator finding that the relevant IBOR is no longer representative

# How crucial are FLTRs for non-derivative products?

- Advance visibility for cash-planning purposes, but ...
  - In securitization and structured deals, payments are subject to a waterfall
  - Compounded setting-in-arrears SOFR can be hedged to a fixed rate by entering into an overnight index swap (i.e., where the floating rate is USD-SOFR-COMPOUND)
  - See data on historical differences between 3-month OIS rate and ex post compounded setting-in-arrears for effective federal funds rate, available at <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/Thoughts-on-ISDA-Methodologies.pdf>
- ARRC User's Guide to SOFR (April 2019)
  - discusses simple vs. compounded averages; in-arrears vs. in-advance rate definitions; conventions to allow longer notice periods under in-arrears rates; and hybrid models (principal adjustment or interest rollover)
  - “those who are able to use SOFR should not wait for the term rates in order to transition”
  - see discussion on pp. 17-18 of the higher transactions costs of hedging a SOFR FLTR than a compounded set-in-arrears SOFR

# Practical questions for derivatives

- Conduct and relationship risk for dealers
  - disclosure of pricing methodology, material risks
  - sufficiency of simple spread adjustment to address value transfer in non-linear and complex products? Are there any known systematic biases?
  - need for further adjustments (volatility, correlation, convexity)?
- Effect on specific products – cross-currency swaps, floating rate agreements
- Consensual close-out and rebooking in advance of 2021. When will the LIBOR forward curve cease to be a robust mechanism for pricing early termination?
- How will counterparties assess the trade-offs between hedge basis risk and transaction costs? Increased requests for scenario analysis?
- How are hedging covenants in credit agreements drafted? Flexible enough to permit, e.g., hedging LIBOR with SOFR OIS, or FLTR with SOFR OIS?

# Regulatory issues under Dodd-Frank Title VII

- Compliance burden and economic costs if amendments to include fallbacks or replace rate trigger the application of regulatory requirements. See ARRC Title VII Letter to U.S. regulators (July 2018)
  - Loss of grandfathered status under uncleared margin and (if CFTC extends mandates to SOFR) clearing and trade execution?
  - Triggering of swap dealer business conduct rules
  - Swap trading relationship documentation, confirmations
  - Real-time reporting
  - Swap data reporting, portfolio reconciliation
- BCBS/IOSCO Statement on Margin Implementation (March 2019):
  - “Amendments to legacy derivative contracts pursued solely for the purpose of addressing interest rate benchmark reforms do not require the application of the margin requirements for the purposes of the BCBS/IOSCO framework, although the position may be different under relevant implementing laws”

# Loan market's response to SOFR

- Too many differences between LIBOR and SOFR
  - SOFR is a historic rate, not a forward rate (like LIBOR)
  - SOFR is an overnight rate, not a term rate (like LIBOR)
  - SOFR is a risk-free rate, not a cost of funds rate (like LIBOR)
  - Does not track LIBOR
    - Volatility at quarter- and year-end
    - Moves downward in a distressed market while LIBOR moves up

# Ways to address the loan market's concerns

- Fed will try to come up with a term rate (based on SOFR) by 2021
  - Depends on whether the SOFR swap market is robust enough
  - Fed doesn't think this term rate (if there is one) is the best way to price loans
- Fed wants banks to price loans based on an average of SOFR over a period of time
  - Simple average or compounded?
  - Determine in advance or in arrears?
  - Fed will start publishing average compounded SOFRs in Q2 2020
- Other reference rates
  - US Dollar ICE Bank Yield Index
  - Ameribor

# ARCC Recommended Fallbacks for Syndicated Loans

- April 2019: ARCC recommended language for syndicated loans
  - Highly precise (i.e., long and dense)
  - Provides for an early opt-in
  - Two approaches:
    - the amendment approach
      - Fed very unhappy with its inclusion
    - the hard-wired approach
  - Hardwired approach:
    - Automatic transition to alternative pricing basis
      - Eliminates chaos in 2021
      - Eliminates “winners and losers” based on loan market conditions in 2021
    - Waterfall of reference rates:
      - Term SOFR
        - Contemplates future additional tenors

# Fallbacks (cont'd.)

- Compounded SOFR (in advance or in arrears)
  - Will be on a screen
- Borrower and Administrative Agent agree
- Spread adjustment is that recommended by the Fed
  - Will be on a screen
- Amendment approach
  - Essentially the same as the current market (but longer)
- May 2019: ARRC recommended language for bilateral loan
  - Amendment approach (either with or without a borrower veto right)
  - Waterfall approach
  - Hedged loan approach
    - Fallback to ISDA fallbacks

# UK-Sterling LIBOR Developments

- United Kingdom: In 2015, the Bank of England established The Working Group on Sterling Risk-Free Reference Rates
- Working Group's goal is to implement the Financial Stability Board (FSB) recommendation to develop alternative "risk-free rates" (RFR) for use instead of LIBOR-style reference rates
- In April 2017, the Working Group recommended the SONIA Benchmark as its preferred RFR for GBP LIBOR and aims for the market to transition broadly to SONIA as the primary sterling interest rate benchmark in bond, loan and derivative markets in the next 4 years
- Transition to SONIA as main focus of the Bank of England, FCA and Working Group.
- Working Group launched a consultation, with results published in November 2018 on SONIA forward-looking term SONIA reference rates (TSRRs); recognition that term rates better suit certain users' needs
  - Comparison with ISDA and its Consultation which contemplates transition for key IBORs to directly referencing RFRs (derivatives being more than 90% of the market in notional value)
  - If, though, bond markets transition to TSRRs, then the market will require suitable hedging instruments that reference TSRRs as well

# Eurozone-Developments

- European Union (Euro): Most widely used benchmarks for financial contracts are EONIA (the Euro Over Night Index Average) and EURIBOR (the Euro Interbank Offered Rate)
  - Administered by EMMI (European Money Markets Institute)
- As LIBOR, these benchmarks are based on unsecured interbank market and are both “critical benchmarks” under the BMR.
- September 2017 ECB, European Commission and ESMA announced working group on alternative Euro overnight RFRs; working group to consider (i) alternative RFRs, (ii) term structures for these RFRs, (iii) contractual robustness of legacy and new contracts and (iv) transition from EONIA to RFRs
- Following a consultation on 21 June 2018 on candidate RFRs to replace EONIA from 2020, it was concluded that ESTER (now: €STR) is the most reliable and robust unsecured candidate rate (88% of respondents agreed) as (i) ECB is the administrator, (ii) rate methodology is robust, (ii) rate is not volatile
- The Working Group has published guiding principles for fallback provisions in new contracts for euro-denominated cash products in January 2019

# Eurozone-Developments

- EMMI published the results of its consultation, confirming that the EONIA methodology will change to €STR plus spread on 2 October 2019. EONIA is expected to be discontinued on 3 January 2022.
- In March 2019, the working group endorsed recommendation to market participants regarding (i) the transition from EONIA to €STR and (ii) the calculation of a €STR-based term structure (also as fallback for EURIBOR contracts)
- The ECB announced a one-off spread between €STR and EONIA, to be used by EMMI in the new EONIA methodology as of October 2019. The methodology used to calculate the spread (which will be 8.5bp) is based on the recommendations of the working group on euro risk-free rates published on 14 March 2019
- EURIBOR is due to be authorised under the European Benchmark Regulation. On 6 May, EMMI announced that it has applied for authorisation from the Belgian FSMA. As a subsequent step, EMMI has started transitioning panel banks to the new hybrid methodology
- Political agreement has been reached meanwhile to extend the transition period for administrators of critical benchmarks (which include EURIBOR) and third country benchmarks to 31 December 2021. The 2 year extension of the transition period under the Benchmark Regulation will be used to focus on work on third country benchmarks and the recognition, endorsement and equivalence regimes

*Chris Arnold, Mayer Brown London*

*Patrick Scholl, Mayer Brown Frankfurt*

# **The Upcoming Market Changes for Interest Derivatives and Changes to 2014 ISDA Credit Derivatives Definitions**

# The new ISDA Definitions for Interest Rate Derivatives: Why now?

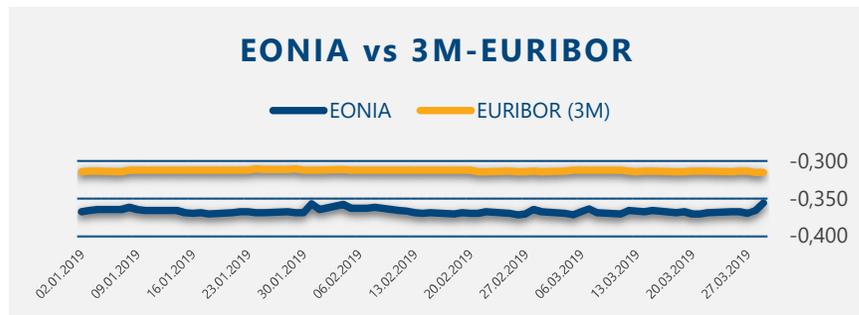
- The ISDA Definitions were last updated in 2006
- Since then, 58 Supplements have been published
  - Deleting/amending obsolete Floating Rate Options and adding new ones
  - Amendments to certain settlement methodologies
- EU Benchmark Regulation and the IOSCO Principles for Financial Benchmarks require entities to have „robust written plans“ that nominate „alternative benchmarks“ if a benchmark „materially changes“ or „ceases to be provided“
- Technology advances necessitate ability to code into digital format

# The 2020 ISDA Interest Rate Derivatives Definitions – What to expect?

- Incorporation of all supplements published since 2006
- Incorporation of provisions/concepts from the 2006 ISDA Definitions Benchmarks Annex (part of the 2018 ISDA Benchmarks Supplement)
- Additional fallbacks for –IBOR based rates that would apply upon *permanent discontinuation* (subject to ongoing consultations by ISDA)
- Expected that the IBOR rate options in the new Definitions will contain the same index cessation event trigger and the same fallbacks to the adjusted RFR plus spread as those that will be included in the amendments to the 2006 ISDA Definitions

# New ISDA Market Standards for RFRs

- LIBOR scandal (2012)
- EU Benchmark Regulation (2016)
- IBOR rates to be discontinued and therefore replaced by so-called risk-free rates (RFRs), in the case of a LIBOR discontinuation for several market segments
- *Open issue*: details of fallback clauses for IBORs in OTC derivatives, e.g. amending interest period, the day count fraction, margin adjustments etc.



Data source: EMMI ([www.emmi-benchmarks.eu](http://www.emmi-benchmarks.eu))

## Overview of overnight RFRs\*

USD	<b>SOFR</b>	Secured Treasury repo rate
GBP	<b>SONIA</b>	Unsecured wholesale rate
EUR	<b>€STR</b>	Unsecured wholesale rate
JPY	<b>TONA</b>	Unsecured wholesale rate
CHF	<b>SARON</b>	Secured general collateral repo rate

\* Financial Stability Board: Overnight Risk-Free Rates, A User's Guide (4 June 2019)

# New Market Standards for RFRs: *Calculation*

- There are technical issues with respect to the switch from an IBOR to a RFR rate. RFRs typically have a lower nominal value, that also does not reflect the increased costs and risks for longer terms (*term liquidity risk*)
- Using RFRs for non-daily use, typically involves compounding *in arrears*

## General compound interest formula

$$\left[ \prod_{i=1}^{d_b} \left( 1 + \frac{r_i * n_i}{N} \right) - 1 \right] * \frac{N}{d_c}$$

## Example for interest rate adjustment

„GBP-SONIA-Compound“\*

$$\left[ \prod_{i=1}^{d_0} \left( 1 + \frac{SONIA_i * n_i}{365} \right) - 1 \right] * \frac{365}{d}$$

$d_0$	Number of London Banking Days in the relevant Calculation Period
$i$	1 ... $d_0$
$SONIA_i$	Daily SONIA-rate
$n_i$	Number of calendar days in the relevant Calculation Period on which the rate is $SONIA_i$
$d$	Number of calendar days in the relevant Calculation Period

\* ISDA: Supplement no. 55 to the 2006 ISDA Definitions (23 April 2018); the above text provides a shortened summary only.

# New Market Standards for RFRs: SONIA (GBP)

- Discontinuation of the GBP LIBOR expected by the end of 2021.
- SONIA is an overnight unsecured rate administered by the Bank of England (since April 2016).
- Compounding daily rate in arrears for interest period most likely approach for derivatives.
  - Spread between LIBOR and SOFR to be determined based on spread of mean/median over static lookback period.
- The compounded SONIA is relatively stable, which means that although term rates are achieved by compounding in arrears, the applicable rate is relatively predictable.
- ISDA has provided a supplement (no. 55) to their 2006 ISDA Definitions to incorporate SONIA.

ISDA supplement for SONIA:



Supplement number 55 to the 2006 ISDA Definitions  
published April 23, 2018

## Section 7.1 Rate Options.

Section 7.1(w)(vii) is amended by deleting it in its entirety and restating as follows:

(vii) "GBP-SONIA-COMPOUND" means that the rate for a Reset Date calculated in accordance with the formula set forth below in this subparagraph, will be the rate of return of a daily compound interest investment (it being understood that the reference rate for the calculation of interest is the Sterling daily overnight reference rate).

"GBP-SONIA-COMPOUND" will be calculated as follows, and the resulting percentage will be rounded, if necessary, in accordance with the method set forth in Section 8.1(g), but to the nearest one ten-thousandth of a percentage point (0.0001%):

$$\left[ \prod_{i=1}^d \left( 1 + \frac{\text{SONIA}_{t_i} \times n_i}{365} \right) - 1 \right] \times \frac{365}{d}$$

where:

"d," for any Calculation Period, is the number of London Banking Days in the relevant Calculation Period;

"i" is a series of whole numbers from one to d, each representing the relevant London Banking Days in chronological order from, and including, the first London Banking Day in the relevant Calculation Period;

"SONIA<sub>t<sub>i</sub></sub>" for any day "t<sub>i</sub>" in the relevant Calculation Period, is a reference rate equal to the daily Sterling Overnight Index Average (SONIA) rate as provided by the administrator of SONIA to, and published by, authorized distributors of the rate as of 9:00 a.m., London time, on the London Banking Day immediately following that day "t<sub>i</sub>";

"n<sub>i</sub>" is the number of calendar days in the relevant Calculation Period on which the rate is SONIA<sub>t<sub>i</sub></sub>; and

"d" is the number of calendar days in the relevant Calculation Period.

© 2018 International Swaps and Derivatives Association, Inc. ISDA® is a registered trademark of the International Swaps and Derivatives Association, Inc.

# New Market Standards for RFRs: SOFR (USD)

- SOFR is a secured, short-term (overnight) borrowing rate based on U.S. Treasury repurchase (repo) agreements and general collateral financing data.
- In April 2018, the FRB of New York began publishing daily SOFR data.
- Compounding solution similar to SONIA.
- ISDA has provided a supplement (no. 57) to their 2006 ISDA Definitions to incorporate SOFR.

## ISDA supplement for SOFR:

Supplement number 57 to the 2006 ISDA Definitions  
published on May 16, 2018

### Section 7.1 Rate Options.

(a) Section 7.1(ab) (*U.S. Dollar*) is amended by adding a new Section 7.1(ab)(b) as follows:

(b) "USD-SOFR-COMPOUND" means that the rate for a Reset Date, calculated in accordance with the formula set forth below in this subparagraph, will be the rate of return of a daily compound interest investment (it being understood that the reference rate for the calculation of interest is SOFR). Upon the occurrence of a SOFR Index Cessation Event, the rate for each day in a Calculation Period occurring on or after the SOFR Index Cessation Effective Date will be determined as if references to SOFR were references to the rate (inclusive of any spreads or adjustments) recommended as the replacement for SOFR by the Federal Reserve Board and/or the Federal Reserve Bank of New York, or by a committee officially endorsed or convened by the Federal Reserve Board and/or the Federal Reserve Bank of New York for the purpose of recommending a replacement for SOFR (which rate may be produced by the Federal Reserve Bank of New York or another administrator). If no such rate is recommended within one U.S. Government Securities Business Day of the SOFR Index Cessation Event, then the rate for each day in a Calculation Period occurring on or after the SOFR Index Cessation Effective Date will be determined as if references to SOFR were references to OBFRR, references to U.S. Government Securities Business Day were references to New York City Banking Day and references to SOFR Index Cessation Event were references to OBFRR Index Cessation Event. If no such rate is recommended within one U.S. Government Securities Business Day of the SOFR Index Cessation Event and an OBFRR Index Cessation Event has occurred, then the rate for each day in a Calculation Period occurring on or after the SOFR Index Cessation Effective Date will be determined as if references to SOFR were references to FOMC Target Rate, references to U.S. Government Securities Business Day were references to New York City Banking Day and references to the New York Fed's Website were references to the Federal Reserve's Website.

"USD-SOFR-COMPOUND" will be calculated as follows, and the resulting percentage will be rounded, if necessary, in accordance with the method set forth in Section 8.1(a):

$$\prod_{i=1}^{d_0} \left( 1 + \frac{\text{SOFR}_i \times \frac{d_i}{360}}{1} \right) - 1$$

where:

"d<sub>0</sub>" for any Calculation Period, is the number of U.S. Government Securities Business Days in the relevant Calculation Period;

"i" is a series of whole numbers from one to d<sub>0</sub>, each representing the relevant U.S. Government Securities Business Days in chronological order from, and including, the first U.S. Government Securities Business Day in the relevant Calculation Period;

Copyright © 2018 by International Swaps and Derivatives Association, Inc.

# New Market Standards for RFRs: €STR (EUR) and EURIBOR Developments

- The older EONIA is to be gradually replaced by the €STR, currently under development by the ECB (ECB has provided a one-off spread between €STR and EONIA, set at 8.5 bps).
- Compounding solution similar to SONIA.
- Draft supplement to the 2006 ISDA Definitions circulated in June 2019
- EMMI is planning to have a revised version of the EURIBOR operational by 1 January 2020 to make it compliant with the Benchmark Regulation. Consequences on market standards are still unclear.

Draft ISDA supplement for €STR:

DRAFT

Supplement number [ ] to the 2006 ISDA Definitions  
(published [ ], 2019)

Section 7.1 Rate Options.

a) Section 7.1(f) is amended by adding a new Section 7.1(f)(1) as follows:

(1) "EUR-EuroSTR-COMPOUND" means that the rate for a Reset Date, calculated in accordance with the formula set forth below in this subparagraph, will be the rate of return of a daily compound interest investment (it being understood that the reference rate for the calculation of interest is the euro short term rate (€STR)).

[Upon the occurrence of a EuroSTR Index Cessation Event, the rate for each day in a Calculation Period occurring on or after the EuroSTR Index Cessation Effective Date will be determined as if references to EuroSTR were references to the rate (inclusive of any spreads or adjustments) recommended as the replacement for EuroSTR by the European Central Bank (or any successor administrator of EuroSTR) and/or by a committee officially endorsed or convened by the European Central Bank (or any successor administrator of EuroSTR) for the purpose of recommending a replacement for EuroSTR, (which rate may be proposed by the European Central Bank or another administrator).

If no such rate is recommended before the end of the first TARGET Settlement Day following the day on which the EuroSTR Index Cessation Event occurs, then the rate for each day in a Calculation Period occurring on or after the EuroSTR Index Cessation Effective Date will be determined as if references to EuroSTR were references to **[insert first appropriate fallback rate]**; references to TARGET Settlement Days were references to **[insert relevant business day]**; references to 9:00 a.m., Central European Time (CET) were references to **[insert relevant time]**; references to EuroSTR Index Cessation Event were references to **[insert first appropriate fallback rate]** Index Cessation Event and references to the ECB's Website were references to the **[insert relevant administrator's]** Website.

If no such rate is recommended before the end of the first TARGET Settlement Day following the day on which the EuroSTR Index Cessation Event occurs and an **[insert first appropriate fallback rate]** Index Cessation Event has occurred, then the rate for each day in a Calculation Period occurring on or after the EuroSTR Index Cessation Effective Date will be determined as if references to EuroSTR were references to **[insert second appropriate fallback rate]**; references to TARGET Settlement Day were references to **[insert relevant business day for second appropriate fallback rate]**; references to 9:00 a.m., Central European Time (CET) were references to **[insert relevant time]** and references to the ECB's Website were references to the **[insert relevant administrator's]** Website.

<sup>1</sup> This tracks the fallback wording used for SOFR. An alternative approach could be to track the principles recommended in the EU RFR WG legal action plan: (i) the rate (inclusive of spreads or adjustments) which is formally designated, announced or recommended as a replacement for €STR by a Relevant Issuing Body; (ii) the Eurosystem Deposit Facility Rate (EDFR) plus the spread between €STR and EDFR over a period of (i) TARGET Business Days ending on the EuroSTR Index Cessation Effective Date.

A further alternative is to follow the approach for SONIA and not have specific fallbacks. NB: the ISDA Benchmarks Supplement would provide generic fallbacks if adopted.

# New Market Standards for RFRs: *X-Currency*

- In May 2019, ARRC published potential conventions for dealer-to-dealer swaps on an RFR-RFR-basis.
- As RFRs develop for single currency instruments, there is a need to establish conventions for RFRs in a cross currency context.
- It is preferable to use the same RFR pairs to limit market fragmentation and maintain liquidity.
- *Potential issue for legacy cross currency swaps*: only one rate is triggered and falls back to the designated RFR. ISDA to provide template to trigger both rates at the same time in such a scenario.

# New Market Standards for RFRs: *Consequences for Cash Products*

- Cash products often use (forward-looking) IBORs, rather than overnight rates.
- Thus, there may be a need for forward-looking term rates derived from RFR derivative markets.
- Possibilities for interest observation:
  - **in arrears** (payment on same day, payment delay, lockout period, lookback)
  - **in advance** (last reset, last recent)
  - **hybrid options** (principal adjustment, interest rollover)

Examples of options for interest observation			
Same day		\$	
Payment delay		X	\$
Lockout period		X	\$
Lookback		X	\$
Last reset	X		\$
Last recent	X		\$
Principal adjustment		X	\$
Interest Rollover		X	\$ →
	-3M	Today	+3M
\$ = payment date			
X = payment known			

■ = (secondary) observation period  
■ = interest period

Source: Financial Stability Board: *Overnight Risk-Free Rates, A User's Guide* (4 June 2019)

# Credit Derivatives Developments

- ISDA's Proposed Amendments to the 2014 Credit Derivatives Definitions Relating to Narrowly Tailored Credit Events

- April 2018: CFTC Statement:

*„Manufactured credit events may constitute market manipulation and may severely damage the integrity of the CDS markets... in instances of manufactured credit events, the Divisions will carefully consider all available actions to help ensure market integrity and combat manipulation or fraud involving CDS“*

- December 2018: FCA Newsletter:

*„this behaviour is on 'the wrong side of the line' and goes against the intended purpose of these instruments... may in certain circumstances constitute market abuse by the involved parties – both the CDS counterparty and the firm referenced in the CDS“*

# What's the problem?

- CDS „Credit Events“ trigger on failures to pay debt obligations of over \$1m which may not trigger cross-defaults
- CDS payouts linked to cheapest-to-deliver debt obligation available so minimal payout for creditworthy Reference Entity...
- ...BUT if you can convince a Reference Entity to default on \$1m bond by offering to provide it below market financing...
- Credit Event + low Auction Final Price = \$\$\$\$\$\$ payout
- Codere, iHeart, Hovnanian

# The Proposed Solution

- Amend “Failure to Pay” Credit Event to include creditworthiness test:
  - *“it shall not constitute a Failure to Pay if such failure does not directly or indirectly either result from, or result in, a deterioration in the creditworthiness or financial condition of the Reference Entity”*
- “Guidance on the interpretation of “Failure to Pay” set forth in Exhibit F”
  - *“sets out indicators that the Credit Deterioration Requirement may or may not be satisfied. However, the Determinations Committee will have regard to the broader context in which the non-payment occurred: the factors set out are not exhaustive and no single factor is necessarily conclusive”*
  - *“the non-payment arises directly from an arrangement or understanding (whether or not evidenced in writing) between the Reference Entity and one or more entities **where an essential purpose of the arrangement or understanding** is to create a benefit under a Credit Derivative Transaction”*
- Additional proposed amendments to clarify treatment on Original Issue Discount in bankruptcy (largely US issue)

# More to come...?

June 2019: CFTC/FCA Joint Statement:

*„ The continued pursuit of various opportunistic strategies in the credit derivatives markets, **including but not limited to those that have been referred to as ‘manufactured credit events,’** may adversely affect the integrity, confidence and reputation of the credit derivatives markets, as well as markets more generally. These opportunistic strategies **raise various issues under securities, derivatives, conduct and antifraud laws, as well as public policy concerns.**‘*

*As a result, today the Chairmen and Chief Executive of our respective agencies announce that the agencies will make **collaborative efforts to prioritize the exploration of avenues, including industry input, which will address these concerns** and foster transparency, accountability, integrity, good conduct and investor protection in these markets. These collaborative efforts **would not, of course, preclude other appropriate actions by our respective agencies or authority.**“*

# New Developments on German Bank CDS

- Background:
  - Development of so called “senior non-preferred” bonds in Europe (also based on an amendment to the BRRD, Directive (EU) 2017/2399).
  - In Germany two developments: § 46 f 5-7 KWG (version as of 1. January 2017) and § 46 f 5-9 (version as of 21 July 2018)
  - Publication of the „Additional Provisions of Senior Non-Preferred Obligations) by ISDA on 8 December 2017 and introduction of a new transaction type of a "STANDARD EUROPEAN SENIOR NON PREFERRED FINANCIAL CORPORATE"

# New Developments on German Bank CDS

- What does this change to the structure of bank debt mean under the 2014 ISDA Credit Derivatives Definitions („2014 Defs.”):
  - Three kind of transactions possible: (1) Senior Transaction with Senior Obligation as Reference Obligation, (2) Subordinated Transaction with a Subordinated Obligation as Reference Obligation and (3) Senior Non-Preferred Transaction with a Senior Non-Preferred Obligation as a Reference Obligation (deemed to be a Subordinated Obligation under the 2014 Defs.)
- The 2019 German Bank CDS Protocol
  - Formal amendment of legacy „senior” transaction to Senior Non-Preferred Transactions (in line with DC announcements before)

# New Developments on German Bank CDS

- Consequences for transaction
  - Senior Transaction:
    - Definition of Obligation and Credit Events: Excludes senior non-preferred, Tier 2 and AT 1 for the purposes of a Governmental Intervention and Restructuring
    - Auction Settlement / Cash Settlement / Physical Settlement: related to senior preferred debt only
  - Senior Non-Preferred Transaction:
    - Definition of Obligation and Credit Events: Excludes Tier 2 and AT 1 for the purposes of a Governmental Intervention and Restructuring
    - Auction Settlement / Cash Settlement / Physical Settlement: related to senior non-preferred debt only

# New Developments on German Bank CDS

- Consequences for transaction

- Subordinated Transaction:

- Definition of Obligation and Credit Events: Excludes AT 1 for the purposes of a Governmental Intervention and Restructuring
    - Auction Settlement / Cash Settlement / Physical Settlement: related to Tier 2 debt only

*Ed Parker, Mayer Brown London*

*Henrik Beneke, Landesbank Baden-Württemberg*

# **Initial Margin Implementation for Phase V Entities and Key Legal and Documentation Execution Aspects**

# Where are we now?

## VM & IM TIMELINE

Delayed VM application  
until 2018 for physically  
settled forex forwards

Delayed VM-IM application until  
2020 for exemption for equity  
options (single stock index)



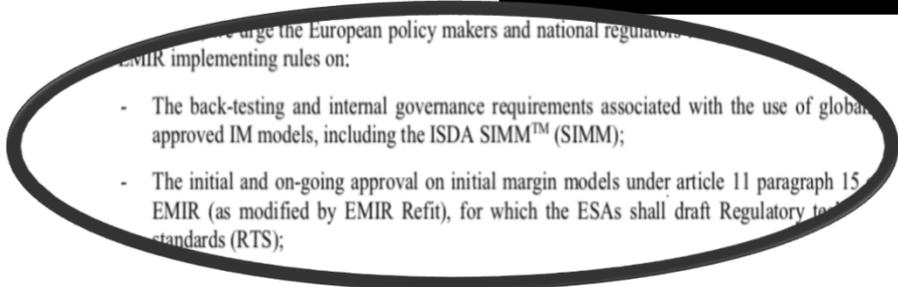
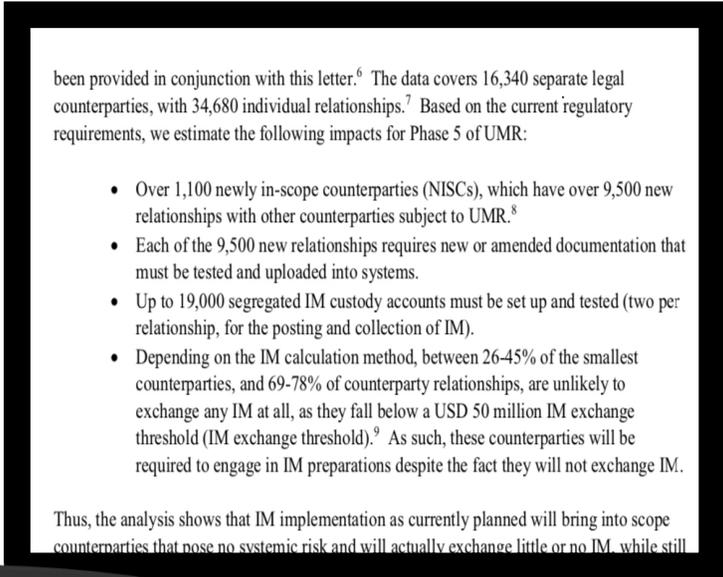
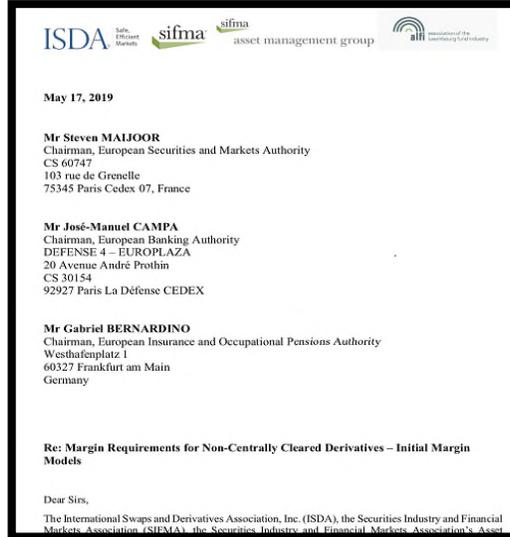
# Let's Talk about Aana!

## IM SEG REQUIREMENTS – CALCULATION OF AANA

Aggregate Average Notional Amount (“AANA”) – Calculation requirements are regime-specific (e.g. different scope of products, currencies and measuring periods)



# Lobbying Efforts: Current Status & Potential Outcomes



# The Threshold Issue



**U.S. Commodity Futures Trading Commission**  
Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581

J. Christopher Giancarlo  
Chairman

(202) 418-5030  
JCGiancarlo@CFTC.gov

April 29, 2019

Hon. Randal K. Quarles,  
Vice Chair for Supervision  
Federal Reserve Board of Governors  
Constitution Ave. & 20<sup>th</sup> Street, NW  
Washington, DC 20551

Dear Randy,

I want to follow up on a recent conversation about "Phase Five" implementation requirements for initial margin on uncleared swaps scheduled for September 2020 ("Phase Five Implementation"). As we discussed, the CFTC's Office of Chief Economist has analyzed market data in light of concerns of many small market participants that will be brought into scope in the Phase Five Implementation.<sup>1</sup> CFTC staff has also reviewed additional data from market participants and industry organizations.

This problem is exacerbated by a significant quirk in the rules: physically-settled FX swaps are included in the calculation of notional amount even though they are exempt from initial margin requirements. An entity doing nothing but \$8 billion of physically-settled FX, for example, would have to prepare to exchange initial margin even though its entire portfolio is exempt from margin requirements.

Not surprisingly, then, the prospect of futile preparations and costs have spurred requests for regulatory relief.

One form of relief would be to raise the material swap exposure threshold from \$8 billion notional to some higher level, say \$50 billion. The CFTC's data analysis indicates, however, that this change might raise concerns about risks to the financial system not intended by the current regulatory structure. More specifically, some entities with notional amounts between \$8 and \$50 billion would drop out of scope despite having calculated initial margin amounts greater than \$50 million.

A different form of relief, however, does not have this drawback: issuance of clarificatory guidance that entities need not have in place systems and documentation to exchange initial margin if their calculated bilateral initial margin requirements are less than \$50 million.

- framework, although the position may be different under relevant implementing laws.
- In the remaining phases of the framework's implementation in 2019 and 2020, initial margin requirements will apply to a large number of entities for the first time, potentially involving documentation, custodial and operational arrangements. The Basel Committee and IOSCO note that the framework does not specify documentation, custodial or operational requirements if the bilateral initial margin amount does not exceed the framework's €50 million initial margin threshold. It is expected, however, that covered entities will act diligently when their exposures approach the threshold to ensure that the relevant arrangements needed are in place if the threshold is exceeded.

The Basel Committee and IOSCO will continue to monitor the effect of meeting the final stage of phase-in, scheduled for 2020.



# The Threshold Issue: dividing across the Group

## Article 29

### Threshold based on initial margin amounts

1. By way of derogation from Article 2(2), counterparties may provide in their risk management procedures that initial margin collected is reduced by an amount up to EUR 50 million in the case of points (a) and (b) of this paragraph or EUR 10 million in the case of point (c) where:

- (a) neither counterparty belongs to any group;
- (b) the counterparties are part of different groups;
- (c) both counterparties belong to the same group.

2. Where a counterparty does not collect initial margins in accordance with paragraph 1(b), the risk management procedures referred to in Article 2(1) shall include provisions on monitoring, at group level, whether that threshold is exceeded and provisions for the retention of appropriate records of the group's exposures to each single counterparty in the same group.

3. UCITS authorised in accordance with Directive 2009/65/EC and alternative investment funds managed by alternative investment fund managers authorised or registered in accordance with Directive 2011/61/EU shall be considered distinct entities and treated separately when applying the thresholds referred to in paragraph 1 where the following conditions are met:

- (a) the funds are distinct segregated pools of assets for the purposes of the fund's insolvency or bankruptcy;
- (b) the segregated pools of assets are not collateralised, guaranteed or otherwise financially supported by other investment funds or their managers.

## Article 28

### Threshold based on notional amount

1. By way of derogation from Article 2(2), counterparties may provide in their risk management procedures that initial margins are not collected for all new OTC derivative contracts entered into within a calendar year where one of the two counterparties has an aggregate month-end average notional amount of non-centrally cleared OTC derivatives for the months March, April and May of the preceding year of below EUR 8 billion.

The aggregate month-end average notional amount referred to in the first subparagraph shall be calculated at the counterparty level or at the group level where the counterparty belongs to a group.

2. Where a counterparty belongs to a group, the calculation of the group aggregate month-end average notional amount shall include all non-centrally cleared OTC derivative contracts of the group including all intragroup non-centrally cleared OTC derivatives contracts.

For the purposes of derivative contracts shall only be taken into account:

3. UCITS authorised in accordance with Directive 2009/65/EC and alternative investment funds managed by alternative investment fund managers authorised or registered in accordance with Directive 2011/61/EU shall be considered distinct entities and treated separately when applying the thresholds referred to in paragraph 1 where the following conditions are met:

- (a) the funds are distinct segregated pools of assets for the purposes of the fund's insolvency or bankruptcy;
- (b) the segregated pools of assets are not collateralised, guaranteed or otherwise financially supported by other investment funds or their managers.

(13) While the thresholds should always be calculated at group level, investment funds should be treated as a special case as they can be managed by a single investment manager and captured as a single group. However, where the funds are

Basel Committee  
on Banking Supervision

Board of the  
International  
Organization of  
Securities Commissions

Margin requirements  
for non-centrally  
cleared derivatives

March 2015

2(ii) The requirement that the threshold be applied on a consolidated group basis is intended to prevent the proliferation of affiliates and other legal entities within larger entities for the sole purpose of circumventing the margin requirements. The following example describes how the threshold would be applied by an entity that is facing three distinct legal entities within a larger consolidated group.

2(iii) Suppose that a firm engages in separate derivatives transactions, executed under separate legally enforceable netting agreements, with three counterparties, A1, A2, A3. A1, A2 and A3, all belong to the same larger consolidated group such as a bank holding company. Suppose further that the initial margin requirement (as described in Element 3) is €100 million for each of the firm's netting sets with A1, A2 and A3. Then the firm dealing with these three affiliates must collect at least €250 million ( $250=100+100+100-50$ ) from the consolidated group. Exactly how the firm allocates the €50 million threshold among the three netting sets is subject to agreement between the firm and its counterparties. The firm may not extend a €50 million threshold to each netting set with A1, A2, A3, so that the total amount of initial margin collected is only €150 million ( $150=100-50+100-50+100-50$ ).

2(iv) Furthermore, the requirement to apply the threshold on a fully consolidated basis applies to both the counterparty to which the threshold is being extended and the counterparty that is extending the threshold. As a specific example, suppose that in the example above the firm (as referenced above) is itself organised into, say, three subsidiaries F1, F2 and F3 and that each of these subsidiaries engages in non-centrally cleared derivatives transactions with A1, A2 and A3. In this case, the extension of the €50 million threshold by the firm to A1, A2 and A3 is considered across the entirety of the firm, ie F1, F2, and F3, so that all subsidiaries of the firm extend in the aggregate no more than €50 million in an initial margin threshold to all of A1, A2 and A3.

# The Scale of Task

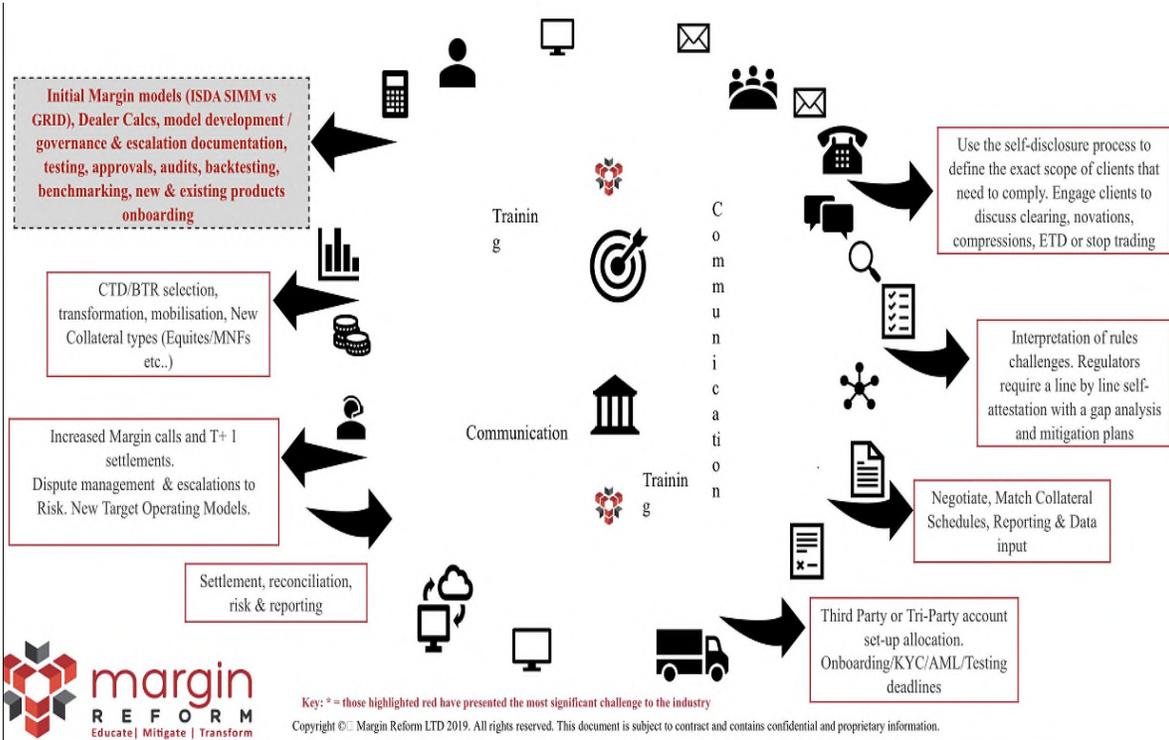
appoint one or  
more custodians  
per counterparty  
group

agree the  
collateralisation  
documentation (for  
example, in the form of  
the Collateral Transfer  
Agreement or the ISDA  
Credit Support Annex/  
Deed)

create a security  
interest over assets  
held by each  
custodian in favour  
of the other  
counterparty

agree account  
control agreement  
documentation  
between the  
counterparties and  
each custodian

# The Wheel of Pain: Where does documentation sit?



**Edmund Parker** / Global Head of Derivatives  
Mayer Brown

**Episode 5: Mission Impossible – the Compliance Process**

371 views

Like Dislike Share Downloaded Save

**Mayer Brown**  
971 subscribers

SUBSCRIBED

Published on 12 Apr 2019

Welcome to Episode 5 for Initial Margin for Uncleared Derivatives in 2019 and 2020, presented by Edmund Parker, Mayer Brown's Global Head of Derivatives & Structured Products, and Chetan Joshi, Founding Partner of Margin Reform. Episode 5 considers the 9 key steps in the Phase 4 and 5 compliance process, illustrated through the compliance 'Wheel of Pain'.

Chetan and Ed look at the 9 key steps in the Phase 4 and 5 compliance process: Self-Disclosure, Client Engagement, Rule Distillation; Legal Agreements; Custodial Onboarding; Technology; Operations; Optimisation; and IM Model Ownership.

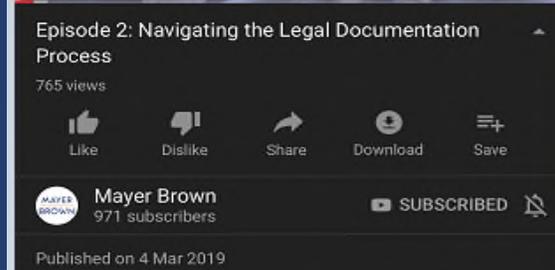
Category Education

# The Documentation Challenge



Requirements to post initial margin (IM) on uncleared OTC derivative trades are being implemented in many of the world's major economies. Welcome to our new series: Initial Margin for Uncleared Derivatives in 2019 and 2020.

Episode 1: Edmund Parker, Mayer Brown's Global Head of Derivatives & Structured Products, provides a detailed overview of the background and documentation requirements for Phase 4 and 5 of the Uncleared Margin Rules. If you are involved in implementing uncleared derivatives margin requirements, this is a must-see.

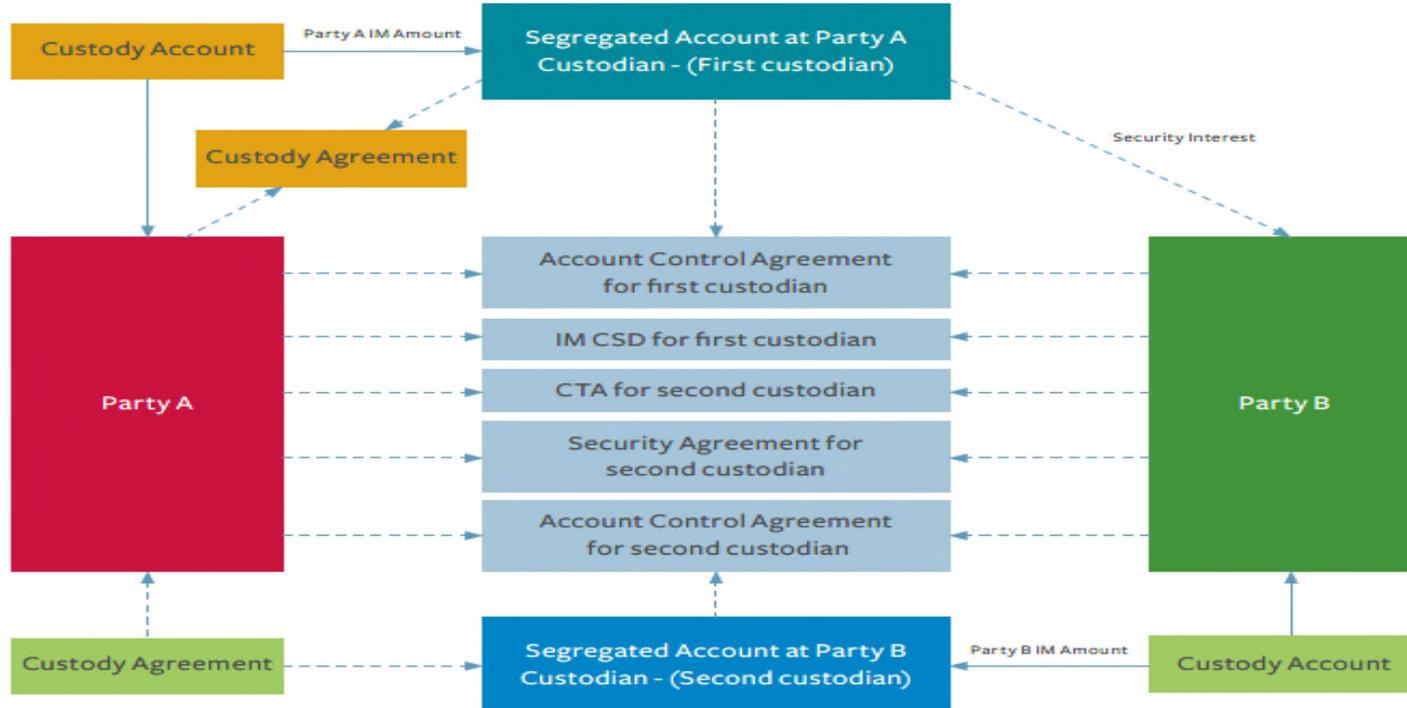


Requirements to post initial margin (IM) on uncleared OTC derivative trades are being implemented in many of the world's major economies. Welcome to Episode 2 of our new series: Initial Margin for Uncleared Derivatives in 2019 and 2020.

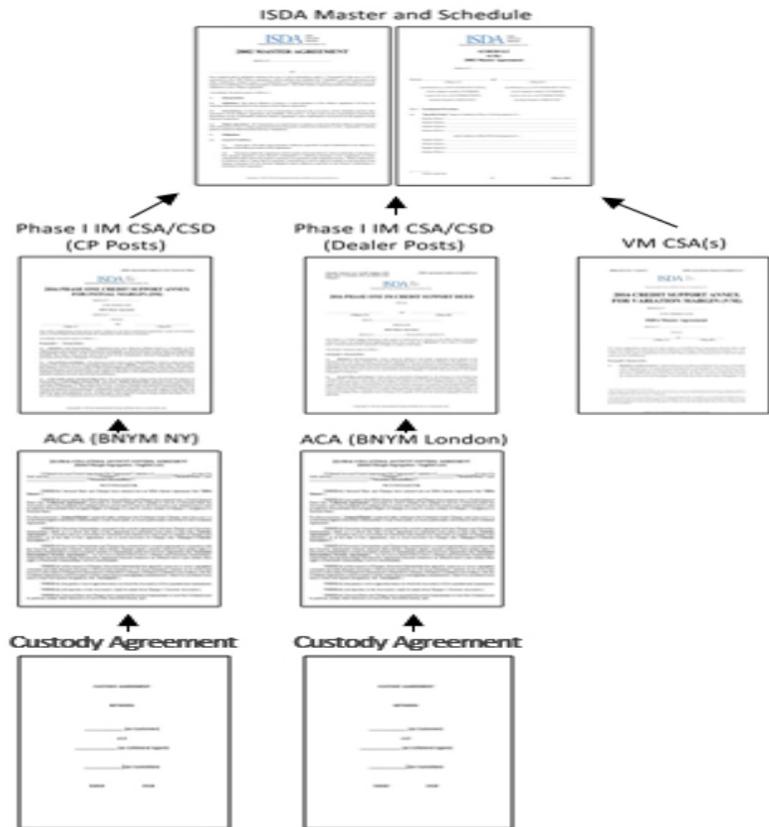
Episode 2 is presented by Edmund Parker, Mayer Brown's Global Head of Derivatives & Structured Products, and Jonathan Martin CEO of DRS. Episode 1 covered the breadth of what IM projects involve, but what happens when you need to get your hands dirty negotiating the documents. How do you set up an infrastructure to do that? And that is what this episode 2 focusses on: successfully navigating, negotiating and executing the legal documentation in an IM project.

Category [Education](#)

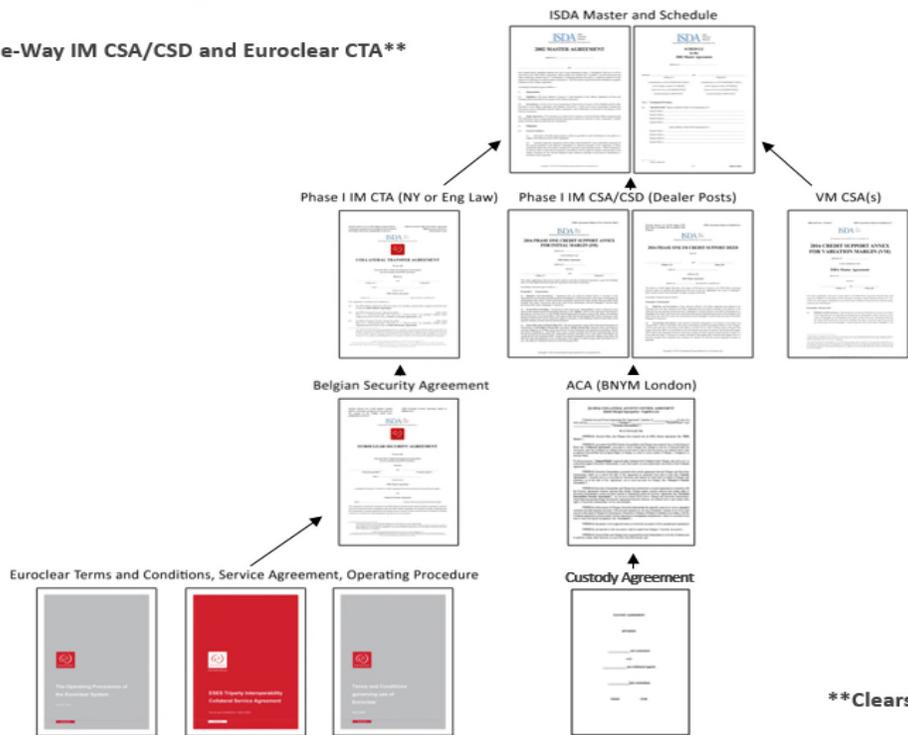
# The Documentation Challenge



# The Documentation Challenge



## One-Way IM CSA/CSD and Euroclear CTA\*\*



\*\*Clearstr

# The Documentation Challenge

Security Interest over Credit Support (IM) (ISDA Agreements Subject to English Law)  
held with a Custodian (IM) on behalf of the Charger



## 2018 CREDIT SUPPORT DEED FOR INITIAL MARGIN (IM)

between

(Party A) and (Party B)

made on

relating to the

ISDA Master Agreement

dated as of between Party A and Party B.

This Deed is a Credit Support Document with respect to both parties in relation to the ISDA Master Agreement referred to above (as amended and supplemented from time to time, the "Agreement") and, subject to Paragraph 7 below, Section 3(d)(ii) of the Agreement will apply in respect of this Deed.

Accordingly, the parties agree as follows:

### Paragraph 1. Interpretation

(a) **Definitions and Inconsistency.** Unless otherwise defined in this Deed, capitalised terms defined in the Agreement have the same meanings in this Deed. Capitalised terms not otherwise defined in this Deed or in the Agreement have the meanings specified pursuant to Paragraph 12, and all references in this Deed to Paragraphs are to Paragraphs of this Deed. In the event of any inconsistency between this Deed and the provisions of the Agreement or any other CSA, this Deed will prevail in the case of (i) matters concerning regulatory initial margin requirements relating to Covered Transactions (IM) posted by a Charger and (ii) specific amendments made herein to the Agreement, the Schedule to the Agreement or any other CSA, and in the event of any inconsistency between Paragraph 11 and the other provisions of this Deed, Paragraph 11 will prevail.

(b) **Secured Party and Charger.** Unless otherwise specified in Paragraph 11, all references in this Deed to the "Secured Party" will be to either party when acting in that capacity and all corresponding references to the "Charger" will be to the other party when acting in that capacity, provided, however, that a reference herein to "Posted Credit Support (IM) being 'held' by a Secured Party at any time...shall be construed as a reference to the Posted Credit Support (IM) credited to the Segregated Accounts at such time in respect of which Security Interest has been created or is, hereunder under this Deed, a reference to a transfer of English Credit Support (IM) or Posted Credit Support (IM) to or from the Custodian (IM) is deemed to be a reference to a transfer to or from the relevant Segregated Accounts, as applicable.

(c) **Scope of this Deed.** The only Transactions which will be relevant for the purposes of determining a "Margin Amount (IM)" under this Deed with respect to a posting obligation of a Charger will be the relevant Covered Transactions (IM) specified in accordance with the provisions of Paragraph 11. Except as expressly

## THE 2018 CREDIT SUPPORT DEED FOR IM (ENGLISH LAW)

- Determining the types of trade caught by IM requirements; "Covered Transactions";
- Determining how IM must be held; transfer provisions; prevention of re-hypothecation; using segregated accounts and custody arrangements;
- Determining the Frequency of IM exchange;
- Determining the amount of IM to be posted, through definitions of Credit Support Amount; Margin Amount (IM); and Minimum Transfer Amount;
- Providing for what type of collateral can be delivered: i.e. what is Eligible Collateral and what is Ineligible Collateral; and
- Which Regulatory Regimes apply.

## ISDA Clearstream Documents (2019)

The following documents are used to document a collateral arrangement between two parties where the...

[Read more →](#)

### Free downloads (9)

- [ISDA Clearstream Collateral Transfer Agreement \(2019\) \(zip\)](#)
- [Blackline ISDA 2016 Clearstream CTA \(English Law\) v ISDA 2019 Clearstream CTA \(pdf\)](#)
- [ISDA 2019 Clearstream Security Agreement \(Luxembourg Law\) Security-provider name \(zip\)](#)

[View all downloads >](#)

## ISDA Euroclear Documents (2019)

The following documents are used to document a collateral arrangement between two parties where the...

[Read more →](#)

### Free downloads (8)

- [ISDA 2019 Euroclear Security Agreement \(zip\)](#)
- [Blackline of ISDA 2019 Euroclear Security Agreement vs 2018 version \(pdf\)](#)
- [ISDA Euroclear Collateral Transfer Agreement \(2019\) \(zip\)](#)

## IM Collateral Documents for use with a Bank Custodian (2019)

The following documents are used to document a collateral arrangement between two parties where the...

[Read more →](#)

### Free downloads (7)

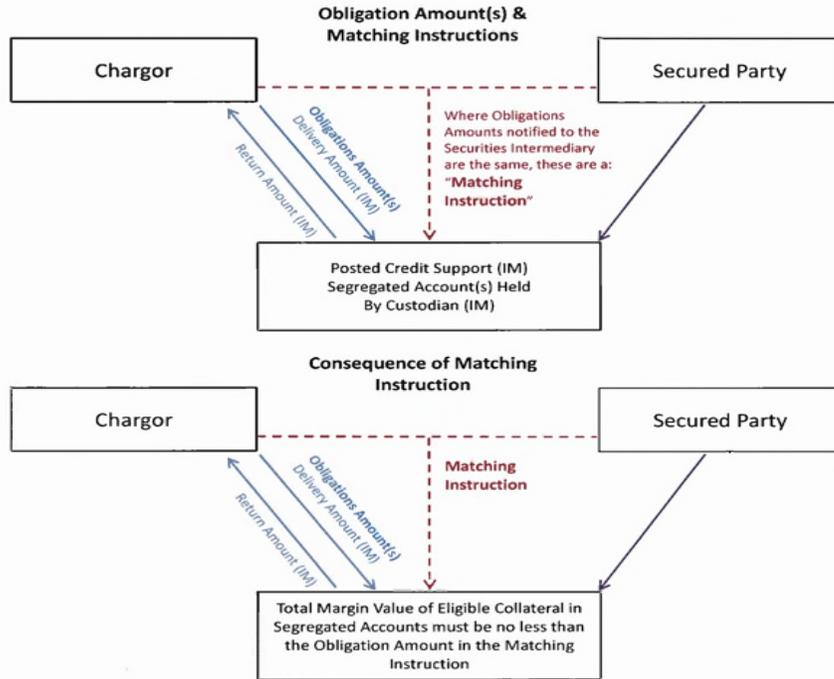
- [ISDA 2019 Bank Custodian Collateral Transfer Agreement for Initial Margin \(IM\) \(zip\)](#)
- [ISDA 2019 English Law Security Agreement for Initial Margin \(IM\) \(zip\)](#)
- [ISDA 2019 New York Law Security Agreement for Initial Margin \(IM\) \(zip\)](#)

## 2018 Credit Support Annex For Initial Margin (IM) (Security Interest – New York Law)

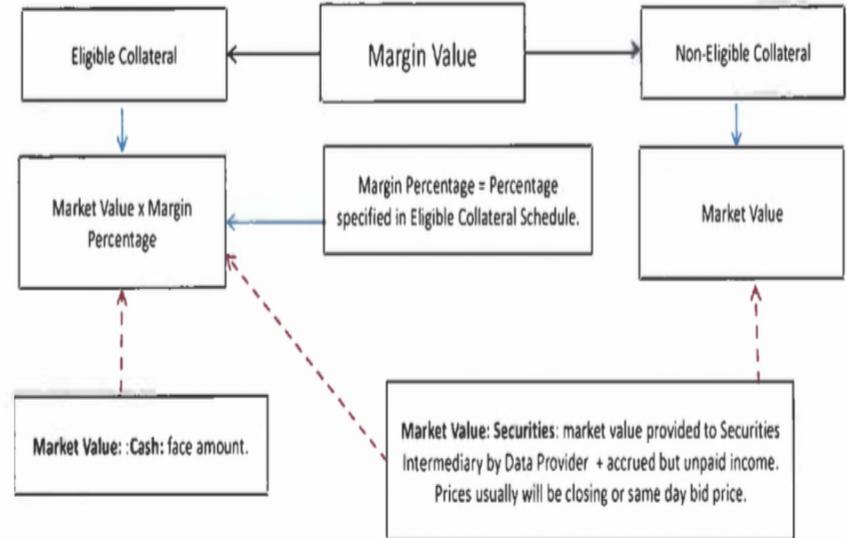
## 2018 Credit Support Annex For Initial Margin (IM) (Security Interest – New York Law)

The 2018 Credit Support Annex For Initial Margin (IM) allows parties to establish initial margin arrangements that meet the requirements of margin regulations for uncleared swaps. ISDA previously published the 2016 Phase One IM Credit Support Annex to support Phase 1 of the initial margin requirements. The 2018 document has been adapted from the 2016 form for use by buy- and sell-side firms in view of the expansion of the impact of IM regulations to firms coming into scope in September 2019 (Phase 4), September 2020 (Phase 5) or later. Like the 2016 Phase One IM Credit Support Annex and the 1994 ISDA Credit Support Annex (Security Interest – New York Law), this document serves as an Annex to the Schedule to the ISDA Master Agreement and creates a New York law security interest over collateral. A blackline against the 2016 Phase One IM Credit Support Annex is also included.

# Account Control Agreements



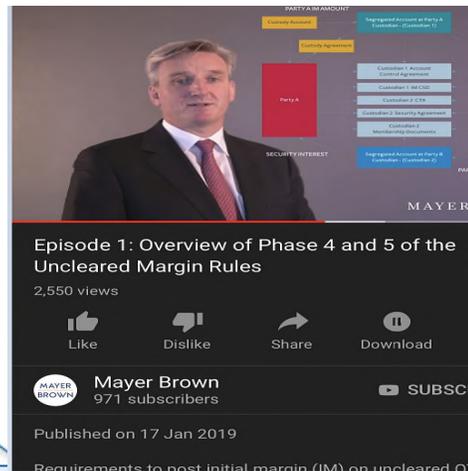
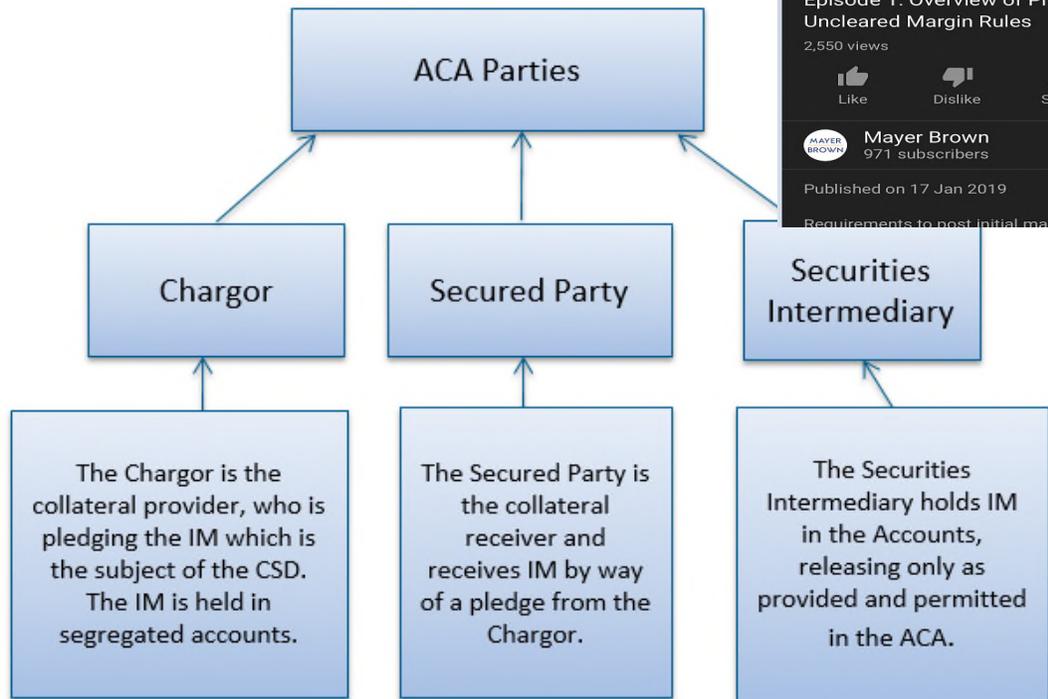
## Determining Margin Value of Eligible Collateral in Segregated Account



# Account Control Agreements

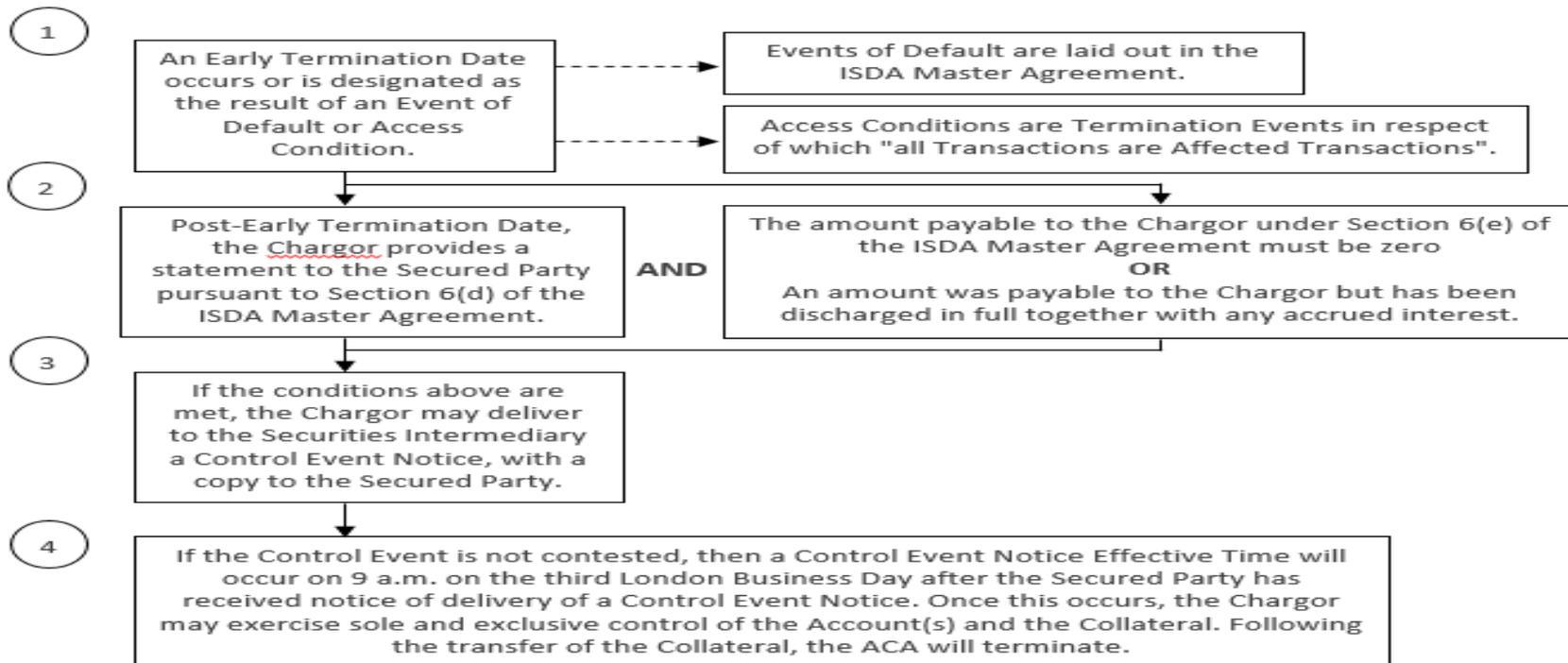
## Essential Components of ACA Documentation

- Parties (see right)
- Representations and Warranties
- Financial Collateral Arrangements
- Handling Collateral - Obligation Amounts; Collateral Eligibility
- Marks to Market
- Substitutions
- Payments of Proceeds
- Notices of Exclusive Control (see below)
- Control Event Notices (see below)
- Notices to Contest
- General Terms and Conditions



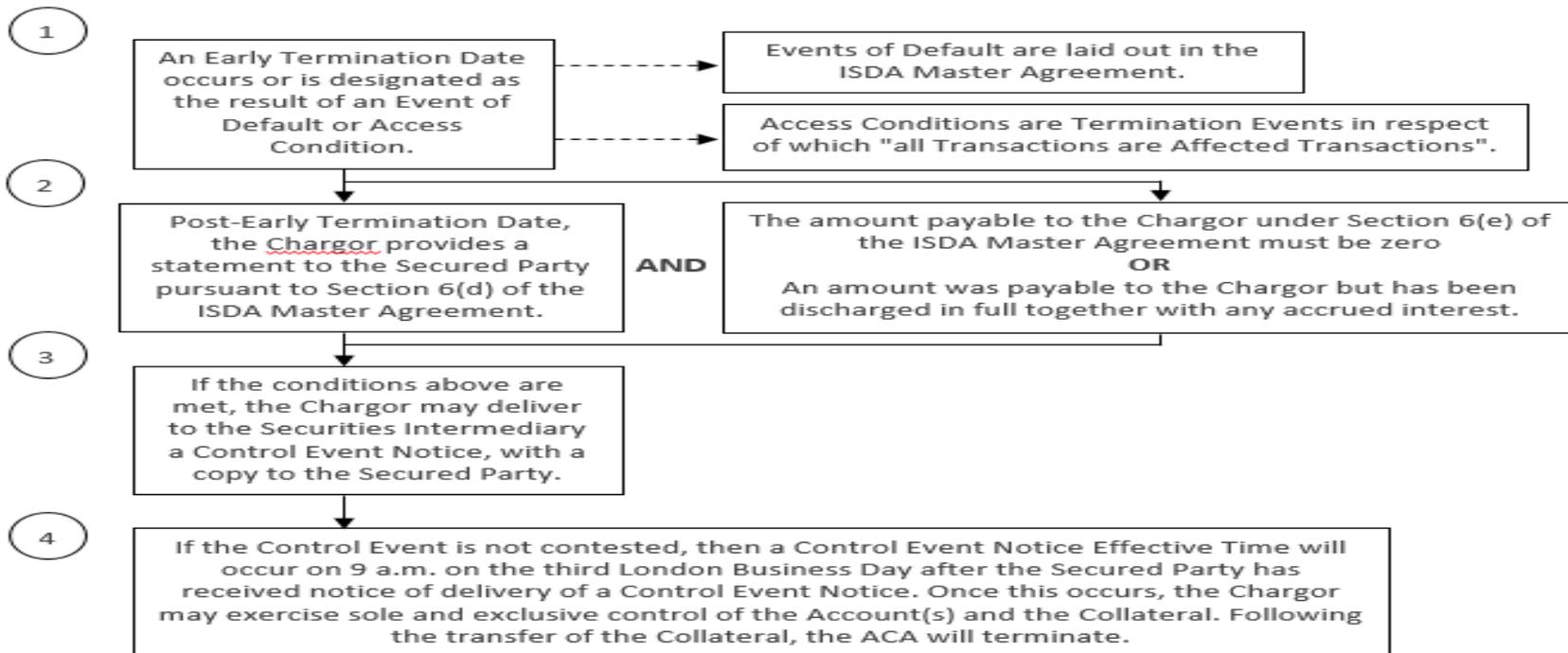
# Account Control Agreements

## Control Event Notice Procedure



# Account Control Agreements

## Control Event Notice Procedure



# Security Agreements

Security interest over Posted Collateral (IM) held with a Custodian (IM)<sup>1</sup> (ISDA 2019 Security Agreement for Initial Margin (IM) subject to Belgian Law)<sup>2</sup>



## 2019 BELGIAN LAW SECURITY AGREEMENT FOR INITIAL MARGIN (IM)

between

("Security-provider") and ("Security-taker")

made on .....

relating to the:

ISDA Master Agreement

between Security-provider and Security-taker;

and

Collateral Transfer Agreement

dated ..... between Security-provider and Security-taker.

This Agreement is entered into in relation to the ISDA Master Agreement and Collateral Transfer Agreement

Accordingly, the parties agree as follows:

Paragraph 1. Definitions, Inconsistency and Headings

(s) *Definitions and Inconsistency.* Unless otherwise defined in Paragraph 10 or elsewhere in Agreement, capitalized terms defined in the Collateral Transfer Agreement have the same meanings in Agreement. All references in this Agreement to Paragraphs are to Paragraphs of this Agreement. In the event of any inconsistency between this Agreement (other than Paragraph 7) and the provisions of the ISDA M Agreement, the Collateral Transfer Agreement or the Control Agreement, the provisions of the ISDA M Agreement, the Collateral Transfer Agreement and the Control Agreement (as applicable) shall prevail at the event of any inconsistency between Paragraph 11 and the other provisions of this Agreement. Paragraph 11 shall prevail. In the event of any inconsistency between Paragraph 7 and the provisions of the ISDA M Agreement, the Collateral Transfer Agreement or the Control Agreement, the provisions of Paragraph 7 shall prevail.

<sup>1</sup> Note that this 2019 Belgian Law Security Agreement for Initial Margin (IM) has been designed for use with regulatory IM. This 2019 Belgian Law Security Agreement for Initial Margin (IM) has been prepared for use in conjunction with an ISDA Collateral Transfer Agreement for Initial Margin (IM). For the avoidance of doubt, in preparing this document as a custodian documentation was reviewed and use of this document is not targeted at, or limited to, any specific custodial platform. Users should consult their legal advisers as to the proper use and effect of this form and the amendments it contains.

Copyright © 2019 by International Swaps and Derivatives Association, Inc.

Security interest over Posted Collateral (IM) held with a Custodian (IM) on behalf of the Security-provider<sup>1</sup> (ISDA 2019 Security Agreement for Initial Margin (IM) subject to Luxembourg Law)<sup>2</sup>



## 2019 LUXEMBOURG LAW SECURITY AGREEMENT FOR INITIAL MARGIN (IM)

Between

("Security-provider") and ("Security-taker")

made on .....

relating to the:

ISDA Master Agreement

between Security-provider and Security-taker;

and

Collateral Transfer Agreement

dated ..... between Security-provider and Security-taker.

This Agreement is entered into in relation to the ISDA Master Agreement and Collateral Transfer Agreement

Accordingly, the parties agree as follows:

Paragraph 1. Definitions, Inconsistency and Headings

Security interest over Clearstream collateral account in the name of the Security-provider in favour of the Security-taker<sup>1</sup> (ISDA 2019 Clearstream Security Agreement subject to Luxembourg Law)<sup>2</sup>



## 2019 CLEARSTREAM SECURITY AGREEMENT

for use with

the Clearstream Triparty Collateral Management

between

..... ("Security-provider") and .....

dated .....

relating to the:

ISDA Master Agreement

(as defined in Paragraph 21 (*Definitions*) of this Agreement) between Security-provider

and

Collateral Transfer Agreement

dated ..... between Security-provider

and

Pledged Account number ..... (as defined in Paragraph

Security interest over Credit Support Amount held in a Euroclear account (or sub-division of a Euroclear account) in its own name for the account of the Pledgee (third party pledgeholder structure)<sup>1</sup> (ISDA 2019 Euroclear Security Agreement subject to Belgian Law)<sup>2</sup>



## 2019 EUROCLEAR SECURITY AGREEMENT

for use with

Euroclear Bank collateral management documentation for non-centrally cleared OTC derivatives

between

..... ("Security-provider") and .....

dated .....

relating to the:

ISDA Master Agreement

(as defined in Section 21 (*Definitions*) of this Agreement) between Security-provider and Security-taker;

and

Collateral Transfer Agreement

dated ..... between Security-provider and Security-taker.

This Agreement is entered into in relation to the ISDA Master Agreement and Collateral Transfer Agreement in order to secure the Security-provider's obligations under the ISDA Master Agreement, the Collateral Transfer Agreement and this Agreement by creating a Belgian law first ranking security interest in respect of the Euroclear Collateral (as defined in Section 21 (*Definitions*) of this Agreement) upon the terms set out herein.

# Other issues: Choice of Custodian & Initial Margin Model

**ISDA SIMM vs Schedule IM** IHS Markit

- ISDA SIMM:
  - Model – Parametric VaR model
  - Structure – hierarchies: Product Class >> Risk class >> Bucket >> Risk Factor
- Sample calculations:

	Portfolio 1 (Naked swap)	Portfolio 2 (Hedged)
Composition	1) \$100M 5Y IRS Pay Fixed (03/Sep/2023)	1) \$100M 5Y IRS Pay Fixed (03/Sep/2023) 2) \$100M 5Y IRS Rec Fixed (10/Sep/2023)
Delta	-\$1,854	\$63
SIMM	\$2,072,528	\$30,058
Schedule IM	\$2,001,000	\$3,154,781
Schedule / SIMM ratio	96%	105%

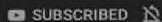


## Episode 3: The Custodian's Guide to Initial Margin Segregation and Asset Transformation

458 views



**Mayer Brown**  
971 subscribers



Published on 10 Apr 2019

Episode 3 is presented by Edmund Parker, Mayer Brown's Global Head of Derivatives & Structured Products, and Mark Higgins, Senior Product Manager of BNY Mellon. In Episode 3, we consider the margin segregation options available for Phase 4 and Phase 5 counterparties. How to source the right collateral to meet IM regulatory obligations; the differences between Triparty and Third

## In this episode we will cover:

- The margin segregation options available for Phase 4 and Phase 5 counterparties.
- How to source the right collateral to meet IM regulatory obligations.
- The differences between Triparty and Third Party collateral management and what may be right for you.
- Collateral transformation – how can you convert assets when needed to meet market obligations?



## Episode 4: Calculating Initial Margin

512 views



**Mayer Brown**  
971 subscribers



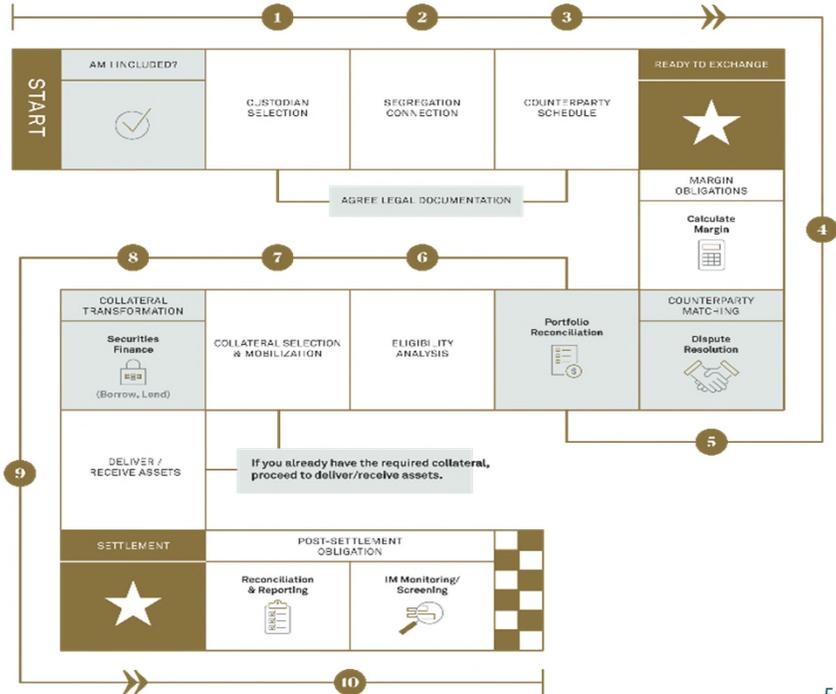
Published on 10 Apr 2019

Welcome to Episode 4 of Initial Margin for Uncleared Derivatives in 2019 and 2020, presented by Edmund Parker, Mayer Brown's Global Head of Derivatives & Structured Products, and Hiroshi Tanase, Executive Director and Product Manager of IHS Markit.

We provide an overview of the initial margin calculation - from the fundamental definition to the specific calculation methodologies - in the context of preparing for regulatory compliance. We cover the definition of IM and its characteristics; the IM calculation methodologies – how to perform the calculation; Implementing a solution; and SIMM validation and backtesting.

Category **Education**

# Other issues: Choice of Custodian & Initial Margin Model



59

## Benefits & Challenges of SIMM

Benefits	Challenges
<ul style="list-style-type: none"> <li><b>Economic benefit</b> → in contrast to Schedule IM</li> <li><b>Minimized IM dispute</b> → common model for all</li> <li>Reduced/shared burden of regulatory approval process</li> <li>Reduced implementation / maintenance cost</li> </ul>	<ul style="list-style-type: none"> <li><b>Performance &amp; scalability</b> → AAD, parallel computing</li> <li><b>Market data</b> → full dataset is required for risk sensitivity calculation</li> <li>SIMM certification, ongoing maintenance and validation</li> </ul>

## The Standard Approach – the (True) Cost of Using It

- IM using the standard approach (aka Schedule IM, Grid-based approach) can be substantially larger

Standardised initial margin schedule

Asset class	Initial margin requirement (% of notional exposure)
Credit 0-2 year duration	2
Credit 2-5 year duration	5
Credit 5+ year duration	10
Commodity	15
Equity	15
Foreign exchange	6
Interest rate 0-2 year duration	1
Interest rate 2-5 year duration	2
Interest rate 5+ year duration	4
Other	15

$\bullet$  *Net standardised initial margin = 0.4 \* Gross initial margin + 0.6 \* NGR \* Gross initial margin*

$\bullet$  (\*NGR: the level of net replacement cost over the level of gross replacement cost for transactions subject to legally enforceable netting agreements)

- With limited netting benefit recognition, Schedule IM can be much larger than SIMM
- The counterparty may charge for additional funding cost through new trades (e.g. MVA)
- Market consensus is to use ISDA SIMM as primary methodology



# Series 1 of Initial Margin for Uncleared Derivatives in 2019 and 2020/Series 2 Coming Soon



Mayer Brown

Subscribe 971

Home Videos Playlists Channels Discussion About



## Initial Margin for Uncleared Derivatives in 2019 and 2020

Mayer Brown • 6 videos • 461 views • Last updated on 18 Apr 2019

A Mayer Brown series, presented by Edmund Parker, Mayer Brown's Global Head of Derivatives & Structured Products; and guests, on the latest thinking and best practices regarding the Uncleared Margin Regulations.

▶ Play all ◀ Share + Save

-  **Episode 1: Overview of Phase 4 and 5 of the Uncleared Margin Rules**  
by Mayer Brown 28:34
-  **Episode 2: Navigating the Legal Documentation Process**  
by Mayer Brown 13:48
-  **Episode 3: The Custodian's Guide to Initial Margin Segregation and Asset Transformation**  
by Mayer Brown 26:00
-  **Episode 4: Calculating Initial Margin**  
by Mayer Brown 26:32
-  **Episode 5: Mission IMpossible – the Compliance Process**  
by Mayer Brown 31:03
-  **Prequel: The New Margin Requirements and Risk Mitigation Techniques for Uncleared Swaps under EMIR**  
by Mayer Brown 24:16

Initial Margin for Uncleared Derivatives in 2019 and 2020   
A Mayer Brown series, presented by Edmund Parker and guests. [Click here for Series 1](#)

# IMpact3

MAYER | BROWN   DRS™  
Alternative, Legal Solutions.   margin  
REFORM™  
Specialist Project Support

**IMpact<sup>3</sup>**  
A WEALTH OF EXPERIENCE,  
DELIVERED WITH PRECISION

## MAYER | BROWN

### Template and play book development

- Preparation of template IM documentation
- Preparation and maintenance of negotiation "playbooks"

### Advice on complex/ bespoke issues

- Consideration of complex or bespoke (i.e. non-playbook) legal and regulatory issues arising during IM negotiations

### Post-completion assurance

- Drafting compliance/legal memorandums (if required)
- Assisting with registration obligations (if required)



## DRS™

Alternative, Legal, Solutions.

### Paralegal / Operations

- Creation of IM draft contracts
- Outreach & chasing
- Review of client amendments
- Creation of revised drafts
- Creation of execution copies
- Maintenance of DMS/project data

### Legal Review

- Validate output to Paralegal team
- Manage escalation to stakeholders
- Ensure playbook compliance

### SME

- Resolution of complex queries
- Liaison with Mayer Brown/ in-house legal
- Training

### PMO

- Process management
- Production of MI
- SLA/KPI monitoring
- Resource management



## margin REFORM™

Specialist Project Support

### Educate

- Practitioner-led collateral expertise and workshop facilitation
- Deciphering the regulatory and business issues that define your scope
- Tailored recommendations on the most appropriate approach to IM compliance

### Mitigate

- Multiple accelerators enabling you to build for success
- A unique approach to the collateral risk model, structure and governance
- Planning all facets of implementation and operational readiness

### Transform

- Phase expertise combined with structured project management
- Full Collateral Management lifecycle including SIMM
- Bringing an efficient, robust and transformed target state operating model to life

IMpact<sup>3</sup> =



26.06.2019 · Henrik Beneke, LL.M., Rechtsanwalt (Syndikusrechtsanwalt) .

**LB  $\equiv$  BW**  
Bereit für Neues

# DRV Initial Margin-Dokumentation & praktische Umsetzungsfragen

5th OTC Derivatives Seminar Mayer Brown am 26.06.2019 in Frankfurt

# Agenda

- |    |  |          |
|----|--|----------|
| 01 | Aufbau und Konzeption der DRV IM-Dokumentation           | Seite 3  |
| 02 | Einzelregelungen und Besonderheiten DRV IM-Dokumentation | Seite 6  |
| 03 | Praktische Umsetzungsfragen                              | Seite 11 |

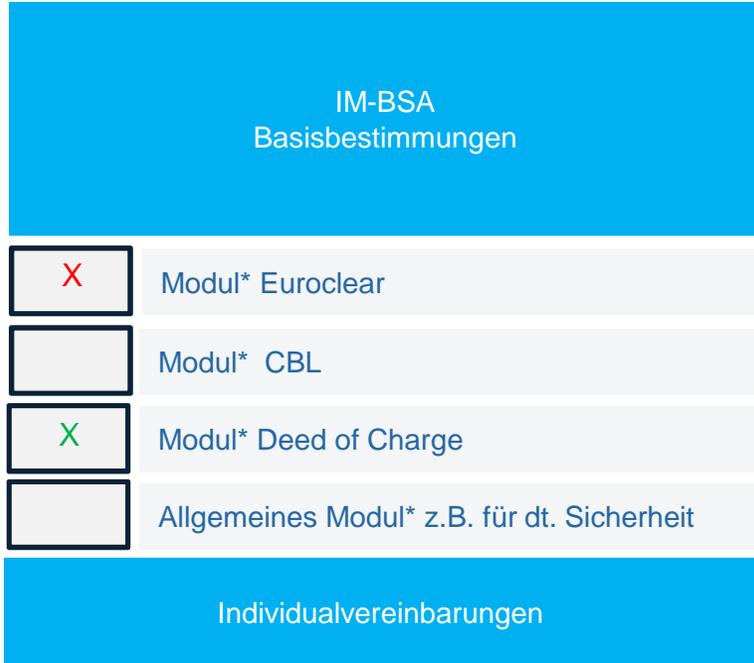
## 01

Aufbau und Konzeption der DRV IM-  
Dokumentation

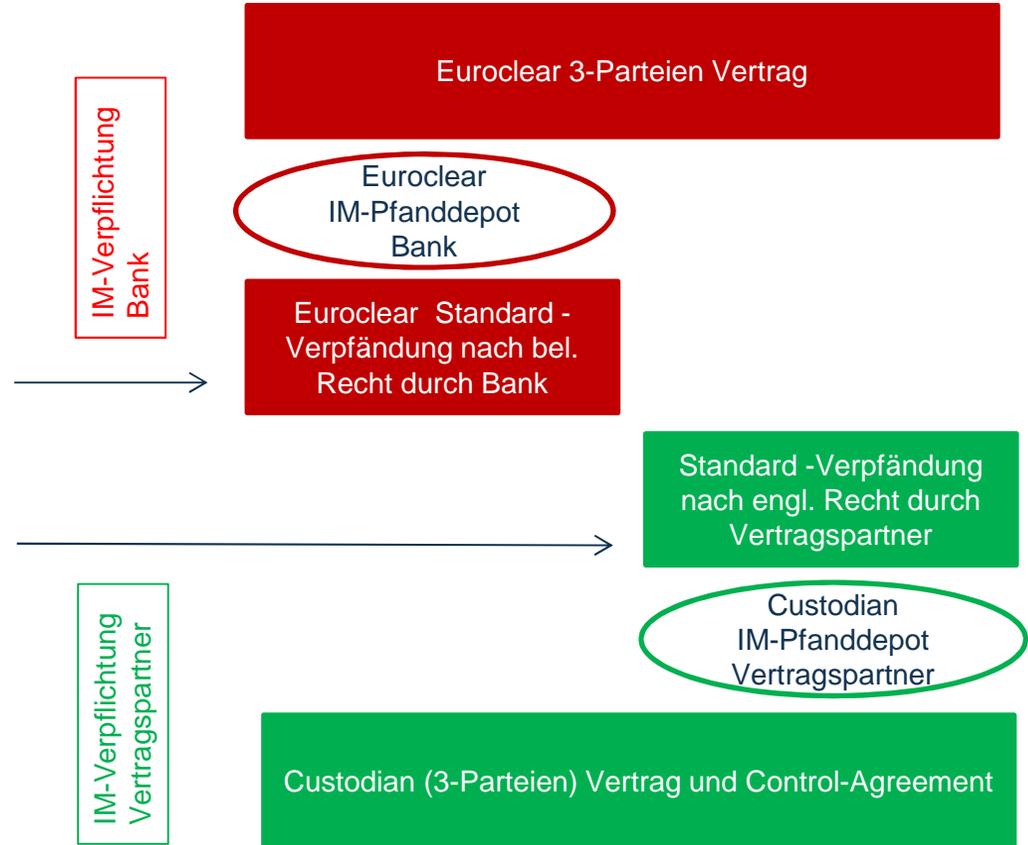
# IM-Besicherungspflicht – Überblick

- **IM-BSA wurde im Arbeitskreis des BdB erstellt und entwickelt und im Oktober 2018 veröffentlicht**
- **IM-Dokumentation/ modularer Ansatz**
- Bei der IM-Dokumentation wurde in modularer Ansatz verfolgt: Sie besteht aktuell aus folgenden Elementen:
  - Dem eigentlichen IM-Besicherungsanhang (IM-BSA) unter deutschem Recht,
  - einer Sicherheitenvereinbarung unter luxemburgischen Recht (Security Agreement)/ IM-Security Agreement pursuant to Luxembourg Law und
  - einer Sicherheitenvereinbarung unter belgischem Recht / IM-Security Agreement pursuant to Belgian Law.
- Letztere Varianten wurden im Hinblick auf die große praktische Bedeutung der beiden Zentralverwahrer Clearstream in Luxemburg und Euroclear in Belgien gewählt.
- **Der IM-BSA ist als zweisprachiges (deutsch/englisches) Dokument entwickelt worden. Die Sicherheitenvereinbarungen sind – da nicht deutschem Recht unterliegend – englischsprachig.**
- **Bei Einbindung von Zentralverwahrern oder auch anderen Verwahrstellen in die Abwicklung der IM-Sicherheitenstellung werden weitergehende Vereinbarungen mit diesen Dritten abgeschlossen werden. Die Dokumentation wird daher meist vielschichtig und der Verhandlungs- und Implementierungsaufwand nicht unerheblich sein.**

# Struktur des IM-BSA



\* Ggf. auch als eigener Anhang oder Zusatzvereinbarung ausgestaltbar



# 02

## Einzelregelungen und Besonderheiten DRV IM-Dokumentation

# Einzelregelungen des DRV IM-BSA 1

## ➤ Nr. 1 Zweck und Gegenstand des Anhangs

- Der Anhang spricht nur von „IM-Sicherungsgeber“ und „IM-Sicherungsnehmer“, obwohl jede Partei beide Rollen inne haben kann
- Der Anhang ist daher immer „zwei Mal“ zu lesen, einmal aus Sicht der Vertragspartei als „IM-Sicherungsgeber“ und einmal aus Sicht als „IM-Sicherungsnehmer“
- Der Anhang begründet zwei rechtlich eigenständige Verträge
- Klarstellung, dass je Vertragspartei ein IM-Pfanddepot bzw. IM-Pfandkonto eingerichtet wird
- Sicherungszweck umfasst alle gestellten Sicherheiten, unabhängig von der Eignung als IM-Sicherheit
- Klarstellung, dass Sicherheit gem. IM-BSA 2-stufig zu stellen sind:
  1. Stellung der IM-Sicherheiten, 2. Belastung durch ein IM-Sicherungsrecht

## ➤ Nr. 2 Begriffsbestimmungen

- Bezeichnung „IM“ (Initial Margin) im gesamten IM-BSA bzw. vor jedem relevanten Begriff. „Ersteinschuss“ wird grds. nicht verwendet
- Verweis auf die weiteren für den IM-BSA notwendigen Verträge: IM-Sicherheitenvereinbarung, IM-Verwahrstellenvereinbarung, IM-Verwahrstellenanhang (soweit notwendig)

## Einzelregelungen des DRV IM-BSA 2

### ➤ **Nr. 3 IM-Unterdeckung / Nr. 4 IM-Überdeckung**

- IM-Sicherheiten müssen dem IM-Pfandkonto/IM-Pfanddepot gutgeschrieben sein und mit einem IM-Sicherungsrecht belastet sein, um nicht bei der IM-Unterdeckung/IM-Überdeckung berücksichtigt zu werden
- Angeforderte IM-Sicherheiten sind gleichtägig dem IM-Pfandkonto/IM-Pfanddepot gutzuschreiben (T+1), auch Möglichkeit zur Mehrfachen Bestimmung pro Tag. Freigabe von IM-Sicherheiten bei IM-Überdeckung gleichtägig (T+1)
- Bzgl. Transfer der IM-Sicherheiten Verweis auf den IM-Verwahrstellenanhang bzw. IM-Verwahrstellenvereinbarung. Verpflichtung des IM-Sicherungsnehmers zur Anweisung an die IM-Verwahrstelle

### ➤ **Nr. 6 Verlust der Eignung als IM-Sicherheiten**

- Verlust der Eignung sobald die aufsichtsrechtlichen Anforderungen nicht mehr erfüllt sind
- Mitteilungspflicht des IM-Sicherungsnehmers über den Verlust der Eignung als IM-Sicherheiten
- Reduzierung des IM-Anrechnungswertes auf 0 nach 5 Tagen => Abweichen von den reg. Vorgaben analog dem VM-BSA

## Einzelregelungen des DRV IM-BSA 4

### ➤ **Nr. 8 IM-Berechnungsstelle und IM-Bewertungsstelle**

- Unterscheidung zwischen „Berechnung“ und „Bewertung“:
  - Berechnung bezieht sich auf den Anspruch der zu leistenden IM
  - Bewertung bezieht sich auf die gestellten IM-Sicherheiten
- IM-Berechnungsstelle kann die Bank oder der Vertragspartner sein; bei Auslagerung auf einen Dritten besteht trotzdem die Pflicht für die jeweilige Vertragspartei

### ➤ **Nr. 10 IM-Verwahrstelle und IM-Sicherheiten**

- Klarstellung, dass die IM-Verwahrstelle als Erfüllungsgehilfe des IM-Sicherungsgebers handelt und der Sicherungsnehmer keine Haftung für die IM-Verwahrstelle übernimmt
- Zusicherung des IM-Sicherungsgebers, über IM-Sicherheiten frei von Rechten Dritter verfügen zu können

## Einzelregelungen des DRV IM-BSA 6

### ➤ **Nr. 15 Individualvereinbarungen**

- Festlegung der zulässigen IM-Sicherheiten, der IM-Verwahrstellen, der IM-Pfanddepots, der IM-Pfandkonten, der IM-Verwahrstellen-anhänge, der IM-Verwahrstellenvereinbarungen
- Festlegung der IM-Berechnungsmethode => ISDA SIMM™ oder Standardansatz
- Festlegung der Freibeträge (Thresholds)

### ➤ **Weitere Regelungen**

- Verfahren bei Streitigkeiten (Nr. 9)
- Weiterverwendungsverbot für gestellte IM-Sicherheiten (Nr. 11)
- Verwertungsrecht (Nr. 12)
- Nichtleistung und Kündigung des DRV (Nr. 13)
- Verpfändungsvereinbarung nach lux. Recht
  - Sog. IM-Security Agreement pursuant to Luxembourg Law
  - Stellt einen Anhang zum IM-BSA dar (Anhang zum Anhang)
  - Ist die „IM-Sicherheitenvereinbarung“ gem. dem DRV IM-BSA
  - Wird im Rahmen des Luxemburger Gutachtens zum IM-BSA mit begutachtet

# 03

## Praktische Umsetzungsfragen

# Initial Margin betrifft viele verschiedene Bereiche einer Bank

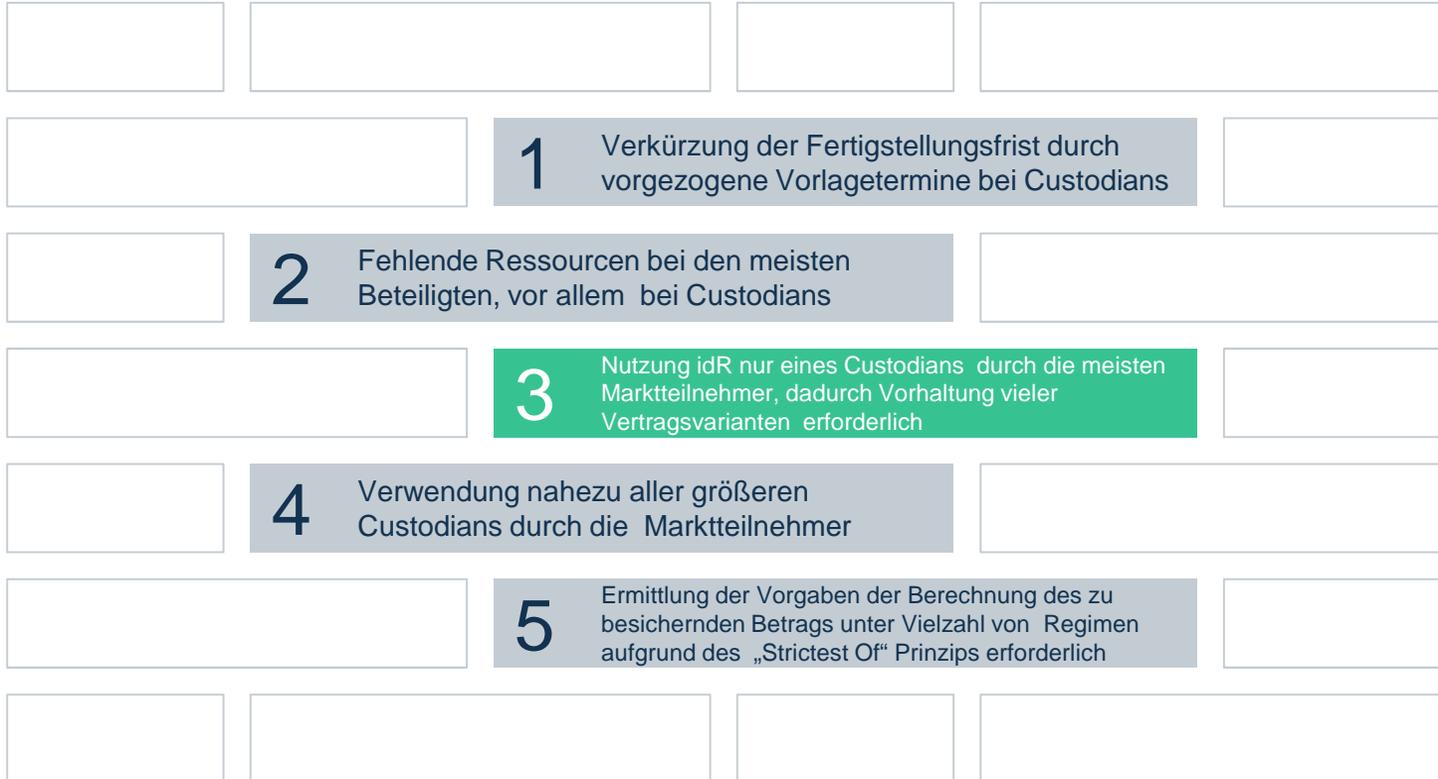


# Einführung IM-Besicherung im Wettlauf gegen die Zeit

- Berechnung des AANA zur Bestimmung des Einführungs-Datums nach allen anwendbaren regulatorischen Regimen
- Identifizierung der zu besichernden Vertragsverhältnisse und Transaktionsarten
- Aufsetzen der IM Besicherungsprozesse in den Systemen der Bank
- Dokumentierung der internen Risikomanagement-Prozesse
- Durchführung von Testläufen mit Vertragspartnern und Drittanbietern im Hinblick auf die Übereinstimmung der Berechnungen der zu besichernden Beträge
- Ggf. Modellabnahme durch lokale Aufsicht; Modellgovernance



# Herausforderungen bei der Fertigstellung der IM Dokumentation



# Aktuelle Umsetzungsfragen

## Drittstaatenausnahme für IM

- Art. 31 DelVO 2016/2251 sieht auch Ausnahme für IM vor.
- Segregation darf im relevanten Land nicht durchsetzbar sein
- Segregation erfolgt aber regelmäßig beim Custodian und damit meist rechtlich durchsetzbar.



**Prüfungskriterien, dass Segregierungsvereinbarung nicht durchsetzbar ist, sind zu definieren.**

## "Schlanke Doku"

- BCBS/IOSCO erfordert nicht zwingend eine vollständige Dokumentation wenn der IM-Threshold 50 Mio € nicht überschritten wird (vgl. Statement vom 5.3.2019)
- Ausgestaltung der Vorgabe des IOSCO Statements durch US-Aufsicht angekündigt
- Entsprechende Erwartung an europ. Aufsichtsbehörden
- Der Zeitplan ist allerdings offen.



**Marktentwicklung beobachten und relevante Kontrahenten identifizieren**

## Risikomanagementverfahren in Bezug auf Sicherheiten

- Sicherheiten dürfen nur nach bestimmten Kriterien entgegen genommen und gestellt werden.
- Die Allokation der Sicherheiten übernimmt Custodian.
- Gemäß Risikomanagementverfahren ist sicherzustellen, dass die Sicherheiten den Anforderungen entsprechen.
- Für die IM-Umsetzung sind die Regelungen in den Custodian-Verträgen zu prüfen.



**Erfüllung von EMIR-Anforderungen von Custodian abhängig**



Noch Fragen???

Vielen Dank für Ihre Aufmerksamkeit!!!

Henrik Beneke, LL.M.  
Rechtsanwalt (Syndikusrechtsanwalt)  
Rechtsabteilung III  
Landesbank Baden-Württemberg

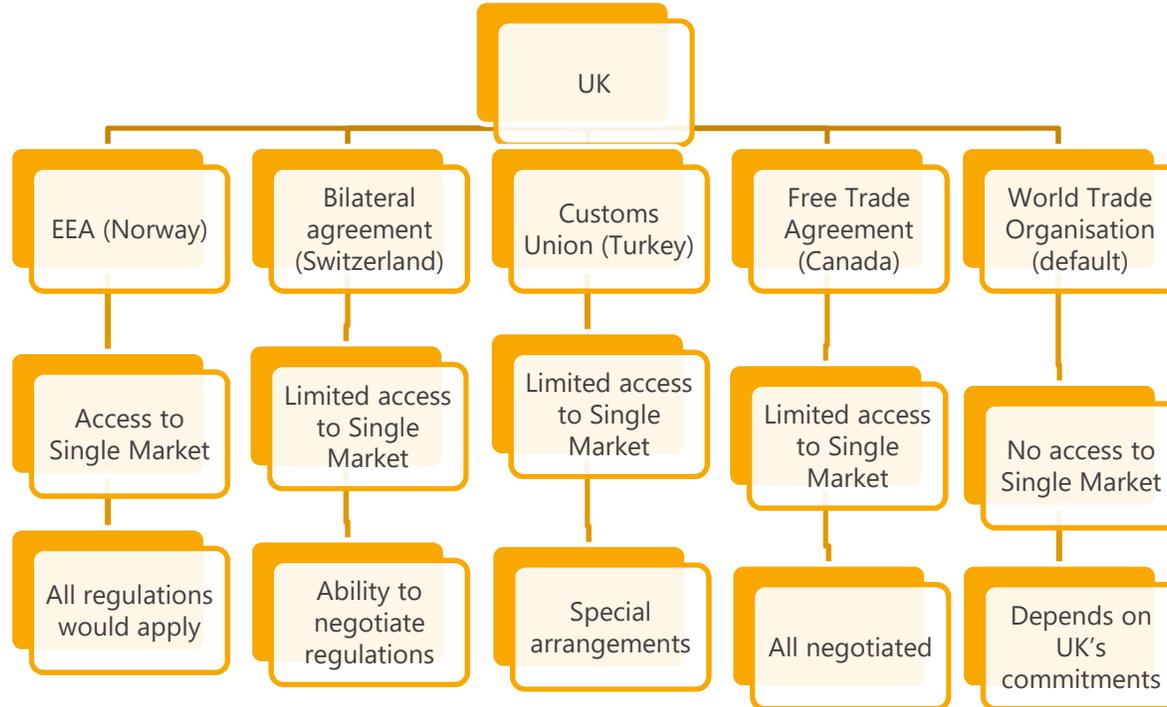
Am Hauptbahnhof 2  
70173 Stuttgart  
Tel.: +49 (0) 711/127-74626  
Fax: +49 (0) 711/127-6674626  
mailto: henrik.beneke@LBBW.de  
<http://www.LBBW.de>

*Patrick Scholl, Mayer Brown Frankfurt*

*Ed Parker, Mayer Brown London*

# **Pre- and Post-Brexit Changes to Derivative Documentation**

# Flashback I : What we said to you in 2016 in Frankfurt: Brexit Options



# Flashback II: What we said to you in 2018 in Frankfurt: Road to Brexit



**October 18–19, 2018:**  
**EU Council.** Brexit deal is put to European leaders. It needs approval from at least 20 of the 27 member countries.

**December 31, 2020:**  
**Transition period ends.** The UK aims to have signed a free-trade deal with the EU.

2019

2020

**October 2018:**

MPs vote on the **final Brexit deal**, including a political declaration about the future UK-EU relationship

**March 29, 2019:**

**UK leaves the EU**, but remains signed up to many of its rules for a transition period while it negotiates a free-trade deal.



# Status of Challenger ISDA Master Agreements



ISDA Safe, Efficient Markets  
International Swaps and Derivatives Association, Inc.

**2002 MASTER AGREEMENT**      **CONTRAT-CADRE 2002**

dated as of \_\_\_\_\_      Effectif au \_\_\_\_\_

and \_\_\_\_\_      et \_\_\_\_\_

have entered and/or anticipate entering into one or more transactions (each a "Transaction") that are or will be governed by this 2002 Master Agreement, which includes the schedule (the "Schedule"), and the documents and other confirming evidence (each a "Confirmation") exchanged between the parties or otherwise effective for the purpose of confirming or evidencing those Transactions. This 2002 Master Agreement and the Schedule are together referred to as this "Master Agreement".

ont, souche et/ou opérations (chaque "Opération") [J]u présent Contrat ("l'Annexe") [S] justificatifs de constituent une entre les parties et des Opérations

Multi-Regime Scope      Multi-régime

ISDA Safe, Efficient Markets  
International Swaps and Derivatives Association, Inc.

**2019 COLLATERAL TRANSFER AGREEMENT FOR INITIAL MARGIN (IM)**      **CONTRAT DE TRANSFERT DE COLLATERAL POUR LA MARGE INITIALE (MI)**

2019

between \_\_\_\_\_      entre \_\_\_\_\_

ISDA Safe, Efficient Markets  
International Swaps and Derivatives Association, Inc.

**2002 MASTER AGREEMENT**

dated as of \_\_\_\_\_

\_\_\_\_\_ and \_\_\_\_\_

have entered and/or anticipate entering into one or more transactions (each a "Transaction") that are or will be governed by this 2002 Master Agreement, which includes the schedule (the "Schedule"), and the documents and other confirming evidence (each a "Confirmation") exchanged between the parties or otherwise effective for the purpose of confirming or evidencing those Transactions. This 2002 Master Agreement and the Schedule are together referred to as this "Master Agreement".

Accordingly, the parties agree as follows:—

**I. Interpretation**

(a) **Definitions.** The terms defined in Section 14 and elsewhere in this Master Agreement will have the meanings therein specified for the purposes of this Master Agreement.

**2016 ISDA Credit Support Annex for Variation Margin (VM) (Title Transfer – French law) – English Translation with blackline against English form**

For counterparties who wish to make use of additional European governing law options, ISDA has prepared French law governed collateral documents. The 2016 ISDA Credit Support Annex for Variation Margin (VM)(Title Transfer – French law) is an updated version of the 1995 ISDA Credit Support Annex (Title Transfer – French law) that is limited to variation margin, and allows parties to establish variation margin arrangements that meet the requirements of new regulations on margin for uncleared swaps. This Credit Support Annex has been prepared for use with the ISDA Master Agreement subject to French law.

[Bilateral Form - Transfer]<sup>1</sup>      (ISDA Agreements Subject to Irish Law)<sup>2</sup>

ISDA Safe, Efficient Markets  
International Swaps and Derivatives Association, Inc.

**CREDIT SUPPORT ANNEX**

# Replication Agreement to Set-Up Trading with a New EU Entity

- Replication Agreements assist to replicate an existing OTC trading relationship with a EU customer under – in principal – the same contractual terms without the need for the full documentation package to be executed
  - Purpose: Overcome EU licensing requirements with regard to an existing UK OTC dealer entity of a certain bank group
- Based on a Replication Agreement a full new master agreement documentation will be set up with a (new) EU group entity mirroring the existing trading relationship with the existing UK OTC dealer entity; the contractual position of the EU customer remains – in principle - unchanged
  - The replication arrangements should also comprise collateral support documentation but not specific collateral arrangements (which have to be entered into separately)
- Replication Agreement usually does not provide for the transfer of the OTC portfolio
  - A separate (full or partial) novation agreement will then be used to transfer transactions

# Replication Agreement to Set-Up Trading with a New EU Entity

- Replication Agreements in case of German law master agreements
  - In principle, a replication agreement style could also be used to newly document a tradition relationship between an EU customer and a new EU group entity
  - However, we frequently see the set up of a new German law clone documentation mirroring the standards agreed with the UK OTC dealer entity
- Replication in case of a move from an Engl. law master agreement to a German law master agreement
  - Due to the change in law, a new German law documentation is necessary to be executed in full
  - In practice, the challenge remains how to – in principle – mirror the content of the existing Engl. law master agreement under German law
- Replications in case of Clearing master agreement (ETD or OTC)
  - In principle, Replication Agreements in this area are more complex given that more changes to the documents are needed
  - Therefore, we also see the execution of a clone documentation

# Content of Replication Agreements

- Engl. law replications agreements
  - Creation of the New Agreement by replicating the terms of the existing agreement (except as modified to account for the jurisdiction of the new entity)
  - Amendments regarding references to UK related aspects
  - Creation of equivalent credit support
  - Changes to specified entity, contact details, tax representations, process agent, client money rules
  - Incorporation of protocols:
    - ISDA 2016 Bail-in Article 55 BRRD Protocol
    - ISDA Resolution Stay Jurisdictional Modular Protocol (German Jurisdictional Module)
    - Dodd-Frank Protocols

# Content of Replication Agreements

- New German law documentation used to switch from English into German law
  - Implementation of ISDA based concepts into German law, in particular
    - Representation and warranties
    - Early termination events and partial close-out netting
  - Implementation of other standards (indemnities, increased cost clauses, netting-sets, unilateral amendment rights)
  - Client protections in case of clearing master agreements; implementation of protections serving the purpose of the UK Client Money Rules (CASS Rules)

# Content of Novation Agreements

- Novation Agreements under English law
  - ISDA Novation Agreement template
  - Regulates Transfer, Release, Discharge und certain undertakings and representations
- Novation Agreements under German law
  - Legal character of the arrangement; usually no full transfer by way of assumption of contract of the full master agreement relationship; only the transactions thereunder are covered
  - Principal content:
    - Arrangement to dissolve all or certain specified transactions between UK OTC dealer entity und their existing master and EU customer and to established in principle the same transactions as of the novation date
    - Arrangement to post/redeliver credit support and agreement on a direct transfer between the UK OCT dealer entity and the new EU group entity to fulfill such arrangement

# Bail-In Recognition Under English Law Master Agreements Post BREXIT

- Background: § 50 and 60 a SAG / Art. 55 BRRD
- In general, two possible ways:
  - Adhere to ISDA 2016 Bail-in Art 55 BRRD Protocol (Dutch/French/German/Irish/Italian/Luxembourg/Spanish/UK entity-in-resolution version) and ISDA Resolution Stay Jurisdictional Modular Protocol (German Module)
  - Bilateral amendment agreement (or new agreement in a replication agreement by reference to the relevant applicable ISDA protocol)

# Further English Law Issues

## Amendments to ISDA Documentation – No Deal Brexit

ISDA



- **No Deal Amendments to ISDA Documentation:**
  - Confidentiality Waiver
  - ISDA EMIR PDD Protocol
  - Margin Documentation
  - Contractual Recognition of Bail-in and Resolution Stays
  - MiFIR Portfolio Compression
- **Governing Law & Choice of Law issues**



*Chris Arnold, Mayer Brown London*

# **EMIR Refit**

# It's finally here!

- Introduced pursuant to Commission's Regulatory Fitness and Performance programme to review legislation to ensure it benefits EU citizens and businesses (esp SMEs) and to make it simpler and easier
- After several consultations over past two years, EMIR Refit finally entered into force on 17 June 2019
- Some changes took effect immediately, other phased in over next few years
- Note that „EMIR 2.2“ rules on regulation and oversight of CCPs (including controversial „location policy“) yet to be adopted

# Summary of immediate changes

- All EU AIFs managed by non-EU AIFMs are FCs (ESPP / SSPE Exemptions)
- New category of „small financial counterparty“ FC- (exempt from clearing)
- NFC clearing: Hedging exclusion from threshold calculation and clearing obligation only for asset classes that exceed threshold
- Delay to mandatory clearing timing for Category 3 and 4 entities and extension of pension scheme clearing obligation to June 2021
- New ESMA/Commission powers to suspend clearing obligation
- Removal of backloading of pre-August 2012 trades from reporting
- Removal of intra-group reporting where at least one NFC

# Summary of future changes

- December 2019: CCPs must provide IM calculation tools and information
- December 2019: National insolvency law to facilitate CCP porting and asset segregation
- June 2020: Limited relief from reporting obligation for NFC-s
- After June 2020: New RTS on risk management procedures
- June 2021: Access to clearing on “FRANDT” terms
- TBD: Resolution of regulatory “patch” excluding FX Forwards from VM

*Matthew F. Kluchenek, Mayer Brown Chicago*

# **Special US Focus on Market, Regulatory and Enforcement Experiences Relevant for German Market Participants**



# Agenda

- 1 Overview of U.S. Derivatives Regulation

---
- 2 Scope of CFTC and Exchange Jurisdiction

---
- 3 Regulators' Enforcement Capabilities

---
- 4 What To Do When the Regulator Calls

---
- 5 Enforcement Trends

---



# Overview of US Derivatives Regulation

# US Derivatives Law & Regulation

## The Commodity Exchange Act of 1936

- Dodd-Frank Act (Title VII - Swaps)

## US Derivatives Regulators:

- Commodity Futures Trading Commission (CFTC)
  - Administers the CEA
  - Key Divisions: DOE / DSIO / DMO
- Futures Exchanges (CME Group and ICE Futures)
  - Administer exchange rules
- National Futures Association (NFA)
  - Administers its rules / examines CFTC registrants
- U.S. Attorney's Office / Department of Justice—Criminal Authority
  - Any "willful" conduct may be subject to criminal prosecution



# Scope of CFTC and Exchange Jurisdiction

# Scope of CFTC Jurisdiction

## “Commodity Interests”

**Scope:** To determine whether the CFTC has jurisdiction over a commodity interest transaction under the CEA, we generally examine two factors:

- whether the transaction involves a “commodity interest,” and
- the location of the parties to, and the execution of, the transaction.

**Commodity interests:** Futures, options on futures, swaps and retail commodity transactions (among others).

**Non-Commodity interests:** Spot transactions, forward contracts, physically-delivered FX swaps and FX forwards, securities, security-based swaps and listed equity option contracts (among others).

- But, the CFTC has anti-fraud and anti-manipulation authority with respect to cash (physical) commodity transactions (such as Bitcoins and crude oil).

**Location:** If a US person is involved or the transaction is executed, arranged or booked in the US, then regulation generally follows.

# Scope of Exchange Jurisdiction Futures & Cleared Swaps

## Deemed Consent

- CME Rule 418 and ICE Rule 4.00 provide that any person “initiating or executing a Transaction on or subject to the Rules of the Exchange directly or through an intermediary . . . expressly consents to the jurisdiction of the Exchange and agrees to be bound by and comply with the Rules of the Exchange,” including rules requiring cooperation and participation in investigatory and disciplinary processes.

## Remedy for Non-Cooperation

- Rule violation and termination of market access and possible referral to the CFTC.

# Regulatory Enforcement



# Regulatory Enforcement – CFTC

CFTC Chairman Giancarlo's Testimony to Congress:

“During my watch, the CFTC has been resolute in holding market participants to the highest standards of behavior. In fact, by any measure, enforcement has been among the most vigorous in the history of the CFTC, including more enforcement actions, more penalties, more large-scale matters, more accountability, more partnering with criminal law enforcement at home and abroad and more whistleblower awards than in prior years.”



# Regulatory Enforcement – CFTC

The CFTC administers the CEA and has wide-ranging civil enforcement powers under the CEA.

- Civil and administrative authority, not criminal.
- May bring actions in federal court or administratively. Most actions are filed in the federal courts.
- Division of Enforcement (DOE) consists of about 160 individuals.
- Main office is in Washington DC, with major branches in New York, Chicago and Kansas City.

# Regulatory Enforcement – SROs

**CME Group:** Through its Market Regulation Dept., authorized to conduct surveillance and bring administrative actions.

- The Market Regulation Dept. is staffed with about 80 individuals.
- Investigations Group and Enforcement Group
- Inquiry → Investigation → Enforcement → Settlement or Hearing

**ICE Futures:** Through its Market Regulation Dept., authorized to conduct surveillance and bring administrative actions.

- Market Supervision Dept. consists of about 15 individuals.

**NFA:** SRO for CFTC registrants.

- Members are required to comply with NFA rules.
- NFA is authorized to bring administrative actions against its members.

# Regulatory Enforcement – DOJ

Acting through the Department of Justice or a U.S. Attorney's office, has power to prosecute criminal conduct, including spoofing and manipulation.

- Most active offices for commodities fraud: Main DOJ, N.D. IL and S.D. N.Y.
- DOJ has a “Securities and Commodities” task force.
- The CFTC’s major fraud and manipulation cases often involve parallel criminal proceedings.
- Active focus on disruptive trading and manipulation cases.
- Common charges include: spoofing, conspiracy to spoof, commodities fraud and wire fraud.



# Evolution of a CFTC/SRO Case

1. Tip / Surveillance
2. Investigation Opened
3. Preservation Notice (CFTC)
4. Documents Requested
5. Testimony Taken
6. Wells Notice (Proposed Charges)
7. Wells Submission
8. Charges / Complaint / Indictment
9. Settlement or Hearing



# The Enforcement Trends



# Ten CFTC/Exchange Enforcement Trends

1. Continued Focus on Disruptive Trading
2. Individual Accountability
3. Product Expansion
4. Non-CFTC Registrants
5. "Piling On"
6. Cooperation
7. Use of Task Forces
8. Strict Liability for Agent Actions
9. Coordination with Other Regulators
10. Criminal Referrals



# Focal Points of Enforcement



# Disruptive Trading

## What is Disruptive Trading?

- Trading with the intent to disrupt the marketplace (e.g., prices) or the actions of other traders (e.g., by causing them to place/cancel orders).
- Disruption can take the form of rogue trading, spoofing, flipping, market impressions, etc.
- Intent may be required to establish a charge (spoofing), but not always (manipulation).

## What Law and Rules Govern Disruptive Trading?

- CEA §4c(a)(5)
- CFTC Rule 180.1
- CME Rule 575 (and related FAQs)
- ICE Rule 4.02(l) (and related FAQs)



# Spooing

## What is Spooing?

- “Spooing” involves the placement of a bid or offer with the intent to cancel the bid or offer before execution.
  - CEA §4c(a)(5)(C) prohibits “any trading, practice, or conduct . . . that is, is of the character of, or is commonly known to the trade as, ‘spooing’ (bidding or offering with the intent to cancel the bid or offer before execution).”
- It is generally understood as a pattern in which a trader places and quickly cancels an order that was never intended to be executed.
- Such an order can cause prices to move up or down because it may alter the appearance of supply or demand, and some traders base their strategies on their perception of supply and demand at various price levels.

# Spooing – Anatomy

1. The trader places a small buy order that he wants to execute.
2. This is quickly followed with a large sell order at a higher price that the trader intends to cancel.
3. By placing the large sell orders, the trader seeks to give the market the impression that there is significant selling interest, which suggests that prices will soon fall, raising the likelihood that other market participants will sell.
4. The market price falls and the small buy order is filled.
5. Once the small buy order is filled, the large buy order is quickly cancelled because the trader did not place the order to get filled on the order, but rather to impact the market.

# Swaps Enforcement

## **Swap Dealer Deficiencies, including Reporting and Supervisory Failures (Nov. 2018): Consent order for \$12 million fine and undertakings.** The CFTC alleged that the bank:

- failed to supervise its SD's activities, which resulted in "thousands of violations of the Act";
- was not transparent with the Commission regarding the compliance inadequacies at the SD; and
- failed to report swap transactions to an SDR and submit large trader reports.

## **Swaps Valuation Deficiencies (Nov. 2018): Consent order for \$10 million fine and undertakings.** The CFTC alleged that the bank:

- failed to accurately disclose to counterparties daily mid-market marks and its valuation methodology;
- failed to accurately report the foregoing data to SDRs; and
- failed to supervise, even when employees had raised concerns to management.

# Swaps Enforcement

**Initial Margin Deficiencies (Oct. 2018): Consent order for \$900,000 fine.** According to NFA:

- NFA approved swap dealer's use of the ISDA SIMM to calculate IM for Interest Rate/FX products;
- The bank had (i) deficient back testing; (ii) inadequate benchmarking; (iii) inaccurate risk exposure reconciliations; and (iv) IM and VM compliance deficiencies.

**Swap Reporting (Sept. 2018): Consent order for \$750,000 fine.** The CFTC alleged that the bank:

- Had multiple swaps reporting errors across more than 50 areas.
- The reporting errors centered primarily on the bank's inability to timely and properly report to an SDR swaps creation data, swaps continuation data, unique swap identifiers, pre-enactment swap transactions, and corrected swaps data.

# Swaps Enforcement

**Swaps Advice (Sept. 2018): Consent order for \$75,000 fine.** The CFTC alleged that the trading advisor:

- Provided advice, for compensation, with respect to the advisability of entering into hedges using OTC swaps and options.
- The advice was in the context of risk management, not speculation, and only to sophisticated clients (i.e., “eligible contract participants”).
- The CFTC found that the advisor had failed to register as a “commodity trading advisor”.

**Swap Valuation (Mismarks) (Nov. 2018): Declination Letter.**

- “Silver platter” cooperation: self-discovered conduct; self-reported conduct prior to the CFTC acquiring knowledge; immediate corrective action; and robust remediation steps.
- The trader was fined \$350,000 and permanently banned from trading on exchange and seeking registration with the CFTC.

# Failure to Supervise - CFTC

## Requirement:

- CFTC Rule 166.3 requires every CFTC registrant to diligently supervise the handling by its employees and agents of all commodity interest accounts carried, operated, advised or introduced by the registrant.
- The CFTC frequently adds failure to supervise charges when it finds other violations, but it can also charge failure to supervise as an independent violation even in the absence of any other underlying violation.

## Elements:

- A violation requires either that: (1) the registrant's supervisory system was inadequate with respect to training, controls, etc.; or (2) the registrant failed to perform its supervisory duties diligently.

# Strict Liability for Agent Actions - CFTC

**Law:** Under CEA §2(a)(1)(B), a non-CFTC registrant or CFTC registrant may be deemed to be strictly liable for the actions of its employees and agents.

**Elements:** “Trader A engaged in the conduct described herein within the course and scope of Trader A’s employment at AGC. Therefore, AGC is liable for the acts, omissions and failures of Trader A . . . that constituted violations of Section 4c(a)(5)(C) of the Act.”

## Questions:

- Is the person that engaged in the conduct an “agent” of the company?
- If agency exists, should the company not be held strictly liable for policy reasons?

# Strict Liability for Agent Actions - Exchanges

- Exchanges, including CME Group, impose the same liability.
  - CME Rule 433 (“Strict Liability for the Acts of Agents”): “the act, omission, or failure of any official, agent, or other Person acting for any party within the scope of his employment or office shall be deemed the act, omission or failure of the party, as well as of the official, agent or other Person who committed the act.”
    - Applies to all persons who trade on the market.
  - CME Rule 501 (“Employees of Members”): “Members shall be responsible for ensuring that their employees comply with all Exchange rules and may, subject to a determination by an Exchange disciplinary committee, be liable for any fines imposed upon such employees by the Exchange.”
    - Applies to members of CME Group.

# Cooperation Considerations

**CFTC Cooperation Advisories:** In 2017, the DOE updated issued two new enforcement advisories. One for companies, the other for individuals. The advisories list four categories of factors that the DOE may consider in determining whether cooperation credit is warranted:

- the value of the cooperation to the DOE's investigation and enforcement action;
  - the value of the cooperation to the CFTC's broader law enforcement interests;
  - the culpability of the company or individual and other relevant factors; and
  - uncooperative conduct that offsets or limits credit that the company or individual would otherwise receive.
- The advisories indicate that there will be some misconduct that the DOE will consider to be so egregious that no credit will be given for cooperation.
  - However, even if persons know the criteria upon which their cooperation will be evaluated, their decision to cooperate may still be driven by what they perceive the benefit of their cooperation to be. Unfortunately, the advisories are silent in this regard, even while other regulators have taken steps to provide such guidance.

# What To Do When The Regulator Calls

## What To Do When the Regulator Calls

1. Immediately route the notice to the appropriate person within the organization (e.g., Legal or Compliance per company policy).
2. Consider retaining outside counsel and protecting the attorney-client and work product privileges.
3. Issue a “litigation hold” to preserve relevant documents.
4. Determine what conduct the CFTC or an exchange is concerned about, who is involved, whether that conduct is ongoing, and whether prompt corrective action is necessary.
5. Determine which stakeholders need to know about the possible investigation, including management, the Board of Directors, independent auditors, and others.



## What To Do When the Regulator Calls

6. Contact the CFTC or exchange staff to learn more about the investigation and who may be a target or subject.
7. Determine whether any individuals will need separate counsel and the company's indemnification obligations, if any.
8. Consider the likelihood and impact of a parallel criminal investigation or civil litigation.
9. Consider whether to cooperate with the regulator at an early stage, including self-reporting any wrongdoing.

Questions?

[Americas](#) | [Asia](#) | [Europe](#) | [Middle East](#)

[mayerbrown.com](https://mayerbrown.com)

Mayer Brown is a global services provider comprising associated legal practices that are separate entities, including Mayer Brown LLP (Illinois, USA), Mayer Brown International LLP (England), Mayer Brown (a Hong Kong partnership) and Tauil & Chequer Advogados (a Brazilian law partnership) (collectively the "Mayer Brown Practices") and non-legal service providers, which provide consultancy services (the "Mayer Brown Consultancies"). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website. "Mayer Brown" and the Mayer Brown logo are the trademarks of Mayer Brown. © Mayer Brown. All rights reserved.