



MAYER | BROWN

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

OTC trading in challenging markets

5 July 2022

# Welcome from our speakers



**Anna T. Pinedo**  
Partner  
Co-leader Global  
Capital Markets  
New York



**Ed Parker**  
Partner  
Global practice head  
Derivatives &  
Structured Products  
London



**Ann-Kathrin Balster**  
Senior Associate  
Frankfurt



**Marcel Hörauf**  
Counsel  
Frankfurt



**Chris Arnold**  
Partner  
Derivatives &  
Structured Products  
London



**Dr. Patrick Scholl**  
Partner  
Head of Capital Markets  
and Financial Services  
Regulatory Germany  
Frankfurt



**Alexei Döhl**  
Counsel  
Frankfurt

# Agenda

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## **Welcome**

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OTC trading in an Environment of Sanctions

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Crypto Derivatives and Crypto Collateral

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ESG and Derivatives

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## **Coffee break**

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Risk Free Rates Hedging under 2021 ISDA Definitions and the German Master Agreement

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The Final Steps for Initial Margin Implementation

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## **Drinks & Fingerfood**

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Chris Arnold

Session 1:  
OTC trading in an Environment  
of Sanctions

# Overview

- The historical context and industry initiatives
- Unique considerations for OTC derivatives
- Key 2022 sanctions measures
- Impact on OTC derivatives
  - Close-out of Transactions
  - CDS on sanctioned Reference Entities
  - Market disruptions
- What's next?

# The Historical Context and Industry Initiatives

## Key sanctions activity:

Pre-2014: Country sanctions – Cuba, N Korea, Iran

2014: Russia/Ukraine-related sectoral sanctions (US/EU)

- Prohibition on new debt/new equity

2017: Venezuela/PDVSA sanctions (US)

- Prohibition on new debt/new equity
- Prohibition on bond trading

2018: Rusal/EN+ sanctions (US)

2020/21: US China Military Company sanctions (US)

- Prohibition on transacting publicly traded securities and derivatives

**2022: Russia sanctions (US/EU/UK/Other G20)**

## Key industry initiatives:

*2014: OFAC General License 1/1A*

*2017: ISDA CDS Additional Provisions for Venezuela/PDVSA and Protocol*

*2018: ISDA Sanctions Working Group formed*

*2019: ISDA White Paper: Economic Sanctions Programs & Derivatives*

*2020: ISDA Guidance Note: Addressing Sanctions Issues in ISDA Documentation*

# Unique considerations for OTC derivatives

- Bilateral contracts with ongoing payment, delivery (and margining)
- Transactions that can be long dated (up to 30 years or more)
- Fluctuation of mark-to-market value
- Ability to close-out all transactions and net exposures and collateral
- „Reference transactions“ permitting exposure to underlyings
- Cross-border potentially impacted by numerous jurisdictions
- Potential systemic impact of market dislocations

# Key Principles from the 2019 ISDA White Paper

1. Sanctions should provide clarity as to which derivatives transactions are affected and actions NSEs are required to take
2. Where derivatives affected, NSEs should be given at least 30 days to close out, voluntarily unwind or novate transactions
3. NSEs should be permitted to net or set-off any collateral or margin received/posted under credit support documentation
5. Ordinary counterparty credit exposure and margining should not constitute an 'extension of credit' for the purposes of any prohibitions on dealings in new debt of a sanctioned entity
6. Transactions entered into in the ordinary course should not be considered as 'services in support' of prohibited activity unless expressly linked that activity
7. NSEs should be permitted to enter into and perform derivatives referencing underlying entities that have become sanctioned. This should include limited right of NSEs to transfer prohibited debt, equity or other instruments of the sanctioned entity to extent necessary to enable orderly settlement of transactions in accordance with established industry processes
8. Sanctions authorities should ensure that where sanctions programs are imposed in a co-ordinated basis the approach to derivatives is harmonized to avoid uncertainty
9. Where obligations under sanctions programs create conflict with other sanctions programs or with other legal, regulatory or contractual obligations on NSEs, sanctions authorities should ensure that such conflict does not arise or provide clear guidance as to how NSEs are to resolve



# Relevant 2022 Russia Sanctions Measures (US)

- Specially Designated Nationals (SDN) designations on Russian banks
- Correspondent and payable through account (CAPTA) sanctions
- New debt/new equity prohibitions on Russian banks
- Asset freeze on Russian Central Bank
- Prohibition on secondary trading of post-March 1 Russia sovereign bonds
- Prohibition on „new investment in Russia“
  - OFAC FAQ 1054 (6 June 2022): „prohibits US persons from purchasing debt or equity securities issued by an entity in the Russian Federation“
- Prohibition on importation of Russian gold

# Relevant 2022 Russia Sanctions Measures (EU)

- Asset freezes on Russian banks
- Restrictions on providing banking facilities to Russian nationals/entities
- Extension of capital markets prohibitions on Russian banks
  - All dealings in new transferable securities and money market instruments
  - Any listing of transferable securities by Russian entities
  - Extension of any new loans or credit
- Prohibition on transactions managing reserves/assets of Central Bank of Russia
- Prohibition on SWIFT access on Russian banks

# Relevant 2022 Russia Sanctions Measures (UK)

- Asset freezes on Russian banks (including correspondent banking and processing sterling payments)
- Extension of capital markets prohibitions on Russian banks
  - All dealings in new transferable securities and money market instruments
  - Any listing of transferable securities by Russian entities
  - Extension of any new loans or credit
- Prohibition on providing foreign exchange reserve/asset management services to Central Bank of Russia

# Impact on OTC Derivatives: ISDA Close Out

- Response of parties to sanctions actions
- Effect of wind-down licenses
- Issues with ISDA Master Agreement termination provisions
  - Failure to pay
  - Illegality
  - Force majeure
- Payment of termination amounts
- Availability of set-off rights

# Impact on OTC Derivatives: CDS Transactions

- Russia sovereign a significantly traded CDS reference entity (single name and index)
- CDS „cleansed“ of post March 1 debt by means of protocol
- Inability of Russia to access US dollar payments system affected ability to make payments on USD-denominated debt
- Failure to Pay Credit Event on 6 June due to failure to pay \$1.9m of default interest accrued on a bond that was repaid late during grace period
- 6 June OFAC FAQ clarified US persons may not purchase Russia bonds
- Effect on CDS Auction Settlement process

# Impact on OTC Derivatives: Market Disruption

- Impossibility to convert/deliver rubles in FX transactions
  - *ISDA/EMTA Additional Provisions for Deliverable Currency Disruption Event for RUB FX transactions*
- Russian equity market closures
  - *ISDA guidance note*
- LME suspension of nickel futures contracts
  - *ISDA guidance note*
- Issues with delivery and settlement of bonds of Russian issuers under ISDA/ GMRA/ GMSLA arrangements

# What's next?

- More sanctions action likely
- Most trading positions now unwound
- Prospect of further disruption, particularly in commodities markets
- Settlement of Russia CDS?
- More information:

ISDA Russian Sanctions and Market Impacts InfoHub

<https://www.isda.org/2022/03/17/russian-sanctions-and-market-impacts-infohub/>



Edmund Parker and Marcel Hörauf

# Session 2: Crypto Derivatives and Crypto Collateral



# What are Crypto-Currencies and Digital Assets?



## 3.1 Nature and Legal Characterization of the Digital Asset

Currently, the vast majority of digital asset derivatives transactions relate to native digital assets. A native digital asset exists solely as a digital record. While these assets may constitute property in some jurisdictions, a native digital asset does not represent or constitute any legal or proprietary interest in other assets or rights. Bitcoin and Ether are examples of native digital assets and the market in digital asset derivatives is currently heavily concentrated in these two forms of digital asset<sup>11</sup>.

Native digital assets can be contrasted with asset-referenced digital assets. These are digital assets that reference an underlying asset or right, either through a legal or operational mechanism. Examples of asset-referenced digital assets include CBDCs and stablecoins. The use of derivatives for certain types of asset-referenced digital assets is expected to develop quickly in the coming years<sup>12</sup>.

Bitcoin is a digital currency/digital asset. It operates without central control. There is no oversight from regulators.

It is governed by peer-to-peer software, with a public ledger recording transactions. These are held on servers, called "nodes", with transactions publically broadcast and shared node-to-node.

Every 10 minutes, "miners" collate transactions into blocks, adding to the blockchain, to create an "account book of bitcoin". Bitcoin is held in a "digital wallet", accessed through software/service providers.

ETH is a cryptocurrency. It is scarce digital money that you can use on the internet – similar to Bitcoin. If you're new to crypto, here's how ETH is different from traditional money.

## What's an Ethereum wallet?



**Want to buy some Ethereum?** It's common to mix up Ethereum and ETH. Ethereum is the blockchain and ETH is the primary asset of Ethereum. ETH is what you're probably looking to buy. [More on Ethereum.](#)

Ethereum wallets are applications that let you interact with your Ethereum account. Think of it like an internet banking app – without the bank. Your wallet lets you read your balance, send transactions and connect to applications.

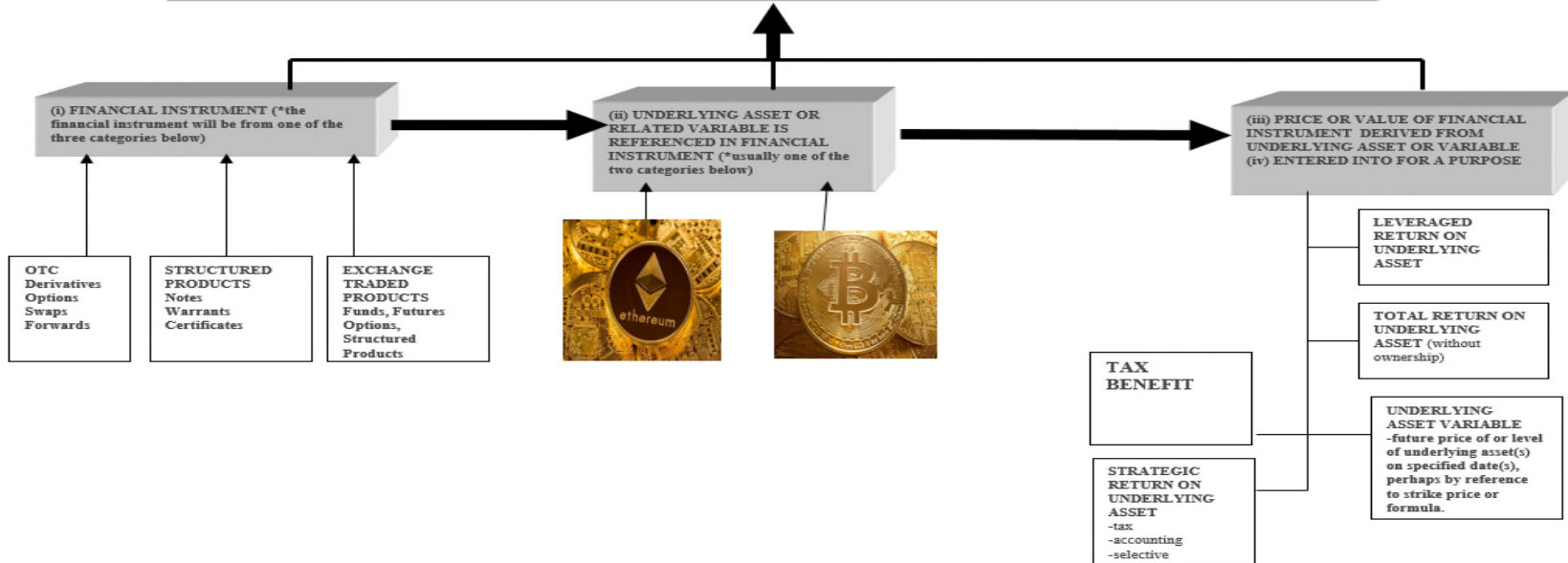
You need a wallet to send funds and manage your ETH. [More on ETH](#)

Your wallet is only a tool for managing your Ethereum account. That means you can swap wallet providers at any time. Many wallets also let you manage several Ethereum accounts from one application.

That's because wallets don't have custody of your funds, you do. They're just a tool for managing what's really yours.

# What are Crypto-Derivatives

A DERIVATIVE IS: “(i) a **financial instrument** referencing (ii) an **underlying asset or other variable**, from which (iii) the **financial instrument’s price or value is derived**, (iv) entered into to meet the purposes of the parties”



# What are the key Cryptocurrencies referenced in Crypto Derivatives



Market Summary > Bitcoin

**18,975.80** USD  
+18,648.80 (5,703.00%) ↑ all time

3 Jul, 09:04 UTC · [Disclaimer](#)

1D 5D 1M 6M YTD 1Y 5Y Max



Market Summary > Ether

**1,054.00** USD  
+1,042.05 (8,720.08%) ↑ all time

3 Jul, 09:00 UTC · [Disclaimer](#)

1D 5D 1M 6M



## ASSETS

 BTC / USD

 ETH / USD

 DOGE / USD

 ALGO / USD

 DOT / USD

 UNI / USD

 COMP / USD

# Exchange Trading: Crypto Futures: Bitcoin



SERVICES | INSIGHTS | EDUCATION

as of July 07 2022, 09:35am CT

OVERVIEW | QUOTES | SETTLEMENTS | VOLUME & OI | TIME & SALES | **SPECS** | MARGINS | CALENDAR

## BITCOIN FUTURES - CONTRACT SPECS

CONTRACT UNIT	5 bitcoin, as defined by the CME CF Bitcoin Reference Rate (BRR)
PRICE QUOTATION	U.S. dollars and cents per bitcoin
TRADING HOURS	<p>CME Globex: Sunday - Friday 5:00 p.m. - 4:00 p.m/ CT with a 60-minute break each day beginning at 4:00 p.m. CT</p> <p>BTIC: Sunday - Friday 5:00 p.m. - 4:00 p.m. CT with a trading halt from 4:00 - 4:30 p.m. London Time (10:00/11:00 - 10:30/11:30 a.m. CT) and a daily maintenance period from 4:00 - 5:00 p.m. CT.</p>

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## Last Trading Activity

CLEARING	GLOBEX	FLOOR	CLEARPORT	PRODUCT NAME	EXCHANGE	PRODUCT GROUP	SUBGROUP	CATEGORY	SUBCATEGORY	CLEARED AS	VOLUME	OPEN INTEREST
BTC	BTC	-	BTC	Options on Bitcoin Futures	CME	Cryptocurrencies	Bitcoin	-	-	Options	53	3,274
ETH	ETH	-	ETH	Ether Futures	CME	Cryptocurrencies	Ether	-	-	Futures	6,245	4,031
BTC	BTC	-	BTC	Bitcoin Futures	CME	Cryptocurrencies	Bitcoin	-	-	Futures	12,227	13,466
MBT	MBT	-	MBT	Micro Bitcoin Futures	CME	Cryptocurrencies	Bitcoin	-	-	Futures	14,820	15,999
MET	MET	-	MET									

CME's Bitcoin futures contract, ticker symbol BTC, is a USD cash-settled contract based on the CME CF Bitcoin Reference Rate (BRR), which serves as a once-a-day reference rate of the U.S. dollar price of bitcoin. The BRR aggregates the trade flow of major bitcoin spot exchanges during a one-hour calculation window into the U.S. dollar price of one bitcoin as of 4 p.m. London Time.

The Bitcoin futures contract trades Sunday through Friday, from 5 p.m. to 4 p.m. Central Time (CT).

A single BTC contract has a value of five times the value of the BRR Index and is quoted in U.S. dollars per one bitcoin. The tick increments are quoted in multiples of \$5 per bitcoin, meaning a one-tick move of the BTC future is equal to \$25.

BTC futures are block trade eligible with a minimum quantity threshold of five contracts.

BTC futures expire the last Friday of the month, and are listed on the nearest six consecutive monthly contracts, inclusive of the nearest two December contracts.

Trade Date: 01 Jul 2022 | PRELIMINARY

# Exchange Trading: Crypto Futures: Ether



## What is the relationship between Ether futures and the underlying spot market?

CME Ether futures are based on the CME CF Ether-Dollar Reference Rate, ETHUSD\_RR, which aggregates ether trading activity across major spot exchanges between 3:00 p.m. and 4:00 p.m. London time.

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## On which exchange are Ether futures listed?

Ether futures are listed and cleared on CME, a US-registered designated contract market (DCM) and derivatives clearing organization (DCO).

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## What regulation applies to the trading of Ether futures?

The trading and clearing of Ether futures is regulated by the Commodity Futures Trading Commission (CFTC), the regulatory body with exclusive jurisdiction over US Ether futures markets.

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## What accounting and other regulatory treatment is afforded to Ether futures in my local jurisdiction?

As with any other derivatives product, the accounting treatment of positions in Ether futures, and the general local regulatory treatment of trading in Ether derivatives, may differ by country and between competent jurisdictions. Market participants are responsible for complying with all applicable US and local requirements. Market participants, particularly those with no experience in trading Ether derivatives, should seek professional counsel as necessary and appropriate to their circumstances.

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## Which platforms support Ether futures trading?

The platforms include a central limit order book via the CME Globex platform and ex-pit trade submission for clearing via CME ClearPort and CME Direct.

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# Exchange Trading: Crypto Options

## 1. What are the contract specifications?

### Options on Micro Bitcoin futures

<b>CONTRACT TITLE</b>	Options on Micro Bitcoin Futures
<b>RULEBOOK CHAPTER</b>	CME 348A
<b>CME GLOBEX AND CME CLEARPORT CODE</b>	Monday Weekly: W1A-W5A Wednesday Weekly: W1C-W5C Friday Weekly 1,2,3,4: W1E-W4E Monthly: WM
<b>CONTRACT UNIT</b>	One Micro Bitcoin futures contract (Commodity Code: MBT) which represents 0.10 bitcoin
<b>TRADING AND CLEARING HOURS</b>	CME Globex: Sunday - Friday 5 p.m. - 4 p.m. Central Time (CT) (6:00 p.m. - 5 p.m. Eastern Time (ET) with a 60-minute break each day beginning at 4 p.m. CT (5 p.m. ET) CME Globex Pre-Open: 4:45 p.m. - 5 p.m. CT (5:45 p.m. - 6 p.m. ET) CME ClearPort: Sunday 5 p.m. - Friday 5:45 p.m. CT (6 p.m. - 6:45 p.m. ET) with a 15-minute maintenance window between 5:45 p.m. - 6 p.m. CT (6:45 p.m. - 7 p.m. ET) Monday - Thursday
<b>SETTLEMENT METHOD</b>	Deliver the nearest to expire future underlying the option.
<b>LISTING SCHEDULE</b>	1 nearest Monday Weekly contract 1 nearest Wednesday Weekly contract 4 nearest Friday Weekly contracts of Weeks 1,2,3,4 2 nearest Monthly contracts
<b>PRICE BASIS</b>	Prices are quoted and traded in U.S. Dollar
<b>MINIMUM PRICE FLUCTUATION</b>	Outright: 5 index points = \$0.50 per contract Reduced tick and Spread: 1 index points = \$0.10 per contract
<b>EXERCISE PROCEDURE</b>	European Style (with no contrary instructions)
	All times: Persistent strikes: \$500,000; \$100,000; \$50,000; \$10,000; \$5,000; \$1,000 If bitcoin > \$500K: \$100,000; 100% below to 400% above underlying \$10,000: 50% below to 100% above underlying



## OVERVIEW

### 1. What is the relationship between Micro Bitcoin and Micro Ether options and their underlying futures contracts?

CME Options on Micro Bitcoin and Micro Ether futures give the buyer of a call/put the right to buy/sell one Micro Cryptocurrency futures contract at a specified strike price at some future date.

Upon termination of trading, each in-the-money Micro Bitcoin or Micro Ether option delivers one contract of the respective future which underlies the option.

### 2. How do Micro Bitcoin and Micro Ether options relate to the spot cryptocurrency market?

The value of CME Micro Cryptocurrency options is tied to the price of underlying Micro Cryptocurrency futures. Micro Cryptocurrency futures, in turn, fluctuate in value relative to price movements in spot bitcoin and ether.

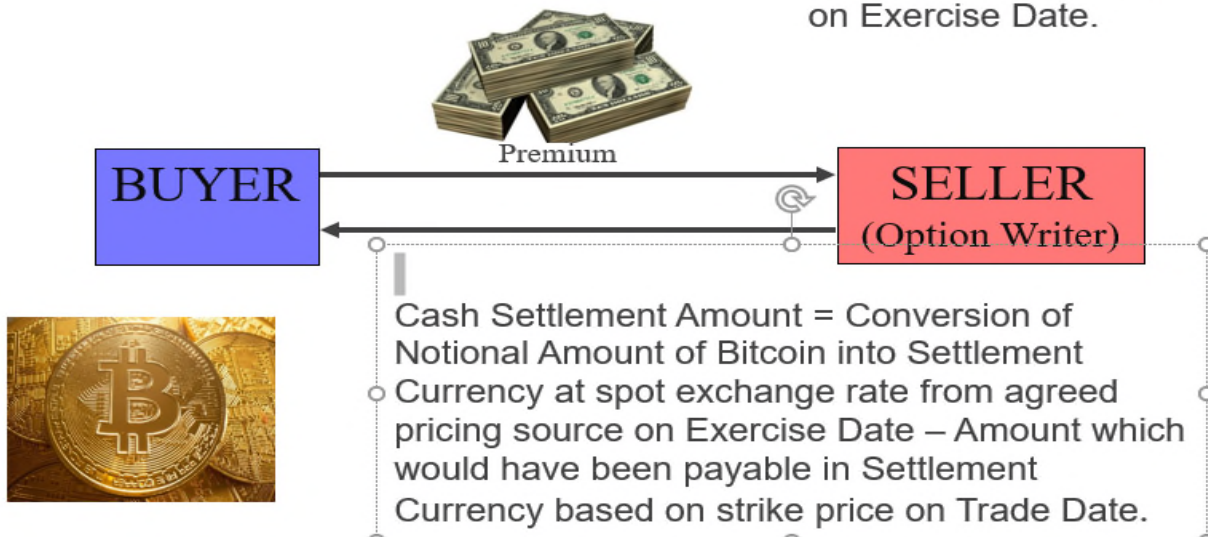
At expiration, in-the-money options will deliver a futures contract which may or may not immediately expire, depending upon the option expiry chosen. However, ultimately Micro cryptocurrency futures expire into the value of a reference rate tied to spot transactions in the respective coin.

Neither Micro Cryptocurrency options nor futures will deliver underlying cryptocurrencies, although the value of these contracts are closely tied to the movement of the associated coin.

# Example Types of OTC Crypto Derivatives: Non-deliverable Digital Asset Options

## Option + Bitcoin

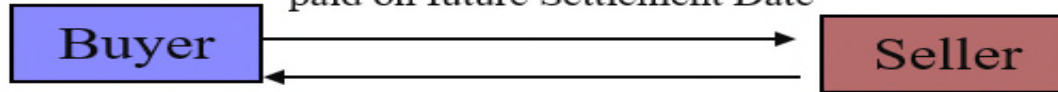
- Buyer has right, but not obligation, to payment of a net cash settlement amount on Exercise Date.



# Example Types of OTC Crypto Derivatives: Non-deliverable Digital Asset Forwards



USD 10,000,000 Settlement Amount  
paid on future Settlement Date



**Cash Settlement Amount** = Conversion of  
Notional Amount of Bitcoin into Settlement  
Currency at spot exchange rate from agreed pricing  
source on Exercise Date – Amount which would  
have been payable in Settlement Currency based on  
strike price on Trade Date.



# Other Examples of OTC Crypto Derivatives

- Forward transactions referencing a Bitcoin future or an Ethereum future
- Forward transactions referencing indices/baskets with cryptocurrency futures
- Excess and Total Return Swaps referencing indices/baskets of cryptocurrency futures and/or other standard commodities futures

# Efforts to develop contractual standards

ISDA<sup>®</sup>

Contractual Standards for  
Digital Asset Derivatives

This paper will:<sup>8</sup>

- Identify the distinguishing features of different types of digital asset, highlighting the key characteristics and features of these assets and their relevance to contractual standards;
- Identify potential disruption events that could occur with respect to digital asset derivatives and provide a framework for defining these events, drawing lessons from the approaches adopted for these events in other asset classes;
- Identify issues relating to how digital assets and the derivatives that reference them can be valued including in circumstances where a valuation source or methodology is disrupted;
- Explain how contractual standards for digital asset derivatives will interact with the existing ISDA documentation architecture, highlighting potential interpretative issues that might arise with respect to the ISDA Master Agreement when considering some of the novel features of digital asset markets; and
- Highlight potential contractual issues to consider when collateralizing digital asset derivatives, whether using traditional or digital forms of collateral.

# Documenting OTC Crypto Derivatives

## ISDA Master and Schedule

  
**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 the 2002 Master Agreement, which includes the schedule (the "Schedule"), and the documents and other confirmatory evidence (each a "Confirmation") exchanged between the parties or otherwise effective for the purposes of confirming or evidencing those Transactions. The 2002 Master Agreement and the Schedule are together referred to as the "Master Agreement".

Accordingly, the parties agree as follows—

**6. Interpretation**

(i) **Definitions.** The terms defined in Section 10 and elsewhere in this Master Agreement will have the meanings therein specified for the purpose of this Master Agreement.

(ii) **Inconsistency.** In the event of any inconsistency between the provisions of the Schedule and the other provisions of this Master Agreement, the Schedule will prevail. In the event of any inconsistency between the provisions of any Confirmation and this Master Agreement, such Confirmation will prevail for the purpose of the relevant Transaction.

(iii) **Single Agreement.** All Transactions are entered into in reliance on the fact that this Master Agreement and all Confirmations form a single agreement between the parties (collectively referred to as the "Agreement"), and the parties would not otherwise enter into any Transactions.

**7. Obligations**

(i) **General Conditions.**

(a) Each party will make each payment or delivery specified in each Confirmation to be made by it, subject to the other provisions of this Agreement.

(b) Payments under this Agreement will be made on the due date for value on that date in the place of the account specified in the relevant Confirmation or otherwise pursuant to this Agreement, in fully immediately funds and in the manner customary for payments of the required currency. Where confirmation is by delivery (that is, other than by payment), such delivery will be made for storage on the due date in the manner customary for the relevant obligation unless otherwise specified in the relevant Confirmation or elsewhere in this Agreement.

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**SCHEDULE to the 2002 Master Agreement**

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

between \_\_\_\_\_ ("Party A") and \_\_\_\_\_ ("Party B")

[inserted as a PARTICULAR TYPE] [inserted as a PARTICULAR TYPE]  
 [with company number XXXXXXXX] [with company number XXXXXXXX]  
 [under the laws of XXXXXXXX] [under the laws of XXXXXXXX]  
 [acting through an XXXXXXXX] [acting through an XXXXXXXX]

**Part 1. Termination Provisions.**

(i) "Specified Entity" means in relation to Party A for the purpose of—


Section X.X.X.X;  
 Section X.X.X.X;  
 Section X.X.X.X;  
 Section X.X.X.X;

and in relation to Party B for the purpose of—

Section X.X.X.X;  
 Section X.X.X.X;  
 Section X.X.X.X;  
 Section X.X.X.X;

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

  
**CREDIT SUPPORT ANNEX**  
 to the Schedule to the ISDA Master Agreement

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

between \_\_\_\_\_ ("Party A") and \_\_\_\_\_ ("Party B")

This Annex supplements, forms part of, and is subject to, the ISDA Master Agreement referred to above and is part of its Schedule. For the purposes of this Agreement, including, without limitation, Sections 1(c), 2(a), 5 and 6, the credit support arrangements set out in this Annex constitute a Transaction (for which this Annex constitutes the Confirmation).

**Paragraph 1. Interpretation**

Capitalised terms not otherwise defined in this Annex or elsewhere in this Agreement have the meanings specified pursuant to Paragraph 10, and all references in this Annex to Paragraphs are to Paragraphs of this Annex. In the event of any inconsistency between this Annex and the other provisions of this Schedule, this Annex will prevail, and in the event of any inconsistency between Paragraph 11 and the other

<sup>1</sup> This document is not intended to create a charge or other security interest over the assets transferred under its terms. Parties intending to establish a collateral arrangement based on the creation of a charge or other security interest should consider using the ISDA Credit Support Annex (English Law) or the ISDA Credit Support Annex (New York Law) as appropriate.  
<sup>2</sup> This Credit Support Annex has been prepared for use with ISDA Master Agreements subject to English law. Users should consult their legal advisers as to the proper use and effect of this form and the arrangements it contemplates. In particular, users should consult their legal advisers if they wish to have the Credit Support Annex made subject to a governing law other than English law or to have the Credit Support Annex subject to a different governing law than that governing the rest of the ISDA Master Agreement (e.g., English law for the Credit Support Annex and New York law for the rest of the ISDA Master Agreement).

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Security interest over Clearstream collateral account (ISDA Clearstream 2019 Collateral Transfer Agreement)  
 Security-taker in favour of the Multi-Region Scope

  
 International Swaps and Derivatives Association, Inc.




**2019 COLLATERAL TRANSFER AGREEMENT**

for use with the Clearstream Triparty Collateral Management Service

between \_\_\_\_\_ ("Party A") and \_\_\_\_\_ ("Party B")

dated \_\_\_\_\_

# Documenting OTC Crypto Derivatives

1998 FX and  
Currency  
Option Definitions

ISDA®  
INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.  
EMTA®  
EMERGING MARKETS TRADERS ASSOCIATION  
THE FOREIGN EXCHANGE  
COMMITTEE

2002 ISDA  
Equity Derivatives  
Definitions

ISDA®  
INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

ISDA.

2021 ISDA  
Interest Rate Derivatives  
Definitions

Version 1.0

## Introduction, Standard Paragraphs and Closing for a Confirmation of a Swap Transaction

Heading

[Letterhead of Party A]

[Date]

Swap Transaction

[Name and Address of Party B]

Dear :

The purpose of this [facsimile/letter] (this "Confirmation") is to confirm the terms and conditions of the Swap Transaction entered into between us on the Trade Date specified below.

The definitions and provisions contained in the 2000 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc., are incorporated into this Confirmation.<sup>1</sup> In the event of any inconsistency between those definitions and provisions and this Confirmation, this Confirmation will govern.

This Confirmation constitutes a "Confirmation" as referred to in, and supplements, forms part of and is subject to, the ISDA Master Agreement dated as of [date], as amended and supplemented from time to time (the "Agreement"), between [Name of Party A] ("Party A") and [Name of Party B] ("Party B"). All provisions contained in the Agreement govern this Confirmation except as expressly modified below.<sup>2</sup>

<sup>1</sup> By using this language, the parties will incorporate the version of the Annex to the 2000 ISDA Definitions most recently published at the date on which they enter into the relevant transaction, as the Annex has been amended and supplemented through that date. If the parties want to incorporate a particular earlier version of the Annex to the 2000 ISDA Definitions, include, at the end of this sentence, and the version of the Annex to the 2000 ISDA Definitions that is incorporated into this Confirmation is the June 2000 version, as amended and supplemented through [January 1, 2001]."

<sup>2</sup> If the parties have not yet executed, but intend to execute, an ISDA Master Agreement, include, instead of this paragraph, the following: "This Confirmation evidences a complete and binding agreement between you and us as to the terms of the Swap Transaction to which this Confirmation relates. In addition, you and we agree to use all reasonable efforts promptly to negotiate, execute and deliver an agreement in the form of the ISDA Master Agreement (Multicurrency-Cross Border) (the "ISDA Form"), with such modifications as you and we will in good faith agree. Upon the execution by you and us of such an agreement, this Confirmation will supplement, form a part of and be subject to that agreement. All provisions contained in or incorporated by reference in that agreement upon its execution will govern this Confirmation except as expressly modified below. Until we execute and deliver that agreement, this Confirmation, together with all other documents referring to the ISDA Form (each a "Confirmation"), confirming transactions (each a "Transaction") entered into between us (notwithstanding anything to the contrary in a Confirmation), shall supplement, form a part of, and be subject to, an agreement in the form of the ISDA Form as if we had executed an agreement in such form (but without any Schedule except for the election of [English law] [the laws of the State of New York] as the governing law and [specify currency] as the Termination Currency) on the Trade Date of the first such Transaction between us. In the event of any inconsistency between the provisions of that agreement and this Confirmation, this Confirmation will prevail for purposes of this Swap Transaction."

# What are the key issues for Documenting Crypto Derivatives raised by ISDA?

**ISDA**

Contractual Standards for  
Digital Asset Derivatives

**ADAPT FROM  
2002/2011 DEFS:**

Illiquidity Event  
Change in Law  
Nationalization,  
Insolvency and  
Delisting  
Hedging Disruption  
Settlement Disruption  
Tax Disruption

\_\_\_\_\_  
**2002 ISDA  
Equity Derivatives  
Definitions**  
\_\_\_\_\_

**ISDA.**  
INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

## 4. DISRUPTION EVENTS

### 4.1 Why are Disruption Events Important?

In common with other asset classes, digital assets may be subject to one-off or periodic events that could interrupt or disrupt the functioning of a digital asset derivatives transaction.

There is a range of events that could occur. Many, including those relating to the underlying technology, will generally impact the product lifecycle directly. Events affecting the broader digital assets market, ecosystem or regulatory framework could also directly or indirectly impact the terms of a transaction (or many transactions).

These events may have different consequences for a transaction.

- They may impact the valuation of the transaction;
- They may impede or prevent settlement of a transaction or the posting of collateral; or
- They could jeopardize the viability or legality of the overall trading relationship.

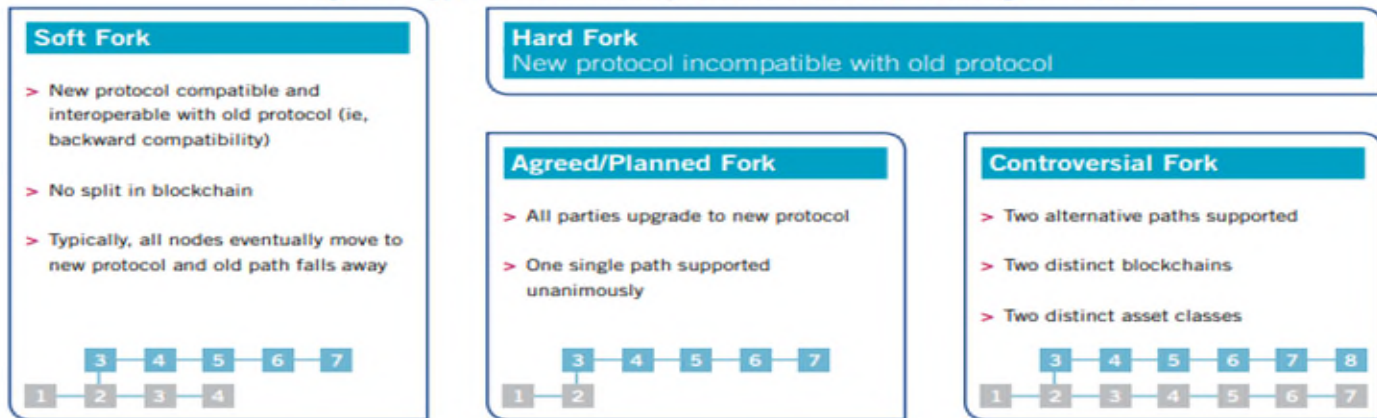
Developing contractual standards for digital asset derivatives will require market participants to identify the types of events that could occur with respect to digital asset derivatives and consider what consequences should result from the occurrence of these events.

# What are the key issues for Documenting Crypto Derivatives raised by ISDA?

ISDA

Contractual Standards for  
Digital Asset Derivatives

Figure 1: Types of Fork that May Arise as a Result of a Change in Protocol



## 4.3.1 Forks

Digital assets are generally identifiable by reference to a specific technology platform (such as a particular software protocol implemented on a distributed network). Events or occurrences in respect of that underlying technology may have an impact on a derivatives transaction referencing a digital asset, depending on the precise nature of the asset and the structure of the transaction.

# What are the key issues for Documenting Crypto Derivatives raised by ISDA?

**ISDA**

Contractual Standards for  
Digital Asset Derivatives

## 4.3.2 Airdrops

The holders of digital assets on a particular network may benefit from an airdrop, which involves the unilateral issuance of a new digital asset to the holders of an associated digital asset.

## 4.3.3 Cyberattacks and Other Disruptions to the Underlying Technology

Disruptions to the underlying technology may also be triggered by cyberattacks or flaws or bugs in the protocol, among other things. These types of disruptions could, for example, affect the value of the digital asset (which may not be restored later), prevent or delay a transfer into a wallet or disrupt the availability of an observed price. It could also result in an observed price that does not reflect the true market value and is liable to a sudden correcting value movement.

## 4.3.4 Change in Law or Regulation

There is considerable uncertainty about the regulatory status and treatment of various types of digital asset. In many jurisdictions, there is a lack of clarity over how existing regulatory frameworks apply in the context of certain digital assets, and the legal and regulatory landscape is continuing to evolve. In certain cases, there are novel conflicts-of-laws issues to consider<sup>19</sup>. As a result, digital assets remain particularly vulnerable to changes in law that could potentially impact a derivatives transaction, including restrictions on the ability of derivatives market participants to invest in, or even assume an exposure to, digital assets. Even if this is not prohibited, prudential regulation of exposures may result in increased costs that make the hedging of these transactions uneconomic.

# What are the key issues for Documenting Crypto Derivatives raised by ISDA?

**ISDA**

Contractual Standards for  
Digital Asset Derivatives

Sample Key Issues:

Valuation not referencing a single trading  
venue  
Liquidity Issues  
Extreme Volatility  
Unavailability of Data  
Calculation Agent Discretion

Potential Valuation Disruption Events:

Benchmark Provider Events  
Calculation Agent Events  
Trading Venue Events

## 5. VALUATION

### 5.1 Why is Valuation Relevant?

Valuations of assets are relevant for three primary purposes in derivatives transactions:

- Determining the extent of payment and delivery obligations under the transaction;
- Determining any close-out amount due on early termination; and
- Determining the extent of collateralization obligations.

In each case, valuations can have a fundamental impact on the economics of an arrangement.

- Valuations for payments and deliveries will directly affect the returns attributable to a particular transaction;
- Valuations on close out will affect the cost associated with terminating a trading relationship; and
- Collateral valuations will determine the volume of assets that is required to be tied up in a collateral arrangement, and therefore the opportunity cost of the transaction, as well as the protection a party has to cover its exposures if there is a default.



# Collateral Issues for Crypto

ISDA



## 7.3 Digital Assets Used as Collateral

Most digital assets, particularly native digital assets, are currently unlikely to be viewed as eligible collateral satisfying mandatory margin requirements under the applicable regulations of major jurisdictions.

Certain money-like instruments (eg, stablecoins that are pegged to and collateralized by fiat currency) have been acknowledged under certain circumstances to present features similar to cash, which is eligible collateral<sup>34</sup>. It is expected that any CBDCs would likely be introduced through specific legislation enabling it to be characterized as cash. Once introduced, CBDCs are therefore very likely to constitute eligible collateral in the relevant jurisdiction. There remains a degree of uncertainty over whether and in what circumstances other asset-referenced digital assets for which the underlying qualifies as eligible collateral (for example, certain security tokens) would themselves qualify as eligible collateral.

The transfer mechanics set out within ISDA's collateral documentation generally apply to cash and securities and may not be well suited to transfers of digital assets. For example, parties may be required to transfer cash, securities or other property as 'distributions', but it is unclear whether this requirement applies to airdrops in the context of digital assets. The application of 'default interest' to digital assets also requires clarification. For instance, in case of a failure to deliver Bitcoin as margin, it is uncertain whether the default rate of interest would run in Bitcoin or its currency equivalent.

The nature of any security interest granted over these digital assets depends on a variety of factors – for example, the location of the asset, the forms of security that can be granted under the applicable law, and other regulatory requirements applying to posted margin such as segregation. Collateral documents may need to be amended in due course to reflect the appropriate forms of security interest granted over digital assets under the relevant law. ISDA intends to produce specific guidance on these issues, focusing on the principal issues that should be considered when providing or receiving collateral in the form of digital assets.

# Crypto Derivatives from a German Law Perspective

- **Crypto assets** are one category of **financial instruments** within the meaning of Sec. 1 (11) 1 (no. 10) of the German Banking Act (**KWG**)
  - Full regime of licensing requirements (Sec. 1 and 32 of the KWG) applies when providing financial services or conducting banking business with respect to crypto assets
  - In particular crypto custody business (*Kryptoverwahrgeschäft*) and crypto security register keeping (*Kryptowertpapierregisterführung*), but also “classic” licensing requirements such as for principal broking business (*Finanzkommissionsgeschäft*), investment brokerage (*Anlagevermittlung*) and own account trading (*Eigenhandel*) or the operating a crypto trading platform (MTF) etc.
- **Derivatives on crypto assets (crypto derivatives):**
  - The definitions of the term “derivatives” in the KWG and WpHG (Securities Trading Act) do not refer to crypto assets as eligible underlying as such
  - The KWG and the WpHG may nevertheless apply to crypto derivatives if the crypto assets (or the crypto derivative as such) qualify as another financial instrument such as:

# Crypto Derivatives from a German Law Perspective

- Securities (*Wertpapiere*)
- Units of account (*Rechnungseinheiten*)
- Commodities (*Waren*)
- Financial contracts for difference (*Differenzgeschäfte*)
- Forwards (futures) referring to the underlying of Art. 8 of the MiFID II DelReg (Reg (EU) 2017/565):
  - In particular: “(f) any other asset or right of a fungible nature, other than a right to receive a service, that is capable of being transferred;”, provided that they are no spot transactions and either
    - their terms foresee a cash settlement at the option of one or more of the parties, otherwise than by reason of a default or other termination event,
    - they are traded on a regulated market, an MTF, an OTF, or a third country trading venue that performs a similar function, or
    - they have the characteristics of other derivatives contracts within the meaning of Art. 7 of the MiFID II DelReg

# Crypto Derivatives from a German Law Perspective

- **Crypto derivatives in context of close-out netting (Sec. 104 of the Insolvency Code (InSO))**
  - Crypto derivatives as fixed-date transactions (*Fixgeschäfte*) regarding goods (*Waren*)?
  - Crypto derivatives as financial service (*Finanzleistung*)
    - Underlying securities (*Wertpapiere*)?
    - Underlying currencies (*Währungen*)?
    - Underlying financial measures (*finanzielle Messgröße*)?
    - Financial contract for difference (*finanzielle Differenzgeschäfte*)?
    - Crypto derivatives as financial service sui generis?

# Crypto Derivatives from a German Law Perspective

- **Crypto derivatives and EMIR, MiFID II and MAR (Market Abuse Regulation)**

- EMIR (clearing, margining, reporting) potentially applicable to crypto derivatives if they are derivatives under EMIR
- Derivative under EMIR = financial instrument as set out in points (4) to (10) of Section C of Annex I to MiFID II as implemented by Art. 7 and 8 of MiFID II DelReg (Reg (EU) 2017/565 (formerly Art. 38 and 39 of Regulation (EC) No 1287/2006)
- I.e. Securities, currencies or financial measures as underlying, financial contract for difference (see previous slide) all covered
- But not: units of account (*Rechnungseinheiten*) → Relevant for Currency Token (*Währungstoken*) which are subject to the KWG but not subject to EMIR / MiFID II / MAR, unless they qualify as financial measure (*finanzielle Messgröße*)

- **Issues under German property law (*Sachenrecht*)**

- The legal categorization under of crypto assets under German property law is often more difficult than under German contract law:

# Crypto Derivatives from a German Law Perspective

- Categorization of crypto assets
  - Asset (*Sache*) within the meaning of Sec. 90 of the BGB? Fungible physical asset?
  - Right (*Recht*) within the meaning of Sec. 453 (1) BGB?
  - **Other items (*sonstige Gegenstände*) within the meaning of Sec. 453 (1) BGB?**
  - Amount of money (*Geldbetrag*)?
  - Banknotes and coins (*Banknoten und Münzen*)
  - Fiat money (*Giralgeld*) or e-money (*E-Geld*)
  - **Securities (*Wertpapiere*)**
- Pledge / full title transfer under German property law? Numerus clausus of the German property law (*Sachenrecht*)
- Governing property law?

# Crypto Derivatives from a German Law Perspective

- **What is coming next: European crypto-assets regulation (MiCA)**
  - Covers issuers of unbacked crypto-assets, and so-called “stablecoins”, as well as the trading venues and the wallets where crypto-assets are held.
  - MiFID II financial instruments are excluded (Art. 1 (2)a) Draft MiCA
  - Current status:
    - The Council presidency and the European Parliament reached a provisional agreement on the markets in crypto-assets (MiCA) proposal on 30 June 2022.
    - The provisional agreement is subject to approval by the Council and the European Parliament before going through the formal adoption procedure.



Patrick Scholl, Marcel Hörauf and Christopher Arnold

# Session 3: ESG and Derivatives



# Overview

## 1. Introduction

- EU Sustainable Finance Strategy
- Major Regulatory Pillars for Data Flows
- Overview of selected EU Regulations

## 2. Key Regulatory ESG Requirements

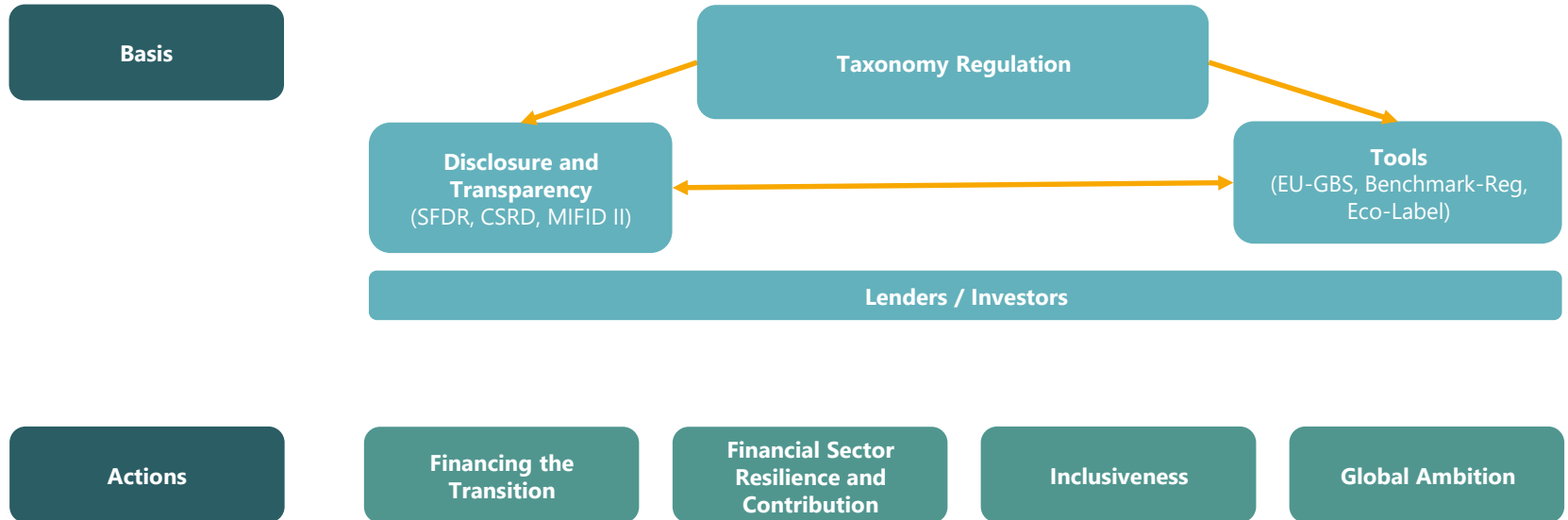
- Taxonomy Regulation
- The Proposal for a Corporate Sustainability Reporting Directive (CSRD)
- Suitability Assessment MIFID II
- Overview of the SFDR
- What is (possibly) coming next?
- Greenwashing, Novel Challenges and ESG Risks

## 3. ESG: Sustainability-linked Derivatives

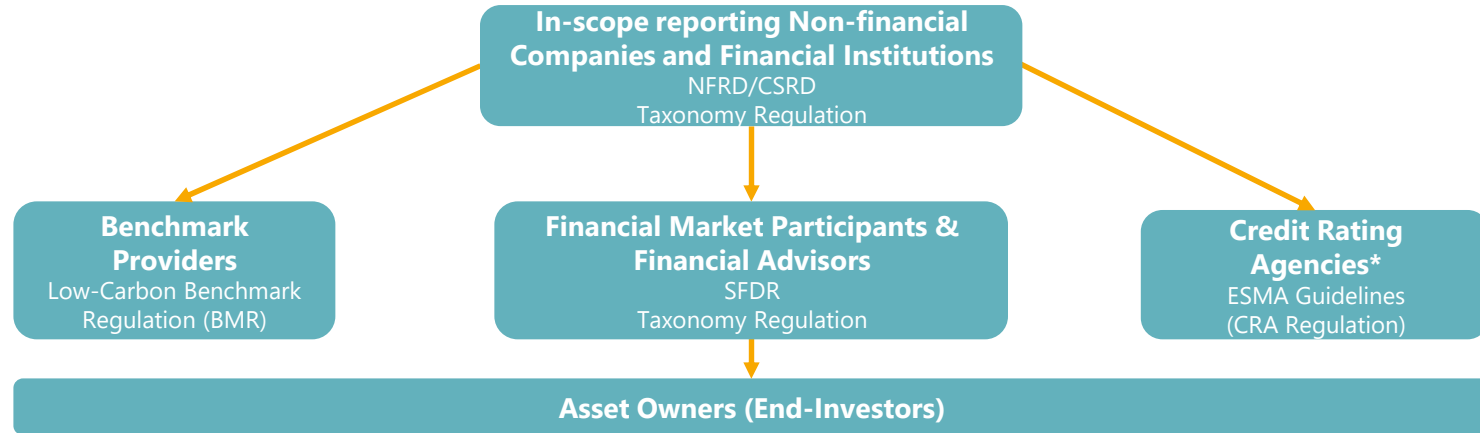
- Evolution of ESG Financial Products
- Sustainability-linked Derivatives
- Establishing KPIs and the Verification Process
- Regulatory Aspects
- Industry Initiatives
- Future Developments

# EU Sustainable Finance Strategy

Renewed Strategy for Financing the Transition to a Sustainable Economy,  
published in July 2021 (COM(2021) 390 final)



# Major Regulatory Pillars for Data Flows



## Glossary:

- **NFRD** = Non-Financial Reporting Directive (Directive 2014/95/EU)
- **CSRD** = Corporate Sustainability Reporting Directive (Proposal COM(2021) 189 final)
- **SFDR** = Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088)
- **BMR** = Benchmark Regulation (Regulation (EU) 2016/1011)
- **CRA** = Credit Rating Agencies Regulation (Reg. (EU) No 462/2013)

\* Reported data will also be required for ESG ratings. It is unclear whether and to what extent the EU will envisage a regulation for ESG ratings.

# Overview of selected EU Regulations

- In March 2018, the EU published a comprehensive **Action Plan on the Financing of Sustainable Growth** (COM/2018/097 final) which laid out a master plan to be implemented by a variety of individual regulatory measures:

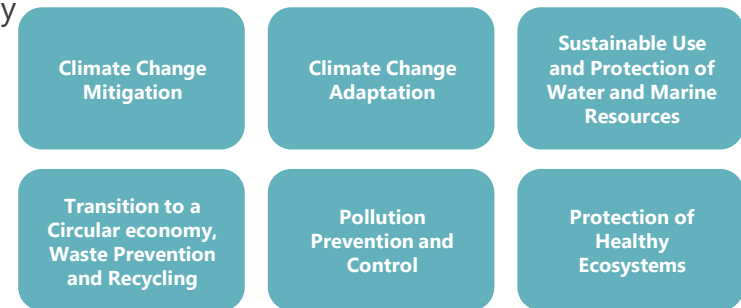


- Level 2 measures under SFDR are currently being finalised
- „Fit for 55“ package aims to amend EU legislation and policy to ensure that the EU is able to meet its new climate targets by 2050

# Taxonomy Regulation – Overview

- An investment is environmentally sustainable if it finances one or more **economic activities** that are considered environmentally sustainable under the Taxonomy Regulation (Art. 3)
- According to the Taxonomy Regulation, an **economic activity** is environmentally sustainable when it:
  - substantially contributes to one of the six defined **environmental objectives**
  - **does no significant harm** to any of the other five objectives
  - complies with **minimum safeguards**
  - For the time being, the regulation is limited to the determination of environmental sustainability (at a later stage the objectives "social" and "governance" will be included)
- Suggested details can be found in the Technical Report of the TEG on Sustainable Finance and its Technical Annex

The six environmental objectives under the Taxonomy Regulation:



Example of quantitative DNSH analysis<sup>1</sup>:



# Taxonomy Regulation – Scope

- Scope of the Taxonomy Regulation through references in the Non-Financial Reporting Directive and the Disclosure Regulation (SFDR) and the upcoming EU Green Bond Regulation:
  - **Who?** EU and its Member States as well as companies already required to report under the Non-Financial Reporting Directive and financial market participants and financial products pursuant to the Disclosure Regulation (SFDR)
  - **What?**
    - Transparency for environmental and sustainable financial products (Art. 5 and 6): pre-contractual documentation and periodic reports
    - Transparency for environmental corporate bonds (via the EU GBS)
    - Transparency for non-financial reporting (Art. 8): disclosure of KPIs/Green Asset Ratio for financial institutions
- Required compliance for activities related to climate change mitigation and adaptation starts in 2022 and for other environmental objectives in 2023

# Taxonomy Regulation – Level 2 Measures

- Technical Screening Criteria - Climate Delegated Act ((EU) 2021/2139):
  - Provides for the first technical screening criteria for companies and financial market participants on which economic activities can be considered to make a substantial contribution to climate mitigation and adaptation objectives
  - On 2 February 2022, the Commission approved in principle a Complementary Climate Delegated Act (C (2022) 631/3) including, under strict conditions, specific nuclear and gas energy activities in the list of economic activities covered by the EU taxonomy
- Environmental Delegated Act: A second delegated act on the other four environmental objectives of the EU Taxonomy is planned for adoption in 2022

# Taxonomy Regulation – Level 2 Measures

- Taxonomy Disclosure Delegated Act ((EU) 2021/2178):
  - undertakings subject to Articles 19a or 29a of Directive 2013/34/EU
  - reporting of Taxonomy eligibility and alignment by way of ‘key performance indicators’ (KPIs)
  - for banks the main metric is the Green Asset Ratio (GAR), and secondary KPIs (like fee or commission based)
  - For 2022, the proportion of Taxonomy-eligible and non-eligible economic activity has to be reported by non-financial undertakings (for financial undertakings this will apply in 2023)
  - As of 2023, full-scale KPI-based disclosure on the degree of alignment with the Taxonomy will become mandatory for non-financial undertakings (for financial undertakings this will apply as of 2024)



# CSRD – Revision of NFRD

- So far, Directive 2014/95/EU – also called the Non-Financial Reporting Directive (**NFRD**) – applies and lays down the rules on disclosure of non-financial and diversity information by certain large companies
- This directive amends the Accounting Directive 2013/34/EU
- EU rules on non-financial reporting **currently apply to large public-interest companies with more than 500 employees**. This covers approximately **11 700** large companies and groups **across the EU**, including
  - listed companies
  - banks
  - insurance companies
  - other companies designated by national authorities as public-interest entities
- **'public-interest entities'** means undertakings within the scope of Article 1 and Annex I, II of NFRD. According to Art. 1(1), 2(1) and Annex I and II, the following types of undertakings are defined as public-interest companies in Germany:
  - *"die Aktiengesellschaft, die Kommanditgesellschaft auf Aktien, die Gesellschaft mit beschränkter Haftung"*
  - *"die offene Handelsgesellschaft, die Kommanditgesellschaft"*

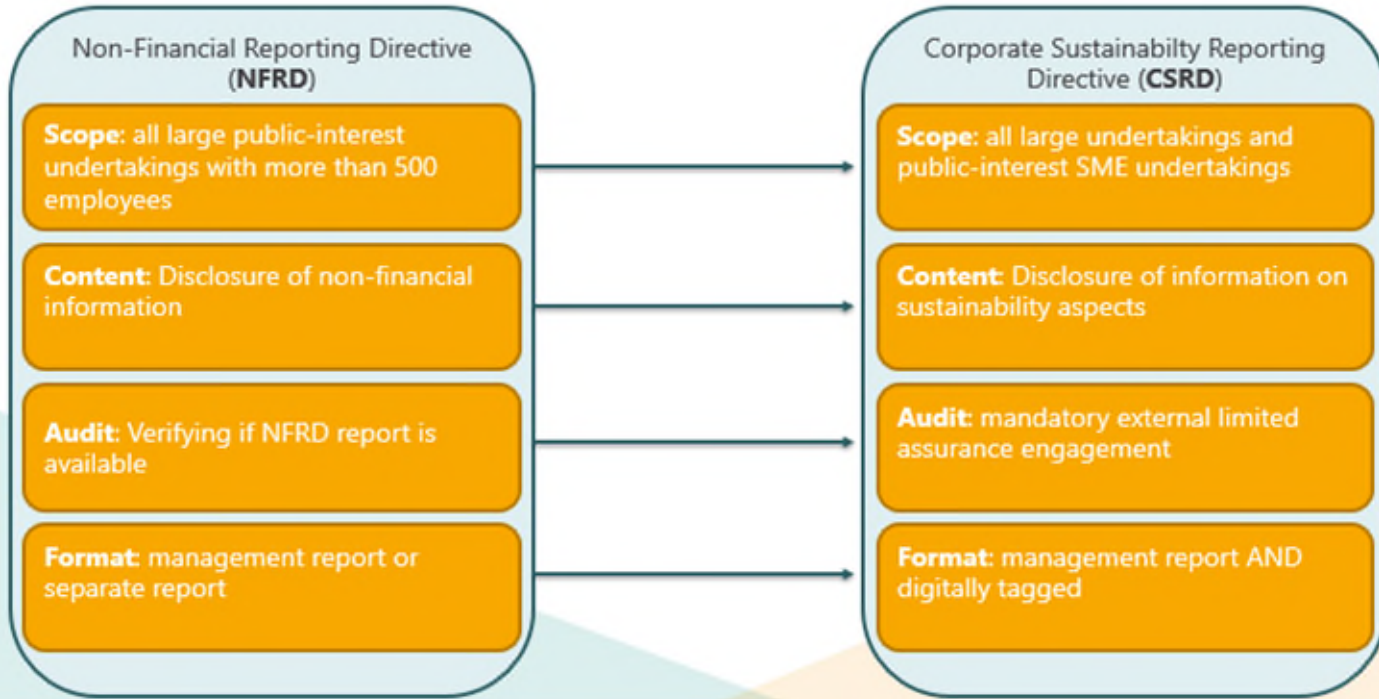
# CSRD – Revision of NFRD

- Under the NFRD, large companies have to publish **information related to**
  - **environmental matters**
  - **social matters and treatment of employees**
  - **respect for human rights**
  - **anti-corruption and bribery**
  - **diversity on company boards (in terms of age, gender, educational and professional background)**
- Germany had transposed the EU Directive NFRD into national law with the CSR Directive Implementation Act (CSR-RUG)
- In Germany, capital market-oriented corporations, insurance companies, credit institutions, limited partnerships and cooperatives are required to submit this report if they either have
  - **more than 500 employees**
  - **or meet two of three size criteria - 40 million euros in turnover, 20 million euros in total assets, number of 250 employees**
- The main provisions in this respect are sections 289b to e of the German Commercial Code (HGB)

# CSRD – Revision of NFRD

- In April 2021, it was decided to extend the scope of the NFRD to smaller companies as well and the proposal for the Corporate Sustainability Reporting Directive (CSRD) was issued: The CSRD
  - Would amend the existing reporting requirements of the NFRD since the information companies report is not sufficient
  - Ensures that companies report the information that investors and other financial market participants subject to the SFDR need
  - **Extends the scope to all large companies and all companies listed on regulated markets without the previous 500-employee threshold (except listed micro-enterprises)**
  - **Requires the audit (assurance) of reported information**
  - Introduces more detailed reporting requirements, and a requirement to report according to mandatory EU sustainability reporting standards
  - SMEs will be allowed to report according to standards that are simpler than the standards that will apply for large companies
  - Requires companies to digitally 'tag' the reported information, so it is machine readable and feeds into the European single access point envisaged in the capital markets union action plan
- In addition, the CSRD would amend the Transparency Directive 2004/109/EC to extend the scope of the sustainability reporting requirements to companies with securities listed on regulated markets, and to clarify the supervisory regime for sustainability reporting by these companies

# CSRD – Revision of NFRD



# CSRD – Development of Reporting Standards

- The European Financial Reporting Advisory Group (**EFRAG**) is responsible for developing draft standards
- The standards will be tailored to EU policies, while building on and contributing to international standardisation initiatives
- Besides, the International Sustainability Standards Board (**ISSB**) published on 31 March 2022 proposals that build upon the recommendations of the Task Force on Climate-Related Financial Disclosures (**TCFD**) and incorporate industry-based disclosure requirements derived from SASB (Sustainability Accounting Standards Board) Standards
- The EFRAG and ISSB standards are based on different objectives:
  - EFRAG considers the **dual materiality** perspective, i.e. that companies must report on the impact of business activities on the value of the company or on the three sustainability dimensions of environment, social and governance.
  - The ISSB focuses on the investor perspective for assessing the value of the company.
- Duplication of effort? Convergence or mutual recognition by EFRAG/ISSB?

# CSRD – European Council's Proposed Amendments as of 21 June 2022

- Extra-territorial scope

For **non-European companies**, the requirement to provide a sustainability report applies to all companies generating a net turnover of EUR 150 million in the EU and which have at least one subsidiary or branch in the EU. These companies must provide a report on their ESG impacts, namely on environmental, social and governance impacts, as defined in this directive.

- Relation to Equivalence Decisions?

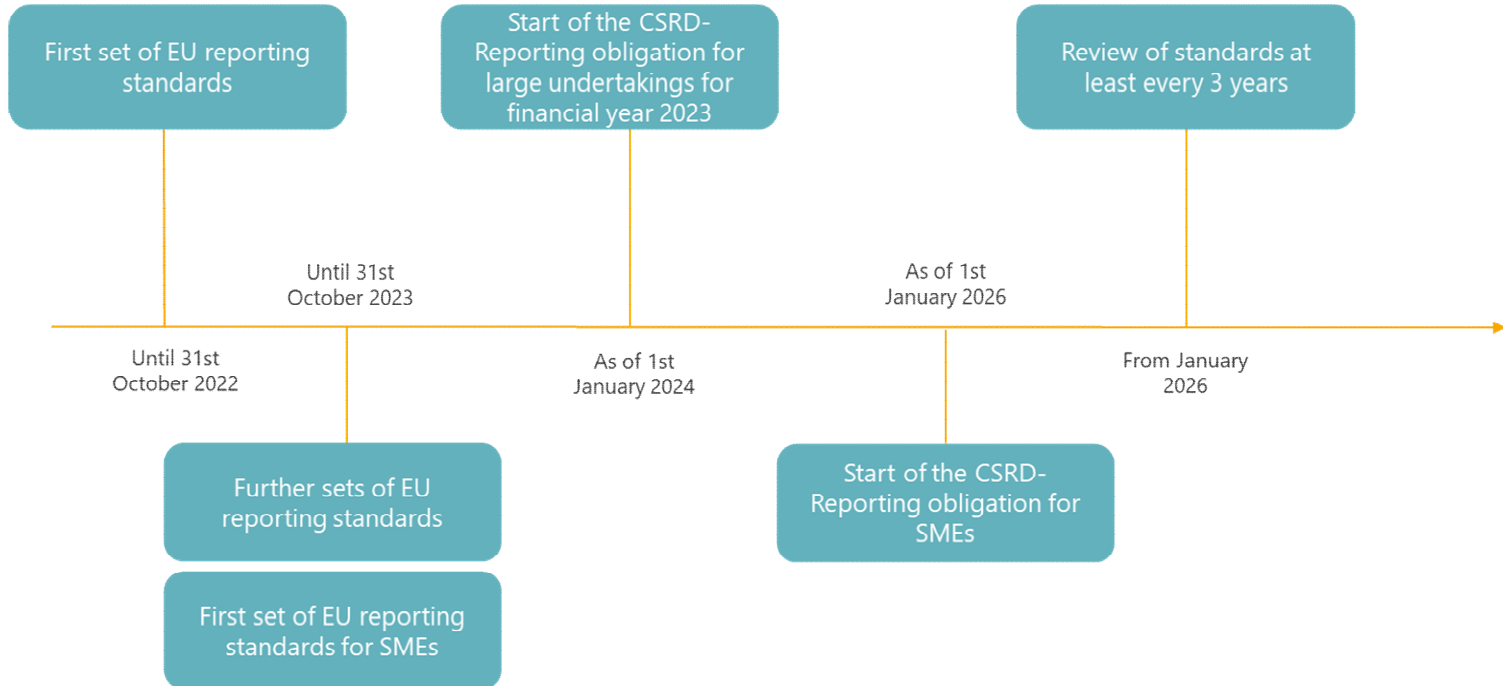
# CSRD – Timetable – European Council's proposed amendments

## **Adjustment of deadlines** *(Article 5 of the proposal)*

Some deadlines were considered too ambitious by many delegations. Several delegations requested that the transposition deadline be set in relation to the entry into force of the Directive, while other delegations suggested that the date of application be put back in order to give undertakings sufficient time to adapt. With this in mind, the Presidency suggests the following deadlines:

- deadlines for transposition by Member States (18 months after entry into force);
- deadlines for implementation by undertakings:
  - 1 January 2024 for undertakings already subject to the NFRD (reporting in 2025 on 2024 data);
  - 1 January 2025 for large undertakings not currently subject to the NFRD (reporting in 2026 on 2025 data)
  - 1 January 2026 for listed SMEs, as well as for small and non-complex credit institutions and for captive insurance undertakings (reporting in 2027 on 2026 data)

# CSRD – Timetable





# MiFID II Suitability Assessment

- With regard to the distribution of financial instruments (i.e. not only financial products in the narrower sense of the Taxonomy Regulation), Delegated Regulation (EU) 2021/1253 amends the **MiFID II DelReg** (DelReg (EU) 2017/565) by introducing **Sustainability Factors** into **Suitability Assessments**:
  - Investment firms providing investment advice or portfolio management shall as part of their suitability assessment also ask the client for its “sustainability preference” and investment firms should offer such products that corresponds with such preference
  - Sustainability preferences relate to (at the investors choice)
    - Financial instruments with a certain minimum proportion of environmentally sustainable investments pursuant to Art. 2 (1) EU Taxonomy
    - Financial instruments with a certain minimum proportion of sustainable investments pursuant to Art. 2(17) SFDR or
    - Financial instruments that consider principal adverse impacts on sustainability factors

# MiFID II Suitability Assessment

- Investment firms shall also provide clients in good time before the provision of investment services with a general description of the nature and risks of financial instruments, also taking into account in particular any “ESG considerations”
- In addition, Delegated Directive (EU) 2021/1269 (amending DeDir 2017/593) integrates **sustainability factors** into the **product governance obligations**. Correspondingly, **target market determinations** are to be amended with respect to “ESG” financial instruments.
  - In Germany, the German Banking Industry Associations, together with the the German Association of Investment and Asset Management and the German Derivatives Association (DDV) have agreed on a common minimum standard for determining the target market agreed for the German market.

# MiFID II in Context of OTC Derivatives

- How to address sustainability preferences in context of Derivatives?
- Can there be eligible products at all?
  - Underlying of derivative is an environmentally sustainable investment (product) within the meaning of Article 2 point (1) of the Taxonomy Regulation / sustainable investment as defined in Article 2 point (17) of the SFDR
  - KPIs for Banks/Counterparties?
- Investment advice: what to do, if (it is clear from the beginning that) there is no product available that suits investors preferences?
- **Any views?**

# Overview of the SFDR – Objectives & Scope

- Sustainable Finance Disclosure Regulation (**SFDR**) ((EU) 2019/2088)
  - The objective is to channel private investment towards sustainable investing while preventing 'greenwashing'
  - The regulation started to be phased in on 10 March 2021; regulatory reporting under Art. 11 commences on 1 January 2022
  - The European Supervisory Authorities (ESAs) have developed through the Joint Committee (JC) draft Regulatory Technical Standards (SFDR RTS), which provide for
    - (i) details on the PAI Statement on the financial market participants' or advisors' website and
    - (ii) pre-contractual and periodic disclosure templates, including on sustainability indicators, asset allocation and the „extent“ of EU Taxonomy alignment by way of a KPI
  - The SFDR RTS will not enter into force before 1 January 2023
  - **Who?**
    - Financial market participants = defined as investment firms, including asset managers which offer portfolio management services, pension providers and insurance-based investors, as well as qualifying venture capital and social entrepreneurship activities
    - Financial advisers
  - **What?** Sustainability-related information with respect to financial products (product level and entity level disclosure)
  - **Where?** Websites, pre-contractual disclosures, reports

# What is (possibly) coming next?

- “Extended Taxonomy”

- The European Commission had mandated the Platform for Sustainable Finance to work on a possible extension to the Taxonomy, to include “activities **significantly harmful** to environmental sustainability and activities with no significant impact on environmental sustainability”
- The taxonomy of significantly harmful activities can be thought of as consisting of two components:
  - the activities for which no technological possibility of improving their environmental performance to avoid significant harm exists, as is the case for the power generation activity using fossil fuels already identified in Art. 19 (3) of the current Taxonomy Regulation; and
  - the activities that fail performance levels set by DNSH technical screening criteria in delegated acts (where such DNSH criteria exist) and are in need of an urgent transition to avoid causing significant harm to environmental objectives

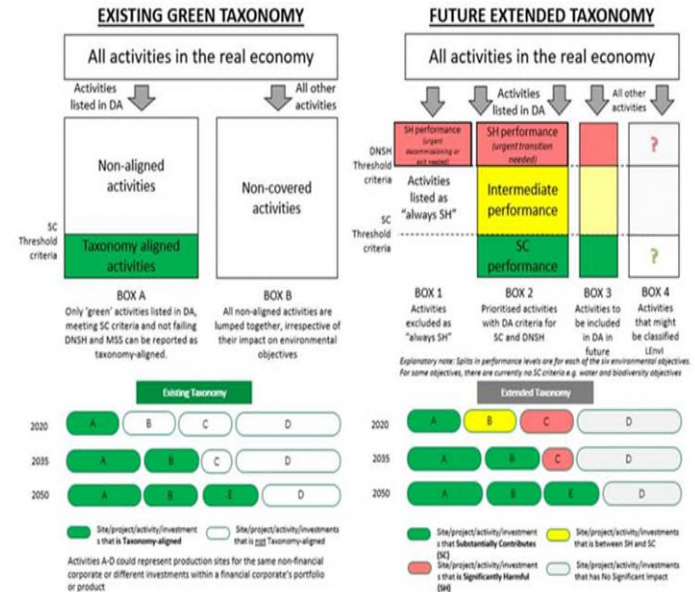


Figure 4-2. Extension of the Taxonomy can facilitate clarity and an improved understanding of the environmental performance of portfolios of activities and can thereby support improved transition strategies and access to financing.

Source: Platform on Sustainable Finance

# What is (possibly) coming next?

- **Sustainable corporate governance initiative**

- Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (COM(2022) 71 final, 2022/0051 (COD))
  - Aims to improve the EU regulatory framework on company law and corporate governance
  - It would enable companies to focus on long-term sustainable value creation rather than short-term benefits
  - It aims to better align the interests of companies, their shareholders, managers, stakeholders and society
  - It would help companies to better manage sustainability-related matters in their own operations and value chains as regards social and human rights, climate change, environment, etc.
- If the directive comes with the proposed content, the German legislator would have to considerably revise the German *Lieferkettengesetz*

# What is (possibly) coming next?

- **Social Taxonomy:** Draft Report by Subgroup 4 from July 2021 and Final Report by the Platform on Sustainable Finance from February 2022
  - The work done on the social taxonomy is liable to be incorporated into existing legislative texts as the NFRD and the SFDR
  - The relationship between the social and environmental taxonomies is still under discussion with regard to three main differences:
    - Economic activities such as job creation are inherently socially beneficial
    - Environmental objectives and criteria can be based on science, but a social taxonomy could be founded on international authoritative standards of topical relevance such as the Bill of Human Rights
    - For some social topics it might be more difficult to develop meaningful quantitative criteria

# Sources of ESG Risks





# Novel Challenges in ESG

## Greenwashing

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- Environmental claims describe statements by businesses that suggest their goods or services have a positive or neutral environmental impact, or less of a negative impact than other similar goods or services.
- Market participants risk claims of 'greenwashing' if they make environmental claims that may not be justifiable and/or misleading.

## Definitions of ESG

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- Currently, there is no broad consensus definition of all the core elements of 'ESG'.
  - E.g. the discussion around the inclusion of nuclear and gas as "environmentally sustainable activities" in the EU Taxonomy or the future treatment of the defense industry.
- Defining the 'S' and 'G' in ESG can be even less clear than defining the 'E'.

## Comparable ESG data

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- Financial market participants need to rely on accurate and reliable ESG data to:
  - i. inform asset pricing and capital allocation in the financial markets;
  - ii. design the ESG products that their wholesale / retail clients increasingly demand; and
  - iii. for their own investment and risk management processes.
- Despite the fact that a wealth of ESG data exists, there are different methodologies, metrics, weightings and subjective judgment in ESG ratings, making it difficult for investors to rely on ESG data.

# "Greenwashing" and potential litigation risks

BUSINESS • Analysis

## Greenwashing 101: How to decipher corporate claims about climate

Companies are eager to tout their environmental progress on Earth Day. Here are five tips for investigating whether their claims tell the full story.

 By Douglas MacMillan  
Staff writer  
April 21, 2022 at 12:49 p.m. EDT

Green|Finance

## Finance Industry's Climate Promises Leave Plenty of Room for Oil and Gas

Research by Reclaim Finance and partner organizations found that, of 150 financial institutions, more than half have no restrictions on fossil-fuel work

Repsol: Good on GBPs, not so sure on green credentials

Climate Bonds INITIATIVE

Banks hit by 'fraud' complaint to SEC over Adani SLB coal links

GlobalCapital

DWS shares slide after greenwashing claims prompt BaFin investigation

FINANCIAL TIMES

Boohoo shares drop 18% as new Leicester factory reports threaten sales

The Guardian

# Key areas of potential exposure for Financial Institutions

- Commitments, targets and disclosures – the key risks
- Due diligence
- Investing, or directing investments in ESG funds, assets and projects
  - How has the ESG performance of the investment been assessed?
  - Asset valuation issues
  - Poor performance or negative outcome – linked to failure to properly assess ESG risks?
- **Greenwashing**
- **Primary AND Secondary** liability theories

# Mitigating risks: What should Financial Institutions be doing?

- The risks of inaction
  - Reputational risk
  - Counterparty / credit risks
  - Physical risks
  - Transition risks (e.g., “stranded assets”)
- Familiarity, and compliance, with the rapidly evolving legislative and regulatory framework
- Focused working groups for ESG issues and disclosures

# Mitigating risks: What should Financial Institutions be doing?

- Disclosures and public statements – accuracy is essential
- Discrepancies between what is “said” and what is “done” – identify and cure
- Focused working groups for ESG issues and disclosures (general and for specific transactions)
- Familiarity, and compliance, with the rapidly evolving legislative and regulatory framework
- Examine supply and value chain issues and requirements to ensure best practice



# ESG: Sustainability-linked Derivatives



# Evolution of ESG financial products

- **“Green”** or **“social”** bonds – usually with a “use of proceeds” structure
- **“Green”** or **“sustainability-linked”** loans
- ICMA/LMA/LSTA **green principles**: (i) Use of proceeds, (ii) Process for evaluation and selection, (iii) Management of proceeds, (iv) Reporting
- **Green frameworks**
- ESG derivatives often linked to, or include, KPIs or other mechanics based on such bonds, loans or frameworks.

# Sustainability-linked derivatives

- **Sustainability-linked derivatives** are most common type of ESG derivative
- Types of sustainability-linked derivative: **Category 1** and **Category 2**
- **Category 1** (more common):
  - BAU derivative transaction
  - Embedded KPI/ESG overlay
- **Category 2:**
  - Underlying derivative transaction
  - Referenced in a separate agreement which includes KPI/ESG cashflows



# Sustainability-linked derivatives - examples

- Interest Rate Swap, FX Swap, Total Return Swap
- Emerging products: Repo and Securities Lending
- KPIs linked to:
  - **Environment:** GHG emissions, energy usage
  - **Social:** diversity performance, demographic of borrowers
- Impact of KPIs on cashflows:
  - **Spread** or **Margin** may be adjusted
  - Additional **premium** may be paid/received (and/or donated to charity)

# Establishing Key Performance Indicators (“KPIs”) and the verification process

- KPIs should be:
  - Specific
  - Measurable
  - Verifiable
  - Transparent
  - Suitable
- How will performance against a KPI be established/verified?
  - Disclosure
  - Involvement of third parties/auditors



# Regulatory aspects

- No specific ESG legislation in the derivatives market (yet).
- Other relevant **ESG legislation initiatives** might include:
  - EU Taxonomy Regulation and Green Bond standard
  - SFDR/NFRD
  - OCC Consultation on Climate Risk
- **Key question:** is it a **derivative** (EU/UK) or a **swap** (US)?
  - Category 1 vs Category 2
  - KPI/ESG cashflows alone unlikely to change characterisation

# Consequences of regulatory characterisation

- If an ESG derivative is a **derivative** (EU/UK) or a **swap** (US) for regulatory purposes – ESG overlay might give rise to additional considerations.
- Margining and valuation:
  - How to value KPI/ESG cashflows?
  - Are existing models for e.g. IM sufficient?
- Reporting and disclosure:
  - To counterparties, repositories etc.
  - How to report KPI/ESG features?

# Industry initiatives

- **ISDA** papers:
  - Regulatory Considerations for Sustainability-linked Derivatives
  - Sustainability-Linked Derivatives: KPI Guidelines
  - IFLD: Sustainability-linked Derivatives: Where to Begin?
- **ICMA** working group:
  - ICMA Sustainability Taskforce – Sustainable Repo workstream

# Key negotiation points for sustainability-linked derivatives

- Defining **KPIs**
- **Disclosure** obligations
- How performance against KPIs will be **verified**
- Involvement of **third parties**
- Consequences of breach of **ESG-related obligations** (including termination rights)
- **Publicity**

# Future developments?

- Standardisation of documents and definitions
- Regulation of ESG Derivatives
- Evolution of ESG ratings



Patrick Scholl,  
Alexei Döhl, Ann-Kathrin Balster

# Session 4: Risk Free Rates Hedging under 2021 ISDA Definitions and the German Master Agreement



# 2021 ISDA Definitions

- Originally published on 11 June 2021
- Main Book currently on version 6 (published on 27 May 2022)
- Most new versions included new floating rates
- Market is still in transition towards the full use of the 2021 Definitions
- Next publication: Form of Amendment for conversion of Equity Swap Transactions that reference 2006 ISDA Definitions and 2002 ISDA Equity Derivatives Definitions -> updating references and used definitions in transactions from 2006 to 2021 ISDA Definitions

# 2021 ISDA Definitions – Structure

- Comprise the “Main Book” – the main definitional booklet and
- 5 Matrices – the definitions in the Main Book reference the matrices for certain specific data or provisions
  - Settlement Matrix
  - Floating Rate Matrix
  - Mark-to-Market Matrix
  - Currency/Business Day Matrix
  - Compounding/Averaging Matrix

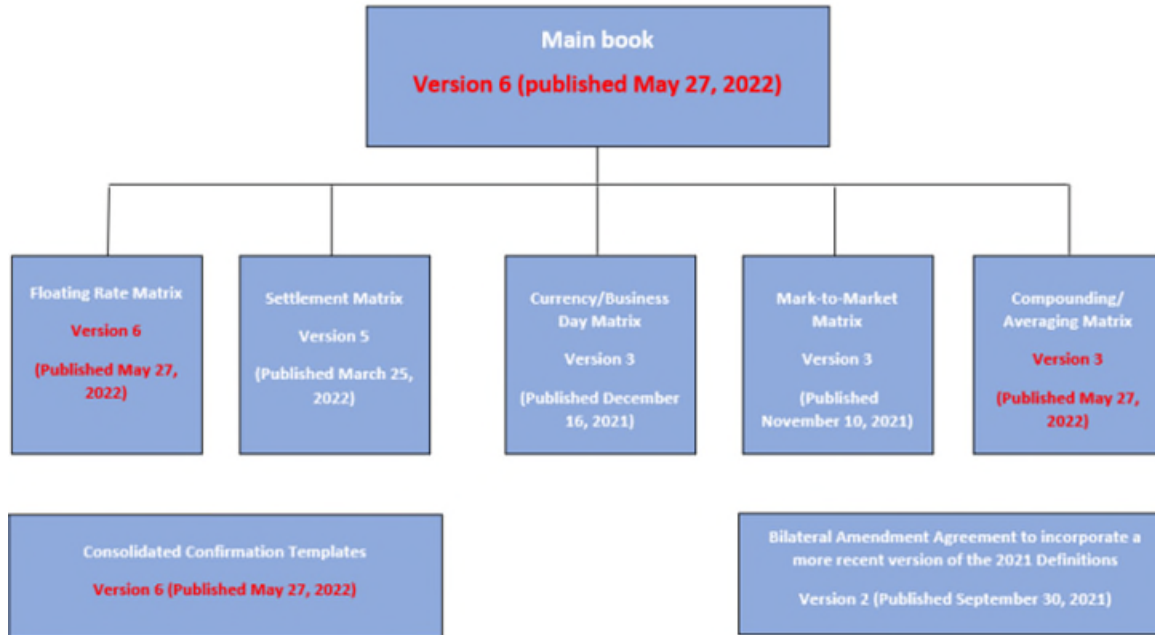
# 2021 ISDA Definitions – Structure

- Auxiliary documents are also provided:
  - Confirmation Templates
  - Form of Amendment Agreement
  - Release Notes for each new version

# 2021 ISDA Definitions – Structure

- Each time new provisions are included a new “version” of the Main Book and relevant matrices is published
- Replaces the supplement system of the 2006 definitions
- Unless otherwise agreed, the latest version of the 2021 Definitions on the trade date of the transaction will apply to each transaction
- All documents are published in an electronic format that allows cross references, but are also available as a pdf
- Limited function for comparisons between different versions

# 2021 ISDA Definitions – Versioning Map



# 2021 ISDA Definitions – RFRs

- Modular Approach: Most provisions are drafted using general language and will be individualised for any FRO by inserting the specific applicable information of the matrices
- An exception are bespoke fallbacks:
  - Most FROs have detailed, specific, bespoke fallback provisions
  - Section 9 of the Main Book which covers Bespoke Triggers and Fallbacks currently includes 87 provisions
  - The Generic Fallback provision in section 8.6 only applies in limited cases (e.g. WIBOR)

# 2021 ISDA Definitions - RFRs

- Since version 1 various new RFRs have been added
- Documenting RFRs is not more effort than any other rate
- Template confirmations and definitions match up well
- For hedging purposes nothing has changed compared to the 2006 definitions
- Provisions for Multiple Floating Rate Options

# 2021 ISDA Definitions - main changes since their first publication

- Inclusion of many new floating rates, e.g. SONIA ICE Term, TONA Compounded Index, rates based on DKK
- Numerous new rates as Averages and Compounded Indices etc
- All-In Compounded Index Method introduced as a new Index Method for use with the new ICE compounded indices
- Provisions regarding Multiple Floating Rate Options

In each case the changes have been made to the main book and the relevant matrices and further documents have been aligned accordingly



# Risk Free Rates under the German Master Agreement – the Master Agreement

- The Master Agreement itself does not give much detail about the nature of the **Reference Basis** (section 5 (1) lists *floating interest rates, exchange rates, prices or other calculation basis*)
- RFRs and hedging are not mentioned / provided for
- It does contain a very **broad fallback provision** in section 5 (2):

*In the event of a disruption of a reference basis... the Bank shall replace this reference basis with another alternative reference basis it deems economically appropriate...*

# Risk Free Rates under the German Master Agreement – additional documents

- Supplemental Agreement for the **Transition** from EONIA to €STR
  - Has served its purpose and is now outdated
- Supplemental Agreement for **IBOR Fallback Provisions**
  - Save for the application for USD LIBOR and hypothetical addition of further annexes (maybe for EURIBOR?) this has served its purpose and is now outdated
- Supplemental Agreement for **€STR Fallback Provisions**
  - Is a useful document where €STR is used
  - Is the only document with fully fledged fallback provisions

There is currently no equivalent covering EURIBOR

# Risk Free Rates under the German Master Agreement – trade confirmations

- As **RFRs** are not covered in the Master Agreement or any further published standard document (except the Supplemental Agreement for €STR Fallback Provisions) they will need to be covered on a trade by trade basis **in the confirmation**
- Different **Approaches**:
  - Literal replication of ISDA standards / specific detailed confirmations for each RFR
  - Certain short cuts to reduce complexity (such as omission of correction time)
  - Introduction/ use of categories to enable flexible use of a template confirmation for different RFRs

# Risk Free Rates under the German Master Agreement – fallback provisions

- Inclusion of detailed **bespoke fallback provisions** in confirmations makes document rather cumbersome
- **Approaches:**
  - Shortening the bespoke provisions
  - Generalizing provisions for most common RFRs
  - Rely solely on section 5 (2) of the Master Agreement
  - Add a specific bespoke annex to the Master Agreement
  - For €STR: Supplemental Agreement (see above)
- **Downside:** different provisions for trades under ISDA vs German Master Agreement documentation

# Risk Free Rates under the German Master Agreement – ISDA Bridge

- Use of bridge language generally **possible**
- BdB published **suggested language** for this purpose on 3 June 2022:

## Formulierungsvorschlag:

<i>"Bei Einzelabschlüssen, [die in englischer Sprache bestätigt werden und] die auf von der International Swaps and Derivatives Association Inc. herausgegebene Definitionen Bezug nehmen, richtet sich die Auslegung dieser Definitionen nach englischem Recht. Unabhängig davon bleibt Nr. 11 Abs. 2 des Rahmenvertrages auch auf derartige Einzelabschlüsse anwendbar."</i>	<i>"Definitions published by the International Swaps and Derivatives Association Inc which are incorporated by reference in Transactions [confirmed in the English language] shall be read and construed in accordance with English law. Irrespective thereof Clause 11 sub-Clause 2 of the Master Agreement shall remain applicable to such Transactions"</i>
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- Some supplemental agreements provide the option "Other benchmark provisions taking **precedence** over this Supplement Agreement"

# Risk Free Rates under the German Master Agreement – ISDA Bridge

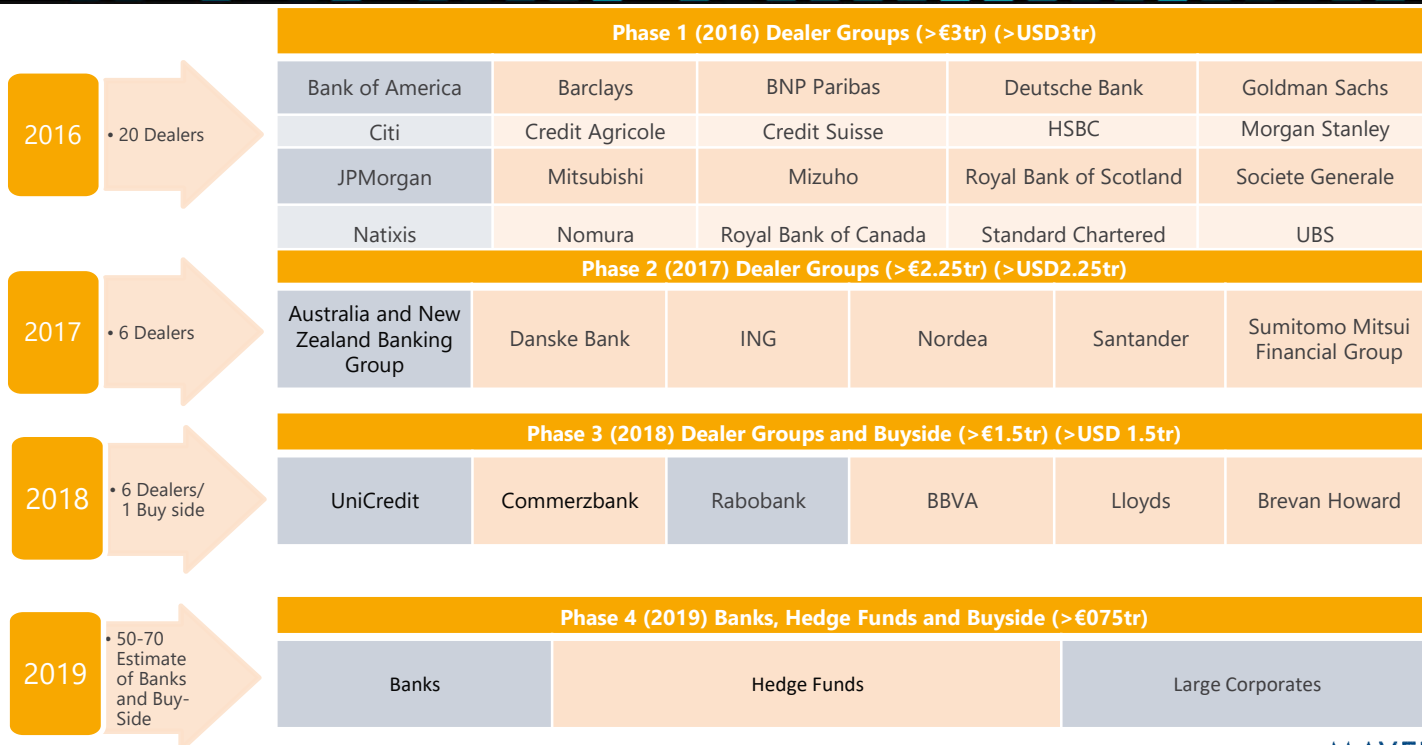
- Important **aspects** when using/drafting bridge clauses:
  - Acceptance by counterparties that do not have access to or are not familiar with ISDA definitions
  - Transparency issues/language
  - Copyright issues
  - Any chain of reference that ends outside of the definitions incorporated by the language used leaves gaps
  - No market standard for 2021 definitions so far



Edmund Parker

# Session 5: The Final Steps for Initial Margin Implementation

# IM Seg Requirements – Entities covered by Phases 1 to 4





# 2. Phase 5 became Phase 5 & 6



## 2.2.2 Extension of the last phase of the implementation of the initial margin requirements

10. Still, in relation to the implementation challenges raised by several trade associations mentioned in the previous point, the BCBS and IOSCO have analysed in more detail the issues around the last phase-in of the requirements and have indicated in July 2019 to having agreed to an extension of this phase-in:

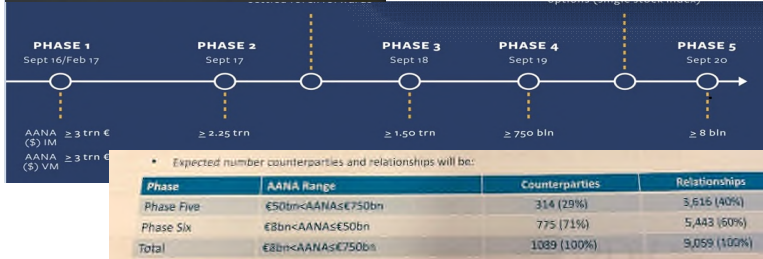
Following from this, the ESAs have reviewed the Commission Delegated Regulation on bilateral margining and have identified the amendments necessary to the EU framework in order to extend the implementation deadline by one year for those counterparties above the 8 billion threshold but below the new 50 billion threshold.

It can also be noted that no further extension of the phase-in and no change of the thresholds, in particular the 8 billion threshold, are envisaged. As a result, it is important that the counterparties complying with the requirements would have one year to be able to comply.

(e) 'from 1 September 2020, where both counterparties have, or belong to groups each of which has, an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 50 billion;';

In Article 36(1), the following point is added:

(f) 'from 1 September 2021, where both counterparties have, or belong to groups each of which has, an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 8 billion.'.



# Initial Margin Phase-in – Phases 6

Phase 5	
Regime	AANA
US	\$50 billion
EU	€50 billion

ISDA International Swaps and Derivatives Association | **ISMA** International Securities Markets Association | **AIMA** Asset Management Group

May 17, 2019

**Mr Steven MALLOOR**  
 Chairman, European Securities and Markets Authority  
 CS 60741  
 100 rue de Grenelle  
 75345 Paris Cedex 07, France

**Mr José-Manuel CAMPA**  
 Chairman, European Banking Authority  
 DEFENSE 4 – ELISAPLAZA  
 20 Avenue André Prothas  
 CS 30354  
 92927 Paris La Défense CEDEX

**Mr Gabriel BERNARDINO**  
 Chairman, European Insurance and Occupational Pensions Authority  
 Werdhoftplatz 1  
 60327 Frankfurt am Main  
 Germany

**Re: Margin Requirements for Non-Centrally Cleared Derivatives – Initial Margin Models**

Dear Sirs,  
 The International Swaps and Derivatives Association, Inc. (ISDA), the Securities Industry and Financial Markets Association (SIFMA), the Securities Industry and Financial Markets Association (SIFMA), the Securities Industry and Financial Markets Association (SIFMA)

**American Bankers Association**  
 Building Success Together

**ii**  
 Institute of International Bankers

Phase 6	
Regime	AANA
US	\$8 billion
EU	€8 billion

Expected number counterparties and relationships will be

Phase	AANA Range	Counterparties	Relationships
Phase Five	€50bn < AANA ≤ €750bn	314 (29%)	3,616 (40%)

Phase six will bring an estimated 775 entities into scope of the IM requirements, more than double the number caught by phase five in 2021. That was enough to cause some bottlenecks and delays, with lengthy custodian onboarding processes, the sheer volume of credit support documentation and custodial agreement negotiation and extensive know-your-customer requirements putting pressure on compliance timetables.

been provided in conjunction with this letter.<sup>6</sup> The data covers 16,340 separate legal counterparties, with 34,680 individual relationships.<sup>7</sup> Based on the current regulatory requirements, we estimate the following impacts for Phase 5 of UMR:

- Over 1,100 newly in-scope counterparties (NISCs), which have over 9,500 new relationships with other counterparties subject to UMR.<sup>8</sup>
- Each of the 9,500 new relationships requires new or amended documentation that must be tested and uploaded into systems.
- Up to 19,000 segregated IM custody accounts must be set up and tested (two per relationship, for the posting and collection of IM).
- Depending on the IM calculation method, between 26-45% of the smallest counterparties, and 69-78% of counterparty relationships, are unlikely to exchange any IM at all, as they fall below a USD 50 million IM exchange threshold (IM exchange threshold).<sup>9</sup> As such, these counterparties will be required to engage in IM preparations despite the fact they will not exchange IM.

Thus, the analysis shows that IM implementation as currently planned will bring into scope counterparties that pose no systemic risk and will actually exchange little or no IM, while still



# Threshold Monitoring: Avoiding Putting in Place Custody Arrangements



- Many P6 Counterparties will only hit the EUR 50m Posting Threshold for a limited number of pairings.
- Consider putting in place Threshold Monitoring Arrangements with 30-40m threshold.
- Consider broadening hedging counterparties.
- Consider moving trades to Clearing.

# Let's talk about AANA!



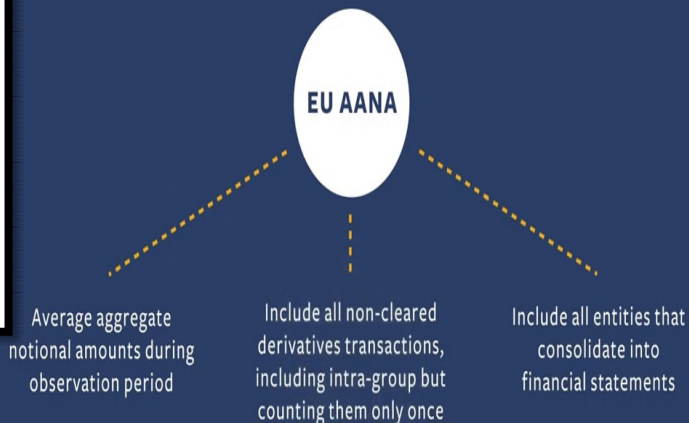
Article 28

## 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.

## 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)



**Observation Period:** March, April, May

# Where and How Regulatory IM Must Be Held



## IM Amount – Highlights

- Determined by approved model (ISDA SIMM™) or regulatory prescribed table (a/k/a “grid” or “schedule”)
- Two-way IM, cannot be netted
- Must be segregated and held by a third-party custodian
- Permitted Threshold – e.g. USD 50M (US Margin Regulations) / EUR 50M (EU Margin Regulations) shared across consolidated group

# IM Documentation Architecture – Illustration



J.P.Morgan

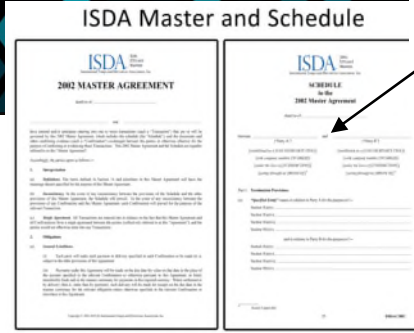
Legal & General  
INVESTMENT MANAGEMENT

CUSTOMY AGREEMENT  
BETWEEN  
\_\_\_\_ (as Customer)  
and  
\_\_\_\_ (as Collateral Agent)

MAYER | BROWN

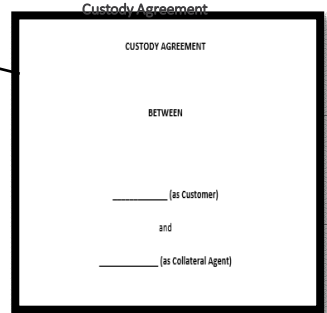
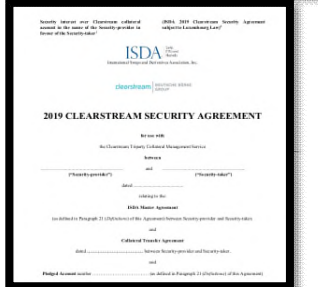
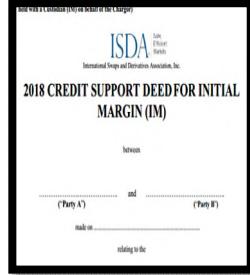
# IM Documentation Battle of the Forms#1: Clearstream v. BNY Mellon

## J.P.Morgan



**Legal & General**  
INVESTMENT MANAGEMENT

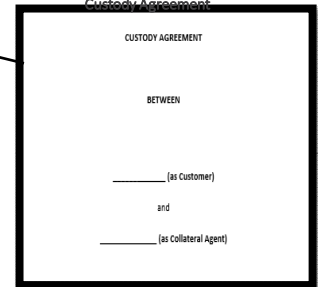
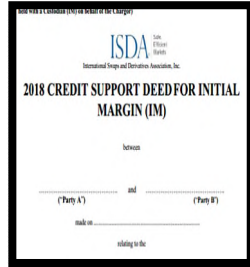
ACA BNY MELLON



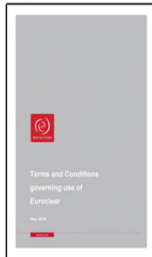
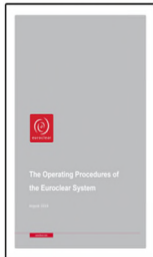
# IM Documentation Battle of the Forms #2: Euroclear v. BNY Mellon



## ISDA Master and Schedule



Euroclear Terms and Conditions, Service Agreement, Operating Procedure





# Umbrella Collateral Exchange Agreements

**Umbrella Agreements:** Rare in Phase 1-4, becoming important in Phase 5 and 6.



## "One-to-many"

Same CSD/CTA terms applied across multiple sub-funds/principals without amendment.



## "One-to-one"

Standard elections of CSD/CTA terms are individually tailored to each sub-fund/principal (by way of a series of separate schedules or similar). Arises where investment manager is instructed under third party mandates – e.g. pension funds / wealth funds – and terms are tailored case-by-case.



## Bespoke

Core operative CSD/CTA provisions subject to material negotiation and amendment for each sub-fund/principal (or groups of sub-fund/principals) deviations being documented in a series of bespoke annexes (or entirely separate

# The Threshold Issue: dividing across the Group

Margin requirements  
for non-centrally  
cleared derivatives

Phase	AANA Range	Relationships	IM ≤ EUR50M	IM > EUR50M
Phase Five	€50bn<AANAs€750bn	3,616	2,125 to 2,595 (59 to 72%)	1,021 to 1,491 (28 to 41%)
Phase Six	€8bn<AANAs€50bn	5,443	4,205 to 4,620 (78 to 85%)	823 to 1,238 (15 to 22%)

## 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 the first subparagraph, OTC derivative contracts which are internal transactions shall only be taken into account once.

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

Basel Committee  
on Banking Supervision

Board of the  
International  
Organization of  
Securities Commissions

Margin requirements  
for non-centrally  
cleared derivatives

2(i) 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(ii) 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(iii) 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.

Basel Committee on Banking Supervision  
Board of International Supervisors

**Press release**

Basel Committee on Banking Supervision  
Press enquiries: +41 61 260 8188  
bcb@bis.org  
www.bis.org

Ref no: IOSCO 04/07/2019  
5 March 2019

### BCBS/IOSCO statement on the final implementation phases of the Margin requirements for non-centrally cleared derivatives

Significant progress has been made to implement the framework for margin requirements for non-centrally cleared derivatives. Based on monitoring of the implementation of the framework across jurisdictions, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) have agreed to finalise the implementation of the framework and clarify its requirements.

- The Basel Committee and IOSCO expect that market participants may need to amend derivatives contracts in response to interest rate benchmark reforms. Amendments to legacy derivatives contracts entered into for the purpose of margin requirements for the purposes of the BCBS/IOSCO framework, although the position may be different under relevant insolvency 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. The Basel Committee and IOSCO note that the framework does not specify requirements, outside of operational requirements if the initial margin is not fully expected, however, that covered entities will all diligently assess their exposures against the threshold to ensure that relevant arrangements remain 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.

# Threshold Monitoring: Illustrating BCBS IOSCO Guidance #1

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 ( $150 = 100 - 50 + 100 - 50 + 100 - 50$ ).

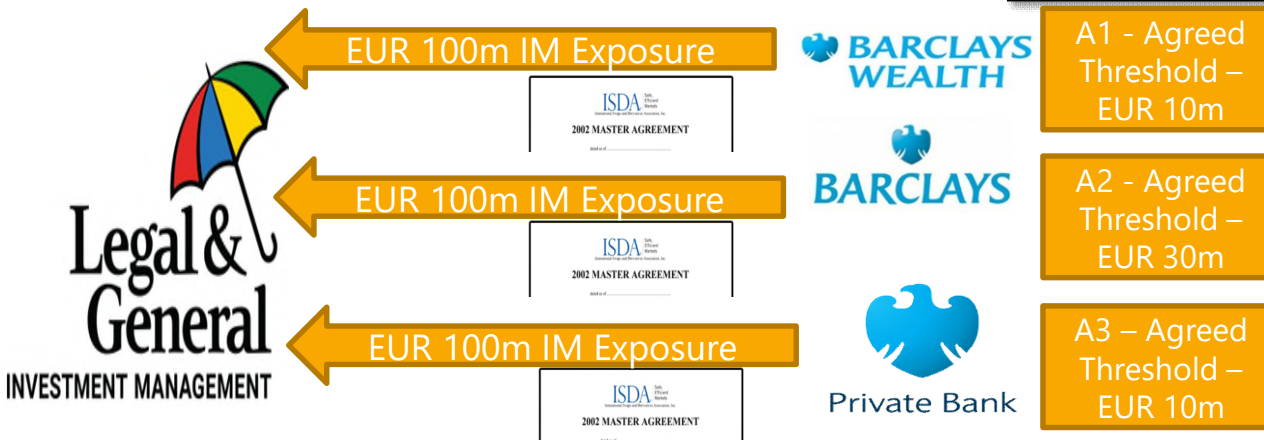
Basel Committee  
on Banking Supervision

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International  
Organization of  
Securities Commissions



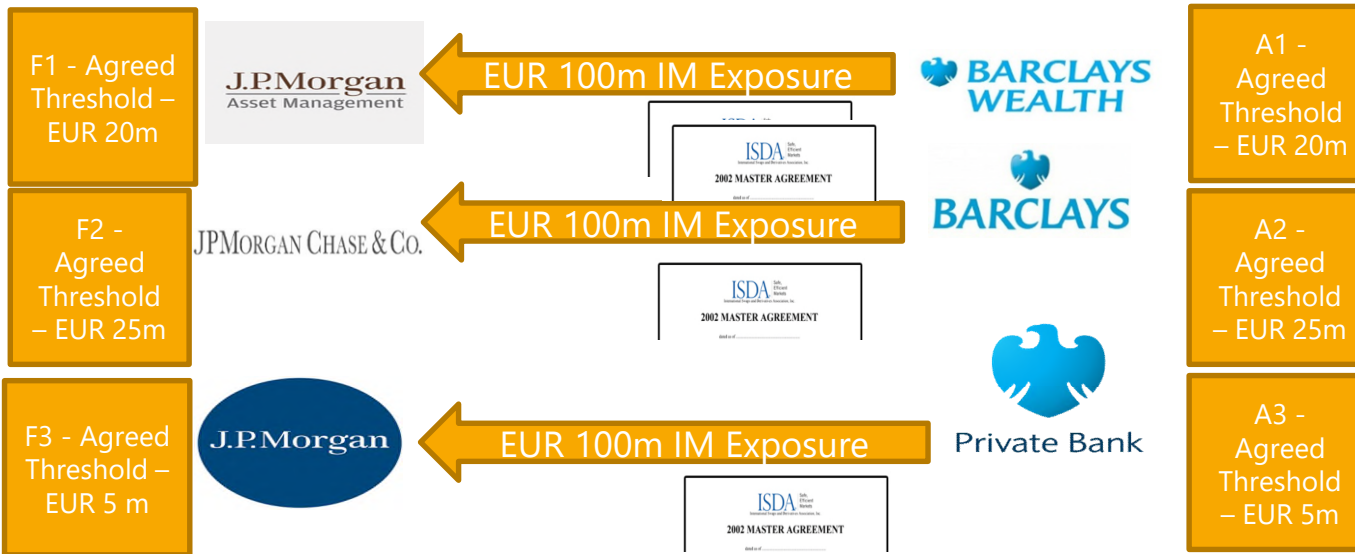
Margin requirements  
for non-centrally  
cleared derivatives

March 2015



# Threshold Monitoring: Illustrating BCBS IOSCO Guidance #2

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.



# IM Threshold Division & Monitoring: Strategic Considerations



Basel Committee on Banking Supervision  
BANK FOR INTERNATIONAL SETTLEMENTS



## Press release

Press enquiries: +41 61 280 8188  
press@bis.org  
www.bis.org

Ref no. IOSCO MR/07/2019

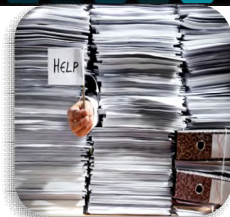
5 March 2019

### BCBS/IOSCO statement on the final implementation phases of the Margin requirements for non-centrally cleared derivatives

Significant progress has been made to implement the framework for margin requirements for non-centrally-cleared derivatives. Based on monitoring of the implementation of the framework across products, jurisdictions and market participants, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) today provide the following guidance to support timely and smooth implementation of the framework and clarify its requirements.

- The Basel Committee and IOSCO realise that market participants may need to amend derivatives contracts in response to interest rate benchmark reforms. 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.
- 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.



- **Can you reduce documentation?** Strategic Splitting of Threshold can reduce IM Document Suites to put in place e.g. allocating a higher portion of the Threshold to an IM Pairing which will never reach that trading level, can mean that an IM Document Suite never needs to be put in place between those entities, saving documentation and ongoing administrative costs.

- **Be aware of Intra-group Tensions for you or your Counterparty**  
Allocating the threshold on an uneven basis across a group can cause costs to fall unevenly within the group, it is not uncommon for this to cause internal tensions and differing viewpoints. Threshold allocation should be considered at an early stage.

- **Threshold Monitoring**
  - Review the Threshold for each Applicable Regime.
  - Establish policies and procedures to monitor IM levels with Counterparty Group. Agree levels which you will start to put IM Documentation in place.
  - Avoid dangers of being locked out of trading.

# The Documentation Challenge

**Episode 1: Overview of Phase 4 and 5 of the Uncleared Margin Rules**  
2,550 views

Mayer Brown  
971 subscribers

Published on 17 Jan 2019

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.



**S2/Episode 1: The Phase 5 Sell-side Counterparty's Perspective**  
19:02 Mayer Brown

**S2/Episode 2: The Enforcers are Coming**  
6:26 Mayer Brown

**S2/Episode 3: Alternatives to English Law in IM**  
12:54 Mayer Brown

**S2/Episode 4: The IM Documentation Challenge**  
24:20 Mayer Brown

**S1/Episode 1: Overview of Phase 4 and 5 of the Uncleared Margin Rules**  
28:34 Mayer Brown

**S1/Episode 2: Navigating the Legal Documentation Process**  
13:48 Mayer Brown

**S1/Episode 3: The Custodian's Guide to Initial Margin Segregation and Asset Transformation**  
26:00 Mayer Brown

**S1/Episode 4: Calculating Initial Margin**  
28:32 Mayer Brown

**S1/Episode 5: Mission Impossible – the Compliance Process**  
31:03 Mayer Brown

**Prequel: The New Margin Requirements and Risk Mitigation Techniques for Uncleared Swaps under EMIR**  
24:14 Mayer Brown

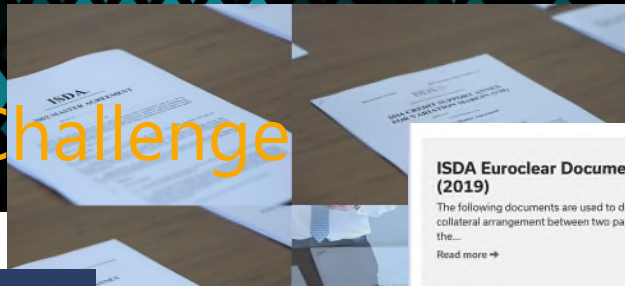
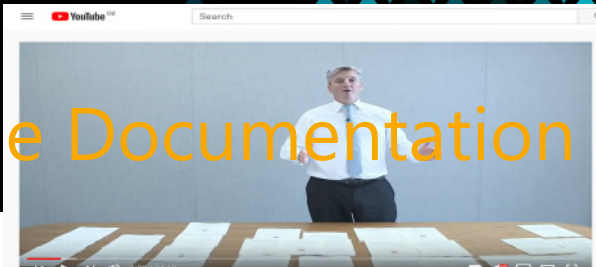
Initial Margin for Uncleared Derivatives in 2019 and 2020  
10 videos • 1,174 views • Last updated on 6 Sep 2019

Initial Margin for Uncleared Derivatives in 2019 and 2020  
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 Requirements.

Initial Margin for Uncleared Derivatives in 2019 and 2020

A Mayer Brown series, presented by Edmund Parker and guests. [Click here for Series 1](#)

# The Documentation Challenge



## 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)
- Backline 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 (IMI) (zip)
- ISDA 2019 English Law Security Agreement for Initial Margin (IMI) (zip)
- ISDA 2019 New York Law Security Agreement for Initial Margin (IMI) (zip)

## 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)
- Backline 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 >](#)

## 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

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



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

between  
(Party A) and (Party B)  
relating to the  
ISDA Master Agreement

This Deed is a Credit Support Deed with respect to both parties in relation to the ISDA Master Agreement entered into between the parties and supplemented from time to time, the "Agreement" with respect to Paragraph 1 hereof, Section 5(b)(ii) of the Agreement will apply in respect of this Deed.

Accordingly, the parties agree as follows:

#### Paragraph 1 Interpretation

(a) Definitions and Interpretation. Unless otherwise defined in this Deed, capitalized terms defined in the Agreement have the same meaning in this Deed. Capitalized terms not otherwise defined in this Deed or in the Agreement have the meaning specified in Paragraph 1. All references to this Deed or Paragraphs 1 to 10 of this Deed, the Deed or any instrument entered into pursuant to this Deed or the provisions of the Agreement are to this Deed. The Deed and any instrument entered into pursuant to this Deed or the provisions of the Agreement shall be deemed to have been entered into on the date of the latest of the dates specified in Paragraph 1(b) and the date of the instrument entered into pursuant to this Deed.

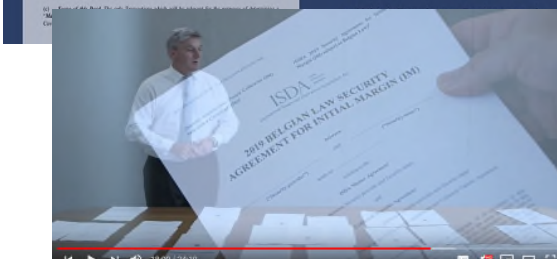
(b) Covered Parties and Covered Transactions. Paragraph 1(a) defines the Deed to be the "Covered Parties" and the "Covered Transactions" which are subject to this Deed. Paragraph 1(a) defines the "Covered Parties" to be the other party when acting in that capacity and all corresponding references to the "Counterparty" in the other party when acting in that capacity, provided, however, that a reference to the "Covered Parties" shall not include the "Covered Parties" at any time, shall be construed as a reference to the "Covered Parties" as defined in the Paragraph 1(a) and the instrument entered into pursuant to this Deed. The "Covered Parties" shall be deemed to have been entered into on the date of the latest of the dates specified in Paragraph 1(b) and the date of the instrument entered into pursuant to this Deed. A reference to a transfer of Eligible Credit Support (IM) or Partial Credit Support (IM) or to a Bank Custodian (IM) in this Deed shall be construed as a reference to those the relevant Segregated Accounts, as applicable.

(c) This Deed shall be governed by the law of the jurisdiction specified in Paragraph 1(d) and shall be construed in accordance with the law of that jurisdiction.

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

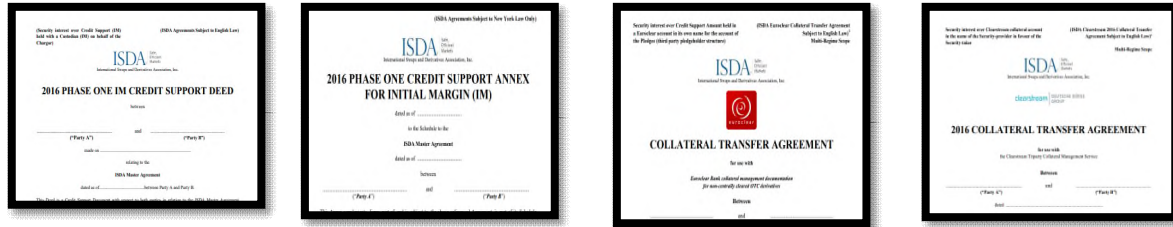
## 2018 Credit Support Annex For Initial Margin (IM) (Security Interest – New York Law)

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 backline against the 2016 Phase One IM Credit Support Annex is also included.



# Initial Margin Documentation: Rolling back the years

- VM required negotiating one document with a counterparty. IM requires multiple documents and potentially two different sets of documentation to negotiate if your counterparty uses a different custodian or a custodian in a different jurisdiction.
- The documentation used for Phase One of IM implementation was drafted in 2016 and used by Phase One to Three Dealers.

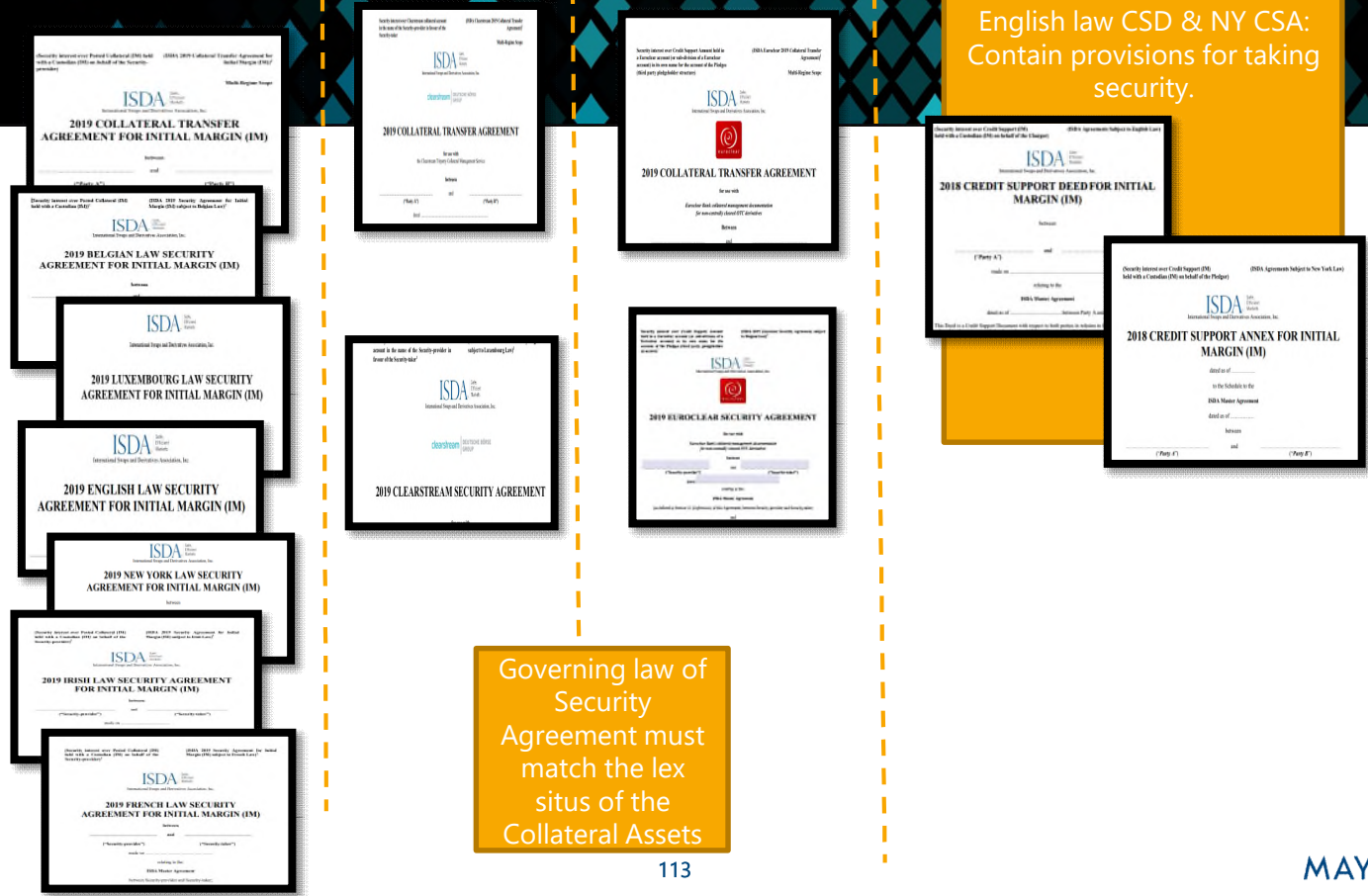


- Other changes to the documentation introduced in 2018/2019 include adding optionality to the access conditions, building in elections for the Calculation Agent, removing some options that had not been used and making some elections presumption neutral. ISDA also developed the bank custodian collateral transfer agreement and a series of security agreements to provide standard documentation to use where a bank custodian is located outside of NY and London.





# Security Agreements



# Japanese Collateral: Additional Amendment Documentation

**ISDA** Safe, Efficient Markets

[Note: Insert the following provision in Paragraph 13(t) of the ISDA 2018 Credit Support Annex for Initial Margin (IM) (Security Interest – New York Law) to be entered into between parties and also attach the below Japanese Security Collateral Provider Provisions (IM) to the back of the ISDA 2018 Credit Support Annex for Initial Margin (IM) (Security Interest – New York Law).]

“(iv) The provisions (the “**Japanese Security Collateral Provider Provisions (IM)**”) in the Japanese Security Collateral Provider Provisions for the ISDA 2018 Credit Support Annex for Initial Margin (IM) (Security Interest – New York Law) attached hereto shall apply.”

**Japanese Security Collateral Provider Provisions for the ISDA 2018 Credit Support Annex for Initial Margin (IM) (Security Interest – New York Law)**<sup>1</sup>

**ISDA** Safe, Efficient Markets

International Swaps and Derivatives Association, Inc.



**Recommended Amendment Provisions for the ISDA Euroclear Collateral Transfer Agreement (Subject to New York Law) and the ISDA Euroclear Collateral Transfer Agreement (Subject to English Law) with respect to Japanese Collateral (“Shichiken”)**<sup>2</sup>

**ISDA** Safe, Efficient Markets

International Swaps and Derivatives Association, Inc.



**Recommended Amendment Provisions for the ISDA Euroclear Collateral Transfer Agreement (Subject to New York Law) and the ISDA Euroclear Collateral Transfer Agreement (Subject to English Law) with respect to Japanese Collateral (“Shichiken”)**<sup>2</sup>

the following provisions in Paragraph 13.18 (Other Provisions):



**ISDA** Safe, Efficient Markets


[Note: Insert the following provision in Paragraph 13(u) of the ISDA 2018 Credit Support Deed for Initial Margin (IM) (Security Interest – English Law) to be entered into between parties and also attach the below Japanese Security Collateral Provider Provisions (IM) to the back of the ISDA 2018 Credit Support Deed for Initial Margin (IM) (Security Interest – English Law).]

“(iv) The provisions (the “**Japanese Security Collateral Provider Provisions (IM)**”) in the Japanese Security Collateral Provider Provisions for the ISDA 2018 Credit Support Deed for Initial Margin (IM) (Security Interest – English Law) attached hereto shall apply.”

**Japanese Security Collateral Provider Provisions for the ISDA 2018 Credit Support Deed for Initial Margin (IM) (Security Interest – English Law)**<sup>1</sup>

**ISDA** Safe, Efficient Markets

International Swaps and Derivatives Association, Inc.



**Recommended Amendment Provisions for the ISDA Clearstream Collateral Transfer Agreement (Subject to New York Law) and the ISDA Clearstream Collateral Transfer Agreement (Subject to English Law) with respect to Japanese Collateral (“Shichiken”)**<sup>2</sup>

Insert the following provisions in Paragraph 13.18 (Other Provisions):


“(a) **Japanese Collateral Provisions (Shichiken)**

(i) The header shall be amended as follows: “Security interest over Clearstream collateral in favour of the Security-taker held in collateral account in the name of the Security-taker”.

(ii) Paragraph 3.2 (Transfers) of this Agreement shall be amended by adding the following provision at the end thereof:

**ISDA** Safe, Efficient Markets

International Swaps and Derivatives Association, Inc.



**Recommended Amendment Provisions for the ISDA 2017 Clearstream Security Agreement with respect to Japanese Collateral (“Shichiken”)**<sup>2</sup>

Insert the following provisions in Paragraph 22.3 (Other provisions):

“(a) **Japanese Collateral Provisions (Shichiken)**

(i) The header shall be amended by adding “and Japanese Law in relation to the Japanese law pledge (*shichiken*)” after “subject to Luxembourg law”.

(ii) The first section of the recitals shall be deleted and replaced with:

# Choice of Custodian & Initial Margin Model

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

458 views

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**Mayer Brown**  
971 subscribers

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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

**ISDA SIMM vs Schedule IM**

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

	Phase 4 Initial Margin	Phase 5 Initial Margin
Composition	\$1 \$100M BY IRS Pay Fixed (03/Sept/2023)	\$100M BY IRS Pay Fixed (03/Sept/2023) 25 \$100M BY IRS Risk Fixed (03/Sept/2023)
Delta	\$1,154	303
SIMM	\$2,192,528	\$284,444
Schedule IM	\$2,000,000	\$1,154,000
Schedule / SIMM ratio	100%	406%

**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?

MAYER BROWN

**Hiroshi Tanase**  
Executive Director  
IHS Markit

**Episode 4: Calculating Initial Margin**

512 views

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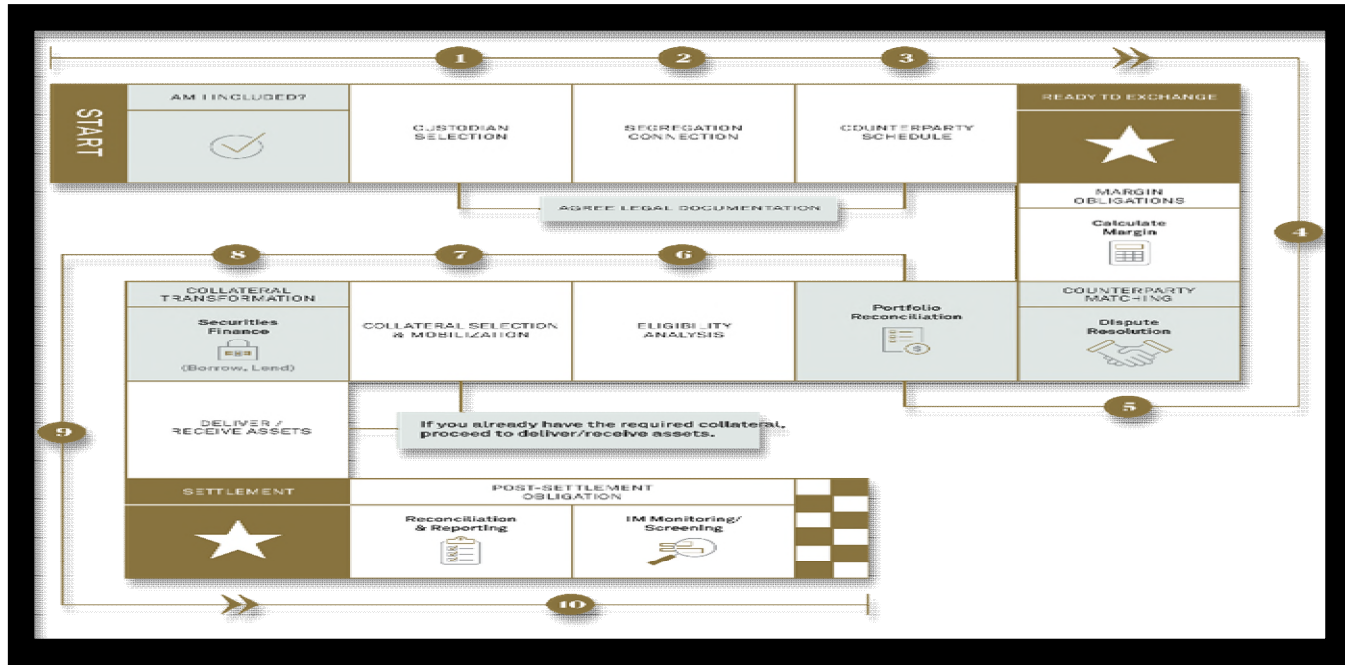
Published on 10 Apr 2019

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

# Choice of Custodian & Initial Margin Model



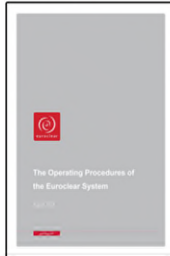
# Euroclear Custody Documentation Package

## (a) Documents in the Euroclear Custodian Documentation Package

The Euroclear Custodian Documentation Package consists of the following inter-linking documents:

- Collateral Service Agreement Terms and Conditions of September 2019;
- Collateral Service Agreement Operating Procedures of November 2020;
- Single Pledgor Pledged Account Terms and Conditions (2011 version);
- Amendment Agreement to CSA Terms and Conditions and SSPA Terms and Conditions (the "Amendment Agreement"); and
- MultiSeg and CSA Form of Agreement.

## Euroclear Terms and Conditions, Service Agreement, Operating Procedure



st-trade mult-clear  
May 2019

## Amendment Agreement to Collateral Service Agreement and Single Pledgor Pledged Account Terms and Conditions

Euroclear Bank for OTCD

This amendment agreement ("Amendment Agreement") amends

- the Single Pledgor Pledged Account Terms and Conditions (2011 version) (SPPA Terms and Conditions) and
- the Collateral Service Agreement Terms and Conditions (CSA Terms and Conditions).

Terms with initial capital letters, which are not specifically defined herein, shall have the meaning given to them in the Terms and Conditions governing use of Euroclear, the Operating procedures of the Euroclear System, the SPPA Terms and Conditions and the CSA Terms and Conditions.



RG 812 - Form of Agreement

## MultiSeg and CSA Form of Agreement

### Purpose

Use this form to enter into one or more Single Pledgor Pledged Account Terms and Conditions, Collateral Service Agreement Terms and Conditions and Operating Procedures, and Amendment Agreement.

### Parties to this Agreement

1. The Participant, the details of which are specified in section "Our Information" below, in its capacity as Pledgor, Pledgor's Representative, Pledgor or Pledgor's Representative pursuant to the Single Pledgor Pledged Account Terms and Conditions and as Collateral Taker or Collateral Clear pursuant to the Collateral Service Agreement Terms and Conditions and Operating Procedures, each time the identity of the Participant and its capacity being specified in the Activation Message sent to the Bank pursuant to Clause 20(i)(c) of the Amendment Agreement, is also referred to as "the Participant"

<sup>1</sup>Bank SA/NV with its registered office at Konink Albert II-laan 1, B-1210 Sint-Joost-ten-Node, registered under number

# Advantages and Key Tensions between Custodians and Euroclear in Pledge Representative Model



**Principal / Contractual Arrangements with Client:** Custodian is agent of its Pledgee Client, documents though characterise Custodian as principal to Euroclear, with no contract between Euroclear and Pledgee

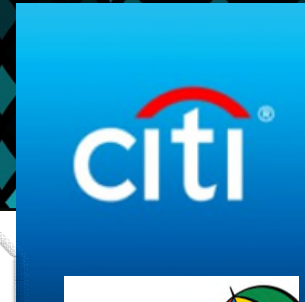
**Representations & Indemnities:** Custodian must give and be liable for representations on behalf of Client and give broad indemnities.

**Negotiability:** provisions are only open to limited negotiations.

## Advantages

- Counterparty uses Custodian as Representative
- Leverages Custodian's existing triparty arrangement
- Pledge and Account Control Agreement is on Euroclear Books

# Euroclear/Citi Structure



(<sup>1</sup>)  
AS CHARGOR  
(<sup>2</sup>)  
AS SECURED PARTY  
AND  
CITIBANK, N.A.  
AS CUSTODIAN

---

ACCOUNT CONTROL AGREEMENT  
(INITIAL MARGIN SEGREGATION)

RG 812 - Form of Agreement

MultiSeg and CSA Form of Agreement

Purpose  
Use this form to enter into one or more Single Pledgor Pledged Account Terms and Conditions, Collateral Service Agreement Terms and Conditions and Operating Procedures, and Amendment Agreement.

Parties to this Agreement

Participant, the details of which are specified in section 'Our Information' below, in its capacity as Pledgor, Pledgor's Representative, or Pledgor's Representative pursuant to the Single Pledgor Pledged Account Terms and Conditions and as Collateral Taker or Collateral Giver pursuant to the Collateral Service Agreement Terms and Conditions and Operating Procedures, each time the identity of Participant and its capacity being specified in the Activation Message sent to the Bank pursuant to Clause 20(i)(c) of the Amendment Agreement, also referred to as the Participant

Bank SANIV with its registered office at Konink Albert II-laan 1 B-1210 Sint-Joost-ten-Node, registered under number



**COLLATERAL MANAGEMENT  
TRIPARTY SERVICES AGREEMENT  
(INITIAL MARGIN SEGREGATION)**

Amendment Agreement to Collateral Service Agreement and Single Pledgor Pledged Account Terms and Conditions

Euroclear Bank for OTCD

13048 mod-1019  
**May 2019**

This amendment agreement (Amendment Agreement) amends

- the Single Pledgor Pledged Account Terms and Conditions (2011 version) (SPPA Terms and Conditions) and
- the Collateral Service Agreement Terms and Conditions (CSA Terms and Conditions).

Terms with initial capital letters, which are not specifically defined herein, shall have the meaning given to them in the Terms and Conditions governing use of Euroclear, the Operating Procedures of the Euroclear System, the SPPA Terms and Conditions and the CSA Terms and Conditions.

Euroclear Terms and Conditions, Service Agreement, Operating Procedure

The Operating Procedures of the Euroclear System

April 2018

ESES Triparty Interoperability Collateral Service Agreement

Terms and Conditions 1 April 2018

Terms and Conditions governing use of Euroclear

April 2018

# Clearstream Custody Documentation Package



## 3. Clearstream Documentation Package

- **Collateral Management Service Agreement (CMSA) for Collateral Givers** ("CMSA (Collateral Giver)") and **Collateral Management Service Agreement (CMSA) for Collateral Receivers** ("CMSA (Collateral Receiver)"). Please note that only one of each of these agreements is entered into to cover all relevant IM Pairings.
- **Counterparty Acceptance List and Collateral Eligibility Criteria:** Appendix A of the CMSA (Collateral Receiver) and CMSA (Collateral Giver) Collateral Givers and Collateral Receivers sets out for both parties the Counterparty acceptance list and "Collateral Eligibility Criteria". The Collateral Giver will also enter into an AutoAssign Supplement with Clearstream authorising the automatic selection of securities from the Collateral Giver's account.
- **Signed Indemnity Letter for CBL's Global Securities Financing Services:** This document enables Collateral Receivers and Collateral Givers to receive reports via email. However, the indemnity letter which broadly absolves Clearstream of liability for failings and provides for indemnities related to failures and deviations in communications processes. In the ordinary course we would have recommended negotiating these provisions.
- **Completed Triparty Collateral Management Customer Operational Profile:** This document, which must be completed by any Collateral Receiver and Collateral Giver provides information to set up customer operational preferences and facilitate the account opening process.



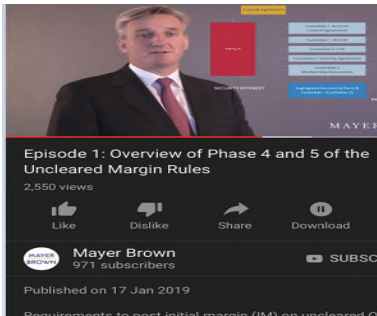
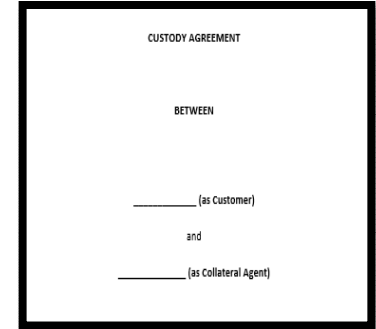
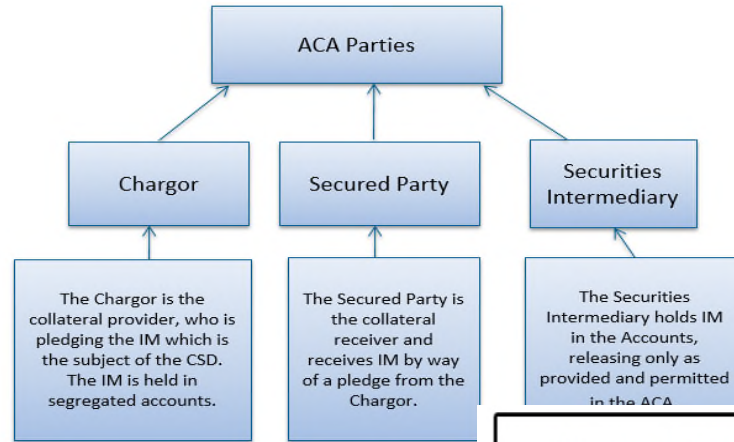


# Custody Documentation Package

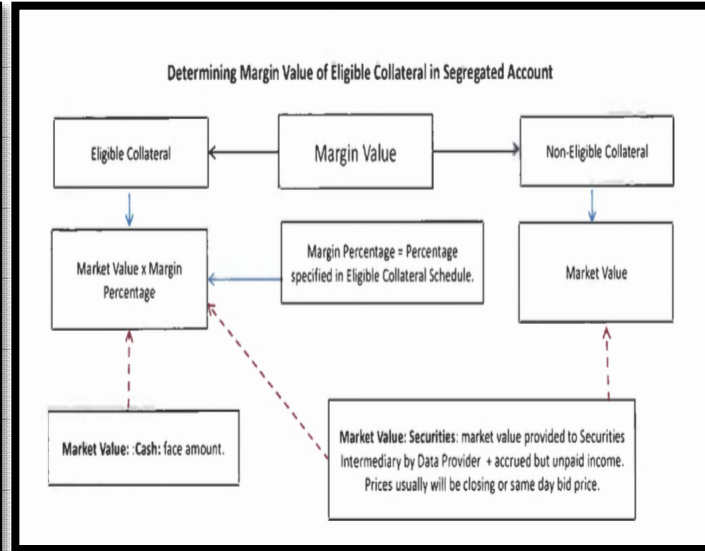
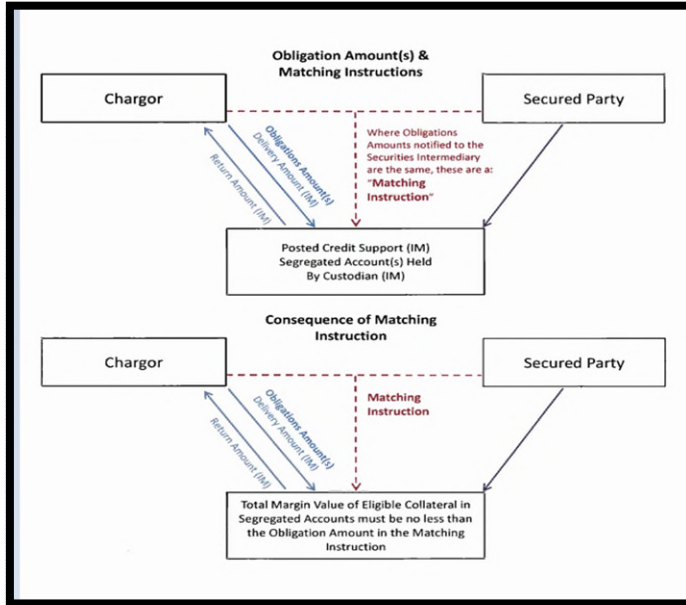


## Essential Components of ACA Documentation

- 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



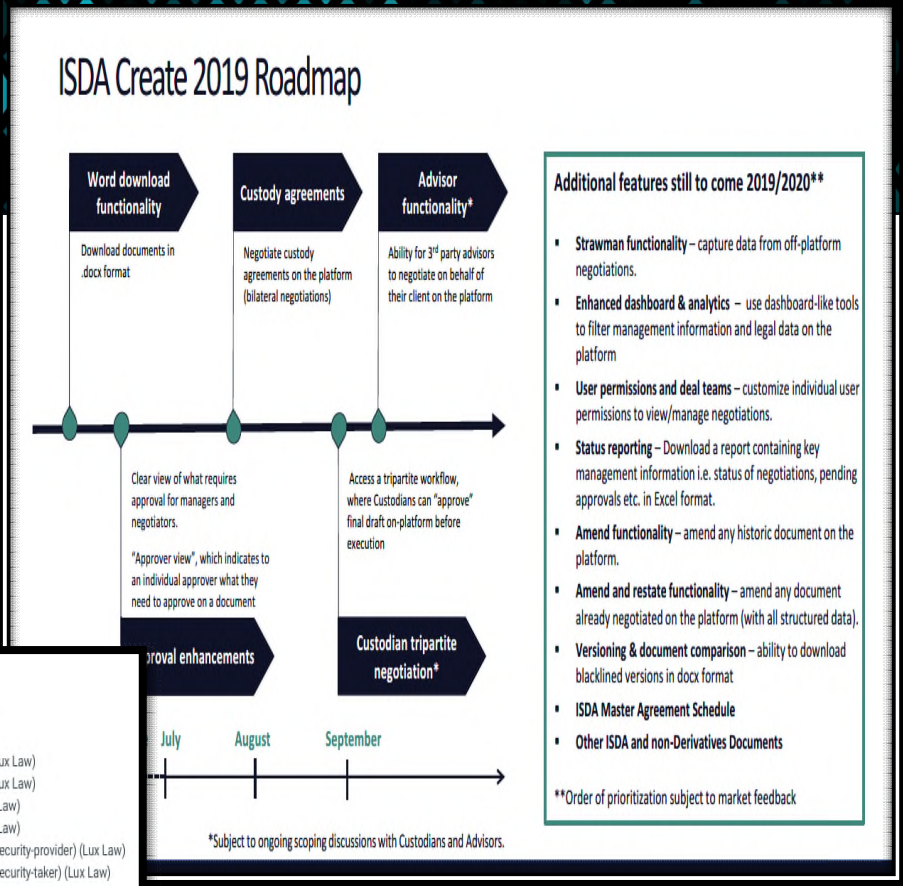
# Technology Solutions



ISDA Create is an online solution that will allow firms to produce, deliver, negotiate and execute documents and capture, process and store data from such documents.

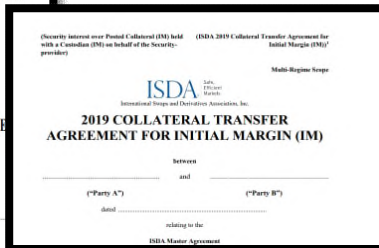
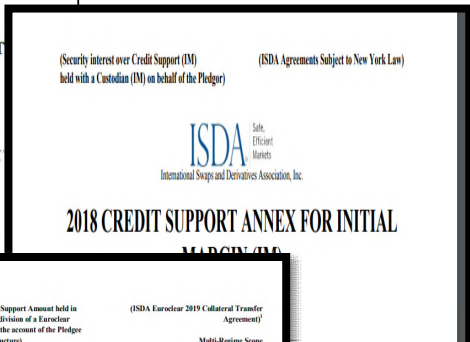
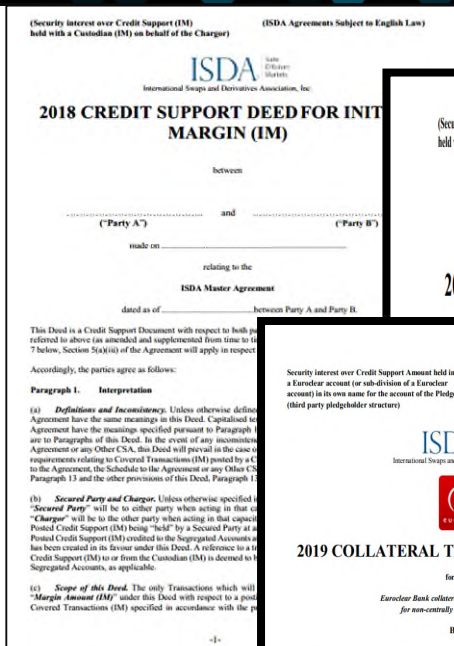
Documents available on ISDA Create as of April 1, 2019

Collateral Transfer Agreements	Credit Support Annexes/Deeds	Security Agreements
2016 Clearstream CTA (Eng Law)	2016 IM CSA (NY Law)	2017 Clearstream SA (Lux Law)
2016 Clearstream CTA (NY Law)	2018 IM CSA (NY Law)	2016 Clearstream SA (Lux Law)
2018 Euroclear CTA (Eng Law)	2016 IM CSA (Jpn Law)	2018 Euroclear SA (Bel Law)
2018 Euroclear CTA (NY Law)	2016 IM CSD (Eng Law)	2016 Euroclear SA (Bel Law)
2017 Euroclear CTA (Eng Law)	2018 IM CSD (Eng Law)	2019 Clearstream SA (Security-provider) (Lux Law)
2017 Euroclear CTA (NY Law)		2019 Clearstream SA (Security-taker) (Lux Law)
2019 Clearstream CTA		2019 Euroclear SA (Bel Law)
2019 Euroclear CTA		2019 ISDA Bank Custodian SA (Eng Law)
2019 ISDA Bank Custodian CTA		2019 ISDA Bank Custodian SA (NY Law)



- Additional features still to come 2019/2020\*\***
- **Strawman functionality** – capture data from off-platform negotiations.
  - **Enhanced dashboard & analytics** – use dashboard-like tools to filter management information and legal data on the platform
  - **User permissions and deal teams** – customize individual user permissions to view/manage negotiations.
  - **Status reporting** – Download a report containing key management information i.e. status of negotiations, pending approvals etc. in Excel format.
  - **Amend functionality** – amend any historic document on the platform.
  - **Amend and restate functionality** – amend any document already negotiated on the platform (with all structured data).
  - **Versioning & document comparison** – ability to download blacklined versions in docx format
  - **ISDA Master Agreement Schedule**
  - **Other ISDA and non-Derivatives Documents**
- \*\*Order of prioritization subject to market feedback

# Credit Support Deed for IM (English Law)/Collateral Transfer Agreement (English Law) Credit Support Annex for IM (NY Law)



- Stand-alone document: amended via a Schedule
- Creates a security interest over collateral (CSD/CSA only)
- Allows parties to establish initial margin arrangements that meet the requirement of margin regulations for uncleared swaps
- 2018/2019 documents adapted from the 2016 form for use by buy- and sell-side firms in view of firms coming into scope in Phases 5 and Phase 6

ISDA  
International Swaps and Derivatives Association, Inc.  
**2018 CREDIT SUPPORT DEED FOR INITIAL MARGIN (IM)**

between

**Paragraph 3. Credit Support Obligations**

(a) **Delivery Amount (IM).** Subject to Paragraphs 4 and 5, upon promptly following a Calculation Date (IM), if the Delivery Amount (IM) equals or exceeds the Chargor's Minimum Transfer to the Custodian (IM) Eligible Credit Support (IM) having equal to the applicable Delivery Amount (IM) (rounded pursuant to Paragraph 13, the "Delivery Amount (IM)" applicable to the equal the amount by which:

(i) the Credit Support Amount (IM) applicable to the Chargor exceeds

(ii) the Value as of that Calculation Date (IM) of all Posted Credit Support (IM) held by the Secured Party (as adjusted to include any prior Delivery Amount (IM) and to exclude any prior Return Amount (IM), the transfer of which, in either case, has not yet been completed and for which the relevant Settlement Day falls on or prior to such Calculation Date (IM)).

(b) **Return Amount** promptly following a C

**Paragraph 7. Default**

For the purposes of Section 5(a)(iii)(1) of the Act, if:

(i) as Chargor, it fails to make any payment to be made by it, or its failure is given to

(ii) as Secured Party, it fails to make any payment of Posted Credit Support for two Local Business Days

(iii) that party fails to comply with Paragraphs 7(i) or 7(ii) to that party,

provided that, if Custodian constitutes or gives rise to

**Paragraph 1. Interpretation**

(a) **Definitions and Inconsistency.** Unless otherwise defined in this Deed, capitalised terms defined in this Agreement have the same meanings in this Deed. Capitalised terms not otherwise defined in this Deed or in this Agreement have the meanings specified in Paragraphs of this Deed. In the event of any inconsistency between this Agreement or any Other CSA, this Deed, margin requirements relating to Covered Transactions made herein to the Agreement, the Secured Party and

**Paragraph 2. Security**

(a) **Covenant to Perform.** Each party as the Chargor covenants with the other party that it will perform the Obligations in the manner provided in the Agreement, this Deed or any other relevant agreement.

(b) **Security.** Each party as the Chargor, as security for the performance of the Obligations:

(i) charges and agrees to charge, with full title guarantee, in favour of the Secured Party by way of first fixed charge

**Paragraph 4. Conditions Precedent, Transfers, Timing, Calculations and Substitutions**

(a) **Conditions Precedent.** Unless otherwise specified in Paragraph 13, each obligation of the Chargor to make a transfer under

**Paragraph 5. Dispute Resolution**

(a) **Disputed Calculations or Valuations.** If a party (a "Disputing Party") disputes (i) the Calculation Agent

**Paragraph 6. Custody Arrangements and the Control Agreement**

(a) **General.** The Custodian (IM) appointed with respect to each party as Chargor is set out in Paragraph 13. Each party as the Chargor and the other party as the Secured Party and the relevant Custodian (IM) have entered, or will, on or before the first day amounts are required to be transferred hereunder, enter into the

**Paragraph 8. Certain Rights and Remedies**

(a) **Secured Party's Rights and Remedies.**

(i) **General.**

(A) For the purpose of the due and payable of

(B) Section 103 of the Act shall not

(ii) **Secured Party's Rights** then, unless the Chargor gives notice to the Chargor,

**Paragraph 9. Representations**

**Paragraph 10. Expenses**

(a) Each party represents and warrants that it has no Disputing Party, equality of the parties, expenses required

**Paragraph 11. Other Provisions**

(a) **Default Interest.** A Secured Party that fails to transfer Posted Credit Support (IM) to the Chargor to the granting of the

**Paragraph 12. Definitions**

As used in this Deed:

"Act" means the Law of Property Act 1925.

"Allocated Margin Flow (IM/IA) Approach" has the meaning specified in Paragraph 3(c)(iii)(B).

"Amendment Effective Date (IM)" means the first date on which a Covered Transaction (IM) is

**Paragraph 13. Elections and Variables**

**Regime Table.**

For the purposes of this Deed, the parties have specified the regulatory regimes (each a "Regime" and together the "Regimes") applicable to them in their capacity as the Secured Party in the below table (the "Regime Table"). For the avoidance of doubt, any Regime that is specified as being applicable in the Regime Table shall not be construed as a representation, admission or acknowledgement that either party is actually regulated under such Regime.

Regime <sup>a</sup>	Party A as the Secured Party (Party B as the Chargor)	Party B as the Secured Party (Party A as the Chargor)
<b>EMIR</b>	[Applicable] / [Not Applicable]	[Applicable] / [Not Applicable]
	SIMM Exception: [Not Applicable] / [Applicable; [Fallback to Mandatory Method] / [Mandatory Method] / [As follows: .....]]	SIMM Exception: [Not Applicable] / [Applicable; [Fallback to Mandatory Method] / [Mandatory Method] / [As follows: .....]]
<b>Prudential</b>	[Applicable] / [Not Applicable]	[Applicable] / [Not Applicable]
	SIMM Exception: [Not Applicable] / [Applicable; [Fallback to Mandatory Method] / [Mandatory Method] / [As follows: .....]]	SIMM Exception: [Not Applicable] / [Applicable; [Fallback to Mandatory Method] / [Mandatory Method] / [As follows: .....]]
<b>CFTC</b>	[Applicable] / [Not Applicable]	[Applicable] / [Not Applicable]

(c) **Conditions Precedent.**

(i) The provisions of Paragraph 4(a) will apply, unless otherwise specified here:

[Not specified][Paragraph 4(a) will not apply].

(ii) **Specified Condition and Access Condition.** For purposes of the provisions of Paragraph 4(a), Chargor Rights Event or Secured Party Rights Event with respect to the other party shall constitute "**Specified Condition**". For purposes of the definitions of the NEC Event, Secured Party Rights Event or Chargor Rights Event (in each case, if applicable), the following Termination Event(s) (to the extent that such Termination Events are applicable in respect of the relevant party under this Agreement) specified below will be an "**Access Condition**" with respect to the party so specified if: (a) that party is an Affected Party with respect to such Termination Event; and (b) all Transactions are Affected Transactions:

	Party A	Party B
Illegality	<input type="checkbox"/>	<input type="checkbox"/>
Force Majeure Event	<input type="checkbox"/>	<input type="checkbox"/>
Tax Event	<input type="checkbox"/>	<input type="checkbox"/>
Tax Event Upon Merger	<input type="checkbox"/>	<input type="checkbox"/>
Credit Event Upon Merger	<input type="checkbox"/>	<input type="checkbox"/>
Additional Termination Event(s):		
.....	<input type="checkbox"/>	<input type="checkbox"/>
.....	<input type="checkbox"/>	<input type="checkbox"/>

**Regime Table Definitions.**

(i) "**Fallback to Mandatory Method**" means, if specified as applicable in the Regime Table with respect to a Regime, ISDA SIMM<sup>TM</sup> will be the Method applicable to such Regime, but if, to the extent that a party notifies the other that it is mandatory under such Regime for such notifying party to apply the Mandatory Method to one or more transaction types with respect to either the Chargor's or the Secured Party's posting or collecting obligation, as applicable (specifying in such notice the relevant transaction types), then with effect from the later of (x) the date which is the [1] calendar day after such notice is

**General Principles.**

Unless otherwise specified or agreed between the parties, the following principles (the "**General Principles**") will apply for the purposes of this Deed and the provisions of this Deed shall be construed accordingly:

(aa) **One Way Provisions:** One Way Provisions are [Applicable/Not Applicable]

[Posting Party for the purposes of One Way Provisions: [Specify Party]]

"**Strictest Of**" means:

(i) in respect of the Margin Amount (IM) applicable to a Chargor's posting obligation hereunder, that:

(A) a Margin Amount (IM) will be determined in respect of each Regime applicable to such

(iv) **Recalculation of Value.** For the purpose of Paragraphs 5(a)(iv)(A) and 5(a)(iv)(B), the Value of Eligible Credit Support (IM) or Posted Credit Support (IM), as applicable, will be calculated in accordance with the following procedure:

With respect to Party A acting in its capacity as the Chargor and Party B acting in its capacity as the Secured Party: [Consultation Procedure][Other Regulatory CSA Procedure][Not applicable][As specified below:

(i) **Amendment to "Termination Currency":** The definition of "**Termination Currency**" has the meaning specified in the Schedule to the Agreement, unless a currency is specified below as the "**Termination Currency**":

[Amendment to "**Termination Currency**" is Not Applicable][The definition of "**Termination Currency**" in the Schedule to the Agreement will be amended with effect from the date of this Deed to mean:

(i) with respect to Party A, [.....][as set out in the Eligible Credit Support (IM) Schedule relating to the posting obligation of Party B], and

(ii) with respect to Party B, [.....][as set out in the Eligible Credit Support (IM) Schedule relating to the posting obligation of Party A].

The parties hereby acknowledge and agree that, for the purposes of determining the amount due under Section 6(e) of the Agreement or, as applicable, the Early Termination Amount, "**Termination Currency**" shall mean:

(A) in relation to a calculation pursuant to either:

COMMISSION DELEGATED REGULATION (EU) 2016/2251

of 4 October 2016

supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty

Collateral management and segregation

1. The procedures referred to in Article 2(2)(c) shall include the following:
  - (a) a daily valuation of the collateral held in accordance with Section 6;
  - (b) the legal arrangements and a collateral holding structure that allow access to the received collateral where it is being held by a third party;
  - (c) where initial margin is held by the collateral provider, that the collateral is held in insolvency-remote custody accounts;
  - (d) that non-cash initial margin is maintained in accordance with paragraphs 3 and 4;
  - (e) that cash collected as initial margin is maintained in cash accounts at central banks or credit institutions which fulfil all of the following conditions:
    - (i) they are authorised in accordance with Directive 2013/36/EU or are authorised in a third country whose supervisory and regulatory arrangements have been found to be equivalent in accordance with Article 142(2) of Regulation (EU) No 575/2013;
    - (ii) they are neither the posting nor the collecting counterparties, nor part of the same group as either of the counterparties;
  - (f) the availability of unused collateral to the liquidator or other insolvency official of the defaulting counterparty;
  - (g) the initial margin is freely transferable to the posting counterparty in a timely manner in case of the default of the collecting counterparty;
  - (h) that non-cash collateral is transferable without any regulatory or legal constraints or third-party claims, including those of the liquidator of the collecting counterparty or third-party custodian, other than liens for fees and expenses incurred in providing the custodial accounts and other than liens routinely imposed on all securities in a clearing system in which such collateral may be held;
  - (i) that any unused collateral is returned to the posting counterparty in full, excluding costs and expenses incurred for the process of collecting and holding the collateral.

3. Initial margin shall be protected from the default or insolvency of the collecting counterparty by segregating it in either or both of the following ways:

- (a) on the books and records of a third-party holder or custodian;
- (b) via other legally binding arrangements;

4. Counterparties shall ensure that non-cash collateral exchanged as initial margin is segregated as follows:

- (a) where collateral is held by the collecting counterparty on a proprietary basis, it shall be segregated from the rest of the proprietary assets of the collecting counterparty;
- (b) where collateral is held by the posting counterparty on a non-proprietary basis, it shall be segregated from the rest of the proprietary assets of the posting counterparty;
- (c) where collateral is held on the books and records of a custodian or other third-party holder, it shall be segregated from the proprietary assets of that third-party holder or custodian.

5. Where non-cash collateral is held by the collecting party or by a third-party holder or custodian, the collecting counterparty shall always provide the posting counterparty with the option to segregate its collateral from the assets of other posting counterparties.

6. Counterparties shall perform an independent legal review in order to verify that the segregation arrangements meet the requirements referred to in paragraph 1(g) and paragraphs 3, 4 and 5. That legal review may be conducted by an independent internal unit, or by an independent third party.

7. Counterparties shall provide evidence to their competent authorities of compliance with paragraph 6 in relation to each relevant jurisdiction and, upon request by a competent authority, shall establish policies ensuring the continuous assessment of compliance.



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# CAN Comply: Collateral and Netting Compliance Service

For European firms in-scope for Undeclared Margin Rules, complying with the ongoing requirements of EMIR can be costly and time consuming. And with each wave of initial margin enforcement, increasing numbers of institutions with smaller in-house teams have come into scope and must comply.

Mayer Brown, Factor and Acadia have partnered to bring together their respective strengths in expert advisory, complex legal work at scale, and scalable agreement technology together to create a flat-fee subscription service for the review and certification of compliance of these arrangements that is cost-effective, secure, and compliant.

Clients simply identify the counterparty relationships they would like analysed and all relevant information is shared via the secure digital Acadia Agreement Manager platform. Factor and Mayer Brown analyze the data provided, perform cross-validation checks, and provide a certificate that the client can rely upon for their compliance, with ongoing annual checks to confirm continued compliance.

This service can be tailored to meet the specific needs of your firm, resulting in peace of mind that all your counterparty agreements are compliant with the regulations.



## A full suite of services

Whether you need minimal or a full-suite services to assist you

### Basic certification

- Information about each counterparty is provided directly or extracted automatically from Acadia Agreement Manager
- Institution confirms no substantive deviation, with guidance provided on what constitutes a deviation
- Cross-check validation is performed for opinions for: Collateral Taker, Collateral Provider, custodian legal opinion, counterparty's custodian
- A certificate is generated that the institution can rely upon, stating that all CP agreements are

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## Frankfurt

Friedrich-Ebert-Anlage 35-37  
60327 Frankfurt am Main  
Germany

T: +49 69 79 41 0  
F: +49 69 79 41 100

## London

201 Bishopsgate  
London EC2M 3AF  
United Kingdom

T: +44 20 3130 3000  
F: +44 20 3130 3001

## New York

1221 Avenue of the Americas  
New York, NY 10020-1001  
USA

T: +1 212 506 2500  
F: +1 212 262 1910