ISDA® Safe, Efficient Markets

By E-mail & Courier

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Dear Sirs,

HKMA response to key comments on proposed margin and risk mitigation standards for non-centrally cleared OTC derivatives

Introduction

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] welcomes the opportunity to provide comments on the HKMA's response to key comments on the Consultation Paper (CP15.02) on Non-centrally Cleared OTC Derivatives Transactions - Margin and Other Risk Mitigation Standards ("**Consultation Response**") issued by the Hong Kong Monetary Authority ("**HKMA**") on 22 August 2016. In particular, ISDA is grateful to the HKMA for providing the industry with the opportunity to raise any key concerns on the Consultation Response in a meeting held on 2 September 2016 ("**Industry Meeting**"). We find the dialogue with the HKMA extremely helpful and this submission is intended to continue our constructive dialogue and to focus on the practical concerns and risks surrounding the implementation of the margin and risk mitigation standards for NCCDs, in particular:

- potential market fragmentation if implementation timelines are not harmonised with those of foreign regulators (see sequence number 1);
- uncertainty and challenges in compliance with multiple rule sets if full substituted compliance is not available (see sequence numbers 2, 4 and 5); and
- inconsistency with regulatory capital treatments and other difficulties that could arise in order to satisfy the exemption conditions for non-netting counterparties and non-enforceable collateral counterparties.

[1] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, Today, ISDA has over 850 member institutions from 68 countries. These members comprise of a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

We hope that our comments in this submission will assist the HKMA with its preparation of the new margin rules for non-centrally cleared OTC derivatives in Hong Kong ("**HK Margin Rules**"). Individual ISDA members may have their own views on the Consultation Response, and may therefore provide their comments to the HKMA directly.

Numbering below corresponds to the sequence number in the Consultation Response and definitions used have their meanings in the Consultation Response.

<u>Margin standards</u>

1. Scope of application: Effective date and phase-in schedule

ISDA welcomes the decision by the HKMA to delay the implementation date beyond 1 September 2016 and its intent to implement margin requirements in an internationally coordinated timeframe. We would like to reiterate our request in the Industry Meeting for the HKMA to align the implementation timeframe for Hong Kong with that for the EU and, to the extent possible, Singapore and Australia in order to minimize further market fragmentation. We also ask the HKMA to take into account any transitional period built into the margin standards of other jurisdictions (e.g. Singapore) when fixing the implementation schedule of the HK Margin Rules.

As noted in the Industry Meeting, AIs would have to undertake many steps to get ready for margin implementation, including counterparty classification, negotiation and conclusion of regulatory compliant documentation, and testing of custodial infrastructure, all of which require a significant amount of time and labour. We thus request the HKMA to provide as much lead time as possible between publication date of the HK Margin Rules and the phase-in dates so that the industry could comply with the HK Margin Rules when they come into effect.

2. Scope of application (cross-border): Partial and substituted compliance
4. Scope of application (cross-border): Approach of comparability assessment

ISDA welcomes the removal of the 'partial compliance' concept. ISDA supports the application of full substituted compliance as it avoids duplicative and conflicting margin rules and allows firms to establish a single system to comply with its obligations arising from multiple margin rule sets.

We welcome the HKMA's clarification in the Consultation Response on the operation of substituted compliance in relation to a foreign margin regime that exempts certain small entities or end users. We further welcome HKMA's clarification in the Industry Meeting that full substituted compliance would be available with respect to a foreign margin regime that has a different product scope – an AI may follow the foreign margin regime if HKMA has issued a comparability determination for such regime even if the foreign regime has a narrower product scope.

ISDA notes that the HKMA may impose additional terms and conditions on a specific comparability determination if the foreign margin regime does not lead to outcomes which are comparable to Hong Kong Margin Rules. ISDA is concerned that such terms and conditions would undermine the concept of substituted compliance and principle 7 of the BCBS-IOSCO

margin framework. As noted in the Industry Meeting, overseas AIs trade through branches in various jurisdictions under a multi-branch master agreement and manage their collateral on a portfolio basis. If they are required to comply with additional terms and conditions when they trade out of their Hong Kong branches, they may have to change such multi-branch approach or incur high costs in changing their existing collateral management systems to manage the differences between the applicable rule sets.

We support the HKMA to follow an outcome-based approach that does not evaluate the margin standards of a foreign jurisdiction on an "element-by-element" basis. Attaching terms and conditions to a comparability determination would require AIs to comply with two (or more) different rule sets. Any slight difference in such rule sets could present AIs with profound challenges in implementation and compliance. The following scenarios are intended to illustrate such challenges if conditions are attached to a comparability determination or a granular approach is taken in assessing the comparability of the margin standards of a foreign jurisdiction.

- Under foreign margin standards, counterparties do not have to exchange margin if the aggregate notional amount of NCCDs of one party is below a certain threshold (e.g., under the proposed Australian margin rules, there is a minimum qualifying level of AUD 3 billion for VM; and under the draft Singaporean margin rules, a financial institution is not subject to margining requirements if the aggregate notional amount of its NCCDs booked in Singapore is below SGD 5 billion). If "unconditional" substituted compliance cannot be relied upon, a foreign branch of an AI would have to exchange margin with counterparties in such foreign jurisdiction who are otherwise not subject to margin requirements when trading with local banks.

- The phase-in schedule of margin requirements in a deemed comparable jurisdiction may not be aligned with that of the HK Margin Rules (e.g., VM may not be fully phased in by 1 March 2017). If "unconditional" substituted compliance cannot be relied upon, a foreign AI would have to create a separate system for its Hong Kong branch to comply with the HK Margin Rules for the short period before the foreign margin requirements are phased in. As detailed in sequence number 5 below, we request the HKMA to consider providing transitional relief for compliance with the HK Margin Rules during such period.

- An intragroup transaction entered into by an AI is exempted under foreign margin standards. If "unconditional" substituted compliance cannot be relied upon, such AI will have to assess whether it can satisfy the conditions for intragroup exemption under the HK Margin Rules, making compliance more complex and subjecting the AI to duplicative rule sets.

- A foreign AI may choose to follow foreign margin standards of a jurisdiction that is not its home jurisdiction (e.g., a Swiss bank would choose to implement EU rules if its business presence and client base are predominantly in the EU, and would establish its system for compliance with the EU rules for operational purposes). Such foreign AI should be allowed to rely on substituted compliance if its home regulator (in addition to HKMA) determines the foreign margin standards to be comparable.

- A foreign AI may choose to follow foreign margin standards to which its counterparty is subject (e.g., the Hong Kong branch of an AI incorporated in the EU may choose to follow US rules when trading with the Hong Kong branch of an AI incorporated in the US, or vice

versa, whether before or after the EU rules are implemented). Such foreign AI should be allowed to rely on substituted compliance if the foreign margin standards of its counterparty are determined to be comparable by its home regulator and/or the HKMA.

In order to avoid application of duplicative rule sets, we urge the HKMA to consider only attaching terms and conditions to a comparability determination in extreme scenarios and where the relevant foreign jurisdiction is not a WGMR member jurisdiction. This provides certainty to the industry as it has largely built its system based on margin standards of WGMR member jurisdictions. Alternatively, we propose that such terms and conditions should only be attached if substituted compliance were to be relied upon by a locally incorporated AI such that overseas AIs could comply with the margin standards under their home jurisdictions without any conditions attached.

We welcome HKMA's plans to consult the industry and give sufficient notice before attaching any terms and conditions to a comparability determination. We would request the HKMA to give due consideration to industry's comments, including comments on the lead time necessary to put in place new documentation and get ready for compliance, especially in the case where HKMA decides to impose terms and conditions on the comparability of a deemed comparable jurisdiction.

3. Scope of application (cross border): treatment of non-netting counterparties and/or non-enforceable collateral counterparties

ISDA welcomes the proposal to exclude transactions with non-netting counterparties and/or non-enforceable collateral counterparties from margin requirements.

However, the derogations from the requirement to post and collect margin are only available where independent legal advice in writing has been given to the effect that netting is not likely to be effective and that, in the event of a challenge in a court of law, the relevant court or administrative authority would likely find the AI's OTC derivative exposures to be the gross and not the net amount, and arrangements for the protection of posted collateral are questionable or not legally enforceable. ISDA submits that this approach would give rise to a number of issues and would not be workable.

Determination of non-netting counterparty should be consistent with treatment for regulatory capital purposes

ISDA supports the suggestion that an AI may better manage and monitor its exposure to the relevant counterparties through regulatory capital requirements and asks that the HKMA to permit an AI to treat a counterparty as non-netting in line with how such counterparty is treated for regulatory capital purposes based on the rules of its home jurisdiction. The rationale for this suggestion is that the regulatory capital rules give firms a significant incentive to treat a jurisdiction as "clean" for netting (following the requisite legal analysis), and so if a firm is willing to take the regulatory capital cost of designating a jurisdiction as "dirty" for netting, the same analysis should be capable of being used for the purposes of the HK Margin Rules. Please refer to the Annex hereto in which we use a worked example to compare the regulatory capital cost when trading with a non-netting counterparty with the margin cost when trading with a counterparty from a netting-friendly jurisdiction.

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If the treatment of a counterparty for regulatory capital purposes is different from that for margining purposes, an AI may be subject to punitive costs. Where an AI is subject to margin requirements when trading with counterparties in a jurisdiction that is "dirty" for netting for regulatory capital purposes, such AI would have to fund the cost of margin but would not get any regulatory capital benefit for the margin posted in such jurisdiction.

Netting analysis is ultimately an internal determination

We also request confirmation from the HKMA that AIs could rely on internal legal advice. Firms are required to perform internal analysis on netting enforceability for regulatory capital purposes and do not just consider external legal opinions but do so using a risk-based approach. An example is Indonesia, where there is a clean industry netting opinion as a matter of Indonesian laws, but the industry typically does not treat Indonesia as a "clean" jurisdiction due to concerns on how local courts would apply local laws and legal principles set out in the opinion. Also, different firms may come to different conclusions based on the same external legal opinion. Ultimately, each firm has to make its own assessment based on external legal opinions and other internal considerations. In this regard, ISDA notes that the response in sequence number 36 makes reference to "an independent internal unit" in the context of an independent legal review of the segregation arrangements for IM. We further note that the EU margin rules[2] would allow firms to make this decision in-house where possible. We therefore submit that HKMA should expand the wording to allow firms to rely on legal review conducted by an internal independent legal unit.

Negative opinions are difficult to obtain if not unobtainable

Where firms obtain netting or enforceability opinions (whether these are industry standard opinions on standard documentation, bespoke opinions or internal legal reviews), these opinions typically confirm that netting is effective or that the relevant agreement is enforceable and set out the conditions which could affect this conclusion (or the circumstances that are not covered by the opinion). However, while local counsel should be able to give an opinion that netting is effective in relation to a particular agreement or counterparty type, based on the law and their experience in that jurisdiction, unless there is a law or precedent stating that netting will not be effective, it will be difficult for local counsel to give an opinion that netting is not effective (and similarly in relation to any opinion that exchange of collateral under the agreement cannot be legally enforced).

Typically netting opinions will set out the reservations to the opinion, which are the circumstances in which counsel cannot be certain that netting would be effective. If a counterparty is able to rely on HKMA's proposal where there are reservations to a relevant opinion, HKMA's proposal is likely to be widely available, even in relation to jurisdictions or counterparty types which the industry currently considers to be "clean" netting jurisdictions. Conversely, if HKMA's

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[2] Article 3(3) of the European Commission *Delegated regulation supporting 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* provides that the independent legal review can be conducted by an internal independent unit or by an external independent third party.

proposal will only be available where a firm has obtained a clear negative opinion in relation to a particular agreement or counterparty type, this will be very difficult to achieve.

Exemption for non-netting jurisdiction should not be linked to that for non-enforceable collateral jurisdiction

In addition, the concerns relating to the enforceability of segregated collateral arrangements are not necessarily linked to the concerns on the effectiveness of netting and the requirement to make the determination on collateral arrangement enforceability should not be dependent on also having obtained an opinion for netting. It should be considered as a separate legal issue. The enforceability of segregated collateral arrangements is relevant to whether IM should be exchanged and the enforceability of netting is relevant to both IM and VM. Thus, if netting is not enforceable, neither IM nor VM should be exchanged whereas if collateral segregation is not enforceable, only IM exchange requirements should be negated.

Relevant jurisdiction for the purpose of netting analysis should be jurisdiction of incorporation of the counterparty or branch

ISDA notes that the HKMA proposal refers to three jurisdictions for the purpose of analysing netting effectiveness and that the formulation of the requirement is based on the definition of "valid bilateral netting agreement" under the Banking (Capital) Rules (Cap. 155L). We submit that such formulation (which is used to determine whether netting is enforceable) is not appropriate for the purpose of determining whether netting is unenforceable. One reason is that parties would never specify the law of a non-netting jurisdiction as the governing law of their individual contracts or agreement. To give an example, ISDA Master Agreements are typically governed by English law or New York law. According to the ISDA netting opinion on English law, close-out netting provisions of the ISDA Master Agreement are enforceable against an English counterparty (in case it is subject to insolvency proceedings in England) as well as against a foreign entity (in the absence of insolvency proceedings in relation to such foreign entity). While English law will be relevant to the enforceability of netting under the ISDA Master Agreement, as an insolvency law matter, the determining law for the purpose of netting analysis would be the law of the place of incorporation of the insolvent counterparty. ISDA thus asks that opinions be obtained only from the jurisdiction of incorporation of the counterparty or location of the branch.

Exemption should cover trades booked in non-netting branch

ISDA would also like to seek clarity that NCCDs booked in a non-netting branch of a locally incorporated AI can also be exempted under the HK Margin Rules.

Reporting regime should be subject to industry consultation

ISDA notes that the HKMA is considering implementing a reporting regime for AI's NCCD exposure to non-netting counterparties and/or non-enforceable collateral counterparties and would request that this will be consulted on so that this regime is fully understood and clear to the industry.

5. Scope of application (cross-border): Process and transitional arrangements for comparability determinations

ISDA supports the concept of "deemed comparable jurisdictions" for WGMR member jurisdictions as an interim solution that provides a practical solution for the industry. ISDA notes the requirement for a foreign AI to notify the HKMA if it intends to follow primarily the margining standards of its home jurisdiction (which is also a deemed comparable jurisdiction) by 31 December 2016. Imposing such notification requirement would not be workable for an AI incorporated in the EU (or Switzerland) as it is almost certain that the EU margin rules would not come into force prior to 31 December 2016. Given the uncertainty of implementation timeframes in some deemed comparable jurisdictions, we request that the HKMA to consider building in a transitional period during which an AI would not be required to comply with the HK Margin Rules if the margin standards of its home jurisdiction (being a deemed comparable jurisdiction) are not finalized or implemented. In fixing the length of such transitional period, considerations should be given to the timeline for the relevant deemed comparable jurisdiction (e.g., the EU) to finalize and implement its rules. In this regard, we note that the draft guidelines on margin requirements of Singapore has included a transitional period of six months

6. Scope of application (covered entities): Financial counterparty limb (viii)

While we welcome the efforts of the HKMA to simplify the application of limb (viii) of the definition of financial counterparty, cross referencing this to limbs (i) and (vi) may not be the clearest approach because such limbs refer to specific Hong Kong authorisations, licensing and registrations. Instead, ISDA suggests referring to factual classifications, for example, "insurance companies", "retirement schemes" etc.

7. Scope of application (covered entities): Financial counterparty – limb (ix)

ISDA notes that the Consultation Response refers to "exclude SPEs which satisfy any of the conditions below…" and requests clarification from the HKMA that an SPE only has to satisfy one of the specified conditions in order to be excluded from the margining framework. In particular, SPEs that satisfy the second condition do not pose systemic risks and thus should be excluded. We submit that the word "and" at the end of the second condition should refer to "or" instead.

8. Scope of application (covered entities): Financial counterparty – investment and private equity funds

ISDA submits that, for the purpose of limb (i), the only relevant consideration is whether the fund is remote from the insolvency risk of the fund manager. ISDA thus requests the HKMA to delete the wording "upon any insolvency of any legal entity of which the fund forms a part and" in limb (i).

12. HKMA's discretionary power to bring foreign bank subsidiaries within scope

Should HKMA make a decision to extend the margining requirement to a foreign incorporated subsidiary, ISDA requests that there should be sufficient lead time given for the entity to comply

with the requirements. HKMA's review should also take into account the existing limitations or industry opinion available for that particular jurisdiction, for example, whether there is an onshore custodian and a netting opinion available.

14. Scope of application (covered instruments): Physically-settled FX forwards and swaps

ISDA notes that the implementation of margin requirements for physically-settled FX forwards and swaps under the draft EU rules is currently delayed until the earlier of the date of entry into application of the European Commission Delegated Regulation specifying some technical elements related to the definition of physically settled FX forwards (i.e., 3 January 2018) and 31 December 2018. We request the HKMA to monitor international developments and the approaches taken by global regulators in implementing VM requirements on such instruments, and align its implementation schedule accordingly.

ISDA also wishes to clarify whether overnight FX swaps or deliverable FX forwards with a shorter settlement date than that for spot trades should be regarded as spot or forward trades. Further, ISDA seeks clarification on whether bond forwards are subject to margining requirements.

15. Scope of application (covered instruments): Physically-settled commodity forwards

ISDA notes HKMA's inclination to align with the BCBS-IOSCO framework on physically settled commodity forwards. ISDA would like to note that they are not subject to the margin requirements in the US and Japan, nor the draft guidelines of Singapore. Further, trades that involve the actual delivery of commodities are often entered into for hedging purposes and subjecting such trades to margining would disincentivize end users from using hedging and managing their risks.

16. Scope of application (covered instruments): Securitisations and covered bonds, equity forwards

ISDA welcomes the 3-year delay for single-stock options and equity index options, as per the latest EU draft RTS. We note that equity basket transactions do not benefit from this delay, and request the HKMA to consider including such products within the scope of the delay.

20. Scope of application: treatment of legacy transactions and definitions of new trades

ISDA notes that requiring all legacy derivatives that are subject to amendment (and not just material amendment) to be margined is inconsistent with other rule sets, for example, in the EU. As noted in the Industry Meeting, ISDA, together with a wide array of market participants, have established a lifecycle trade event matrix that captures industry consensus as to whether the identified trade events would bring a legacy derivative into scope for margining requirements (a copy of which is appended to this submission). In relation to amendments, the industry consensus is that only economically material amendments (i.e. amendments that involve a change in pricing) would bring a legacy derivative into scope for margining requirements. This is the basis upon which global dealers have treated amendments for the purpose of complying global margin

standards and built their systems. We therefore request the HKMA to align its margin rules with the matrix to minimize any inconsistencies with industry practice.

23. Scope of application: HKMA's discretionary power to subject intragroup transactions to margin rules

ISDA notes that HKMA has a discretionary power to add additional criteria to those specified in draft paragraph 2.1.16 if prudential concerns arise, thus potentially subjecting certain intragroup transactions to margin rules. ISDA seeks clarification on the additional criteria that the HKMA may consider adding. These additional criteria should not create any uncertainty and unpredictability in the regime.

24. Application of phase-in thresholds: Level and calculation

According to the Consultation Response, intragroup transactions do not have to be included when calculating the average aggregate notional amount ("**AANA**") as they are eliminated in the consolidation process. We request clarification from the HKMA that this treatment is consistent with the margin standards in the EU and the US under which intragroup transactions are counted once in the calculation of the AANA. Any inconsistency may have an impact on how overseas regulators determine the comparability of the HK Margin Rules and thus the availability of substituted compliance.

36. Margin standards (initial margin): Segregation legal review

Consistent with the response in sequence number 33, ISDA proposes that the test for the return of collateral from the collateral taker on its insolvency to the collateral provider should be in a "timely manner" rather than "returned promptly", so as to be aligned with margin rules in other jurisdictions such as the EU.

37. Margin standards (initial margin): Standardized and IM Model approach

While covered entities should not be able to "cherry pick" the most favourable initial margin terms, ISDA notes that the restriction of using different models for the same asset class across balance sheets may create practical issues in complying with foreign margining requirement. In cases where foreign regulators impose requirements on the IM model approach, covered entities may wish to develop a local model to meet such requirements.

38. Margin standards (initial margin): Internal model approval process

As raised in the Industry Meeting, ISDA would like to seek HKMA's confirmation that modifications made to an industry wide standard model (e.g. the ISDA SIMM model) pursuant to requirements imposed by foreign regulators of a Comparable Jurisdiction would not be subject to HKMA's approval or prior notification to the HKMA.

40. Margin standards (exchange): Posting obligation

ISDA welcomes the HKMA's clarification of the circumstances under which a posting party will not have violated its posting obligations if its counterparty fails to accept the margin posted. We

would welcome further clarity that sub-paragraph (ii) of 5.1.7 is independent of sub-paragraph (i) and is not intended to operate in a dispute scenario.

42. Margin standards (exchange): Timing

ISDA understands from the example that, with respect to a trade between a US entity and a HK entity, trade date or "T" refers to the calendar day of the US (being the later of the two time zones). Accordingly, we submit that "T" should refer to the time zone that is closer to the eastern (not western) side of the International Date Line (note that the line passes through the middle of the Pacific Ocean).

We further seek clarification that the deadline for a margin call to be made would be determined by reference to the time zone that is closer to the eastern side of the International Date Line. With respect to a trade between a US entity and a HK entity, the deadline thus would be 11:59pm of the applicable time zone in the US. We understand that this approach is consistent with that adopted by international regulators.

43. Margin standards (collateral): List of eligible instruments

ISDA requests that, in line with other regimes, shares (whether issued by financial institutions or non-financial companies) which are publicly traded and included in the Hang Seng Index can be included as eligible collateral for IM. Under CFTC margin rules, shares of Standard & Poor's 500 Index and Standard & Poor's 1500 Composite Index are eligible collateral for IM (subject to certain haircuts) with no differentiation between shares issued by financial institutions and non-financial companies. If HKMA is concerned with wrong way risk, we suggest the application of appropriate haircuts to mitigate such risks instead of an outright exclusion of shares issued by all financial institutions.

Risk mitigation standards

49. RMS (application): Effective date and of phase-in schedule

Implementation timeline

ISDA welcomes the deferral of the implementation of the risk mitigation standards ("RMS") beyond 1 September 2016. ISDA further welcomes HKMA's confirmation in the Industry Meeting that the implementation timeline of the RMS would be aligned with the phase-in schedule of the margin requirements for IM, and any delayed phase-in timeline for certain instruments (e.g., some equity instruments are subject to a 3-year delay). As discussed in the Industry Meeting, many existing trading relationships are documented using long form confirmations. In order to comply with the RMS, such trading relationships have to be revised and documented under ISDA Master Agreements, the negotiation of which would involve a significant amount of time and client education. In addition, gap analyses have to be performed and potential changes to current infrastructures have to be implemented to allow for an increase in portfolio reconciliations. Therefore, sufficient lead time has to be provided to the industry in order for it to get ready for RMS compliance.

Scope of products subject to RMS

In addition, ISDA wishes to clarify whether the RMS will apply to the same scope of covered products as those listed in 2.1.1 and 2.1.2 of the SPM.

Materiality threshold for breaches

ISDA requests that the HKMA considers a materiality threshold below which AIs would not be required to approach the HKMA with a report of breaches or failures, or otherwise discusses with AIs on the level of breach that would require reporting.

50. RMS (application): Cross-border application

ISDA welcomes substituted compliance with respect to RMS. To the extent applicable, we request the HKMA to take into consideration the points we make in relation to substituted compliance for margin requirements. In particular, we note that the HKMA is one of the few regulators that align the timing of implementation of the margin standards with that of the RMS. In this regard, we urge the HKMA to adopt a flexible approach and provide transitional arrangements for RMS compliance, especially where the margin and/or RMS standards of an AI's home jurisdiction are not finalized or implemented.

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Annex

The worked example below shows the costs to an AI when it enters into an NCCD with another covered entity. ***Note that this is an indicative example and does not represent the cost of capital of any particular AI.***

Assumptions

1. The counterparty is a standard emerging markets entity with a 50% risk weight.
2. The relevant NCCD is a 10-year interest rate swap with a notional amount of USD100M.
3. The AI has a target tier 1 ratio of 10%, a cost of capital of 12% and funding cost of 30 basis points.
4. The calculations are based on a flat IRS curve.

Non-netting counterparty

If the covered entity is incorporated in a non-netting jurisdiction with no margin standards, the regulatory capital charge for the AI will be 3–4 basis points running. This equates to a total cost to the AI of approximately USD300,000 – USD400,000 for the life of the trade.

Netting counterparty

If the covered entity is incorporated in a netting jurisdiction with margin standards, the regulatory capital charge for the AI will be negligible because its exposure under the NCCD is fully collateralized. The main cost to the AI is the funding cost of the gross IM, which will be 0.5-1 basis points running. This equates to a cost to the AI of approximately USD50,000 – USD100,000 for the life of the trade.

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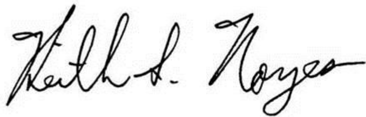
We look forward to continuing our dialogue with you. Please do not hesitate to contact Keith Noyes, Regional Director, Asia Pacific (knoyes@isda.org, +852 2200 5909), Jing Gu, Senior Counsel, Asia (jgu@isda.org, + 65 6653 4173) or Melody Ma, Counsel, Asia (mma@isda.org, +852 2200 5908) for questions related to this response.

Yours faithfully,

For the International Swaps and Derivatives Association, Inc.



Keith Noyes

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Appendix - ISDA Trade Lifecycle Events Matrix

Final Draft 3/14/2016

Purpose: The Life Cycle Trade Event List has been established and agreed by market participants through a series of discussions held within the ISDA WGMR Margin and Collateral Processing and Portfolio Integrity Workstreams. The workstreams are comprised of a wide array of market participants from buy and sell side institutions. The working group both identified and agreed the list of trade events as well as agreed to the general consensus captured in the below matrix as to whether or not these identified trade events would bring a legacy non cleared swap transaction into scope for the new margin rules. The intention of this list is to provide an agreed market guide for firms to utilize in order to comply with certain aspects of the non cleared margin rules within their respective jurisdictions. No firm is legally bound or compelled in any way to follow any determinations made within this list. Please see the legal disclaimers below for further details.

ISDA Trade Life Cycle Events Guide for Non Cleared Margin

Category	Trade Event	Detail	* Bring into scope for Un-cleared margin? Yes or No (Working Group Consensus View)	Notes	Does M&CP Consensus Align With Clearing Y/N
Amendments and Cancellations	Amendment (i.e. Correction)	Amending details that were originally input incorrectly	No		Y
	Economically Immaterial Amendment		No (no change in pricing)		Y
	Economically Material Amendment		Yes (change in pricing)		N(subject to further esma guidance)
	Cancellation	Trade booked in error and subsequently cancelled	No		Y
Trade events	New Trade for In-scope product (post compliance date)		Yes		N/A
	New Trade for out-of-scope product (post compliance date)		No		N/A
	New Trade for out-of-scope product in one jurisdiction and in-scope product for another jurisdiction (post compliance date)		Yes for the entity subject to the regulatory regime where the product is in-scope	The CSA between the parties should cover the products covered by the agreement. So the parties would then agree to include or exclude the product and avoid asymmetric terms.	NA
	Increase	A bilaterally executed agreement to increase the notional on the transaction	Yes	Generally firms seem to feel the entire trade comes into scope.	N(subject to further esma guidance)
	Full Termination	Full Unwind	No		Y
	Partial Termination	Partial Unwind	No	The partial unwind would NOT bring the remaining portion of the trade into scope. (as under clearing logic)	Y
	Allocation	Original Unallocated "Block" Trade allocated to principal parties post go live	No	Assuming trade entered into prior to effective date. Yes, for allocations of trades entered into post effective date.	N/A
	Cleared Positions	Original Bilateral Trade (the "alpha" trade), post compliance	No		N/A
		Cleared Position ("beta" and "gamma" trades)	No		N/A
	Full Novation	Remaining party	Yes		Y
		Step in	Yes		Y
		Step out	No		Y
	Partial Novation	Remaining party	Yes		Y
		Step in	Yes		Y
		Step out	No		Y

	Inter-affiliate Novation		Same as Novation treatment above	This is yes to clearing obligation where the new party is stepping in.	Same as "Full Novation" above, unless the counterparties can rely on the intragroup exemption under Article 4(2) of EMIR.
	Inter-Affiliate Partial Novation		Same as Novation treatment above	This is yes to clearing obligation where the new party is stepping in	Same as "Partial Novation" above, unless the counterparties can rely on the intragroup exemption under Article 4(2) of EMIR.
	Swaption Exercise	Exercise of a Swaption/Resulting Swap from the exercise of a Swaption	No		
	Compression Event	Original Trade - Terminated	No		Y
		Original Trade - Amendment	No		Y
		New resultant trade	Yes	Generally firms say YES to this, NO if its an industry wide run compression.	Yes - Any contract in a clearing obligation product which is entered into or novated between in-scope counterparties after the clearing obligation is in force must be cleared. This is regardless of whether the contract results from a compression exercise or similar.
	Cash Settlement	The actual cash settlement of fees, payments, etc.	No		Y
Intrinsic changes	Amortizing Notionals	Changes to the notional during the course of a trade	No	if pursuant to the original contract terms	Y
	Dividend resets		No	if pursuant to the original contract terms	N/A
	Equity resets		No	if pursuant to the original contract terms	N/A
	Rate resets	Changes to the floating rate of a trade	No	if pursuant to the original contract terms	Y
Other	Successor events	Product/Part of transaction being replaced by an	No	if pursuant to the original contract terms	N/A
Other	Credit Events	Default on a transaction eg bankruptcy/restructuring/obligation default	No	if pursuant to the original contract terms	Y
Other	Corporate Actions	Incl:	No-assuming related to the underlying equity	if pursuant to the original contract terms	N/A
		Bonus Issue/Capitalisation issue		if pursuant to the original contract terms	N/A
		Special Dividend		if pursuant to the original contract terms	N/A
		Spin-Off		if pursuant to the original contract terms	N/A
		Stock Split/Change in nominal value		if pursuant to the original contract terms	N/A
		Reverse Stock split/Change in nominal value		if pursuant to the original contract terms	N/A

Other	Conversions	Parties mutually agreeing and consenting to a conversion post-compliance date which results in a material amendment. Would not include a conversion documented pre-compliance date as an event due to take place in the future (i.e. post-compliance date). Example would be swap on an ADR that is converted to swap on the underlying stock as agreed by both parties, or a stock is dual listed and is converted from a GBP line to a HK line as agreed by both parties.	Yes	Propose similar treatment as swaptions. No, if option to convert is negotiated pre compliance date. Yes, if you amend swap originally referencing ADR to instead reference the underlying post compliance date, because that would be a material amendment.	N/A
Other	Publicly traded / listed swap index	Swap is removed/changed in the index by the administrator of the index (i.e. not at the discretion of the dealer or counterparty). Example would be quarterly roll for index CDS. Would not include rebalancing of the index.	No		N/A
Other	Customized basket index swap	Constituents of the basket are changed at the discretion of the dealer or counterparty. Example would be rebalancing the basket by closing a swap on an old ticker and booking that swap on a new ticker	Yes		
Other	Reference Entity Succession Event		No – if pursuant to original contract terms (i.e., no change in pricing)		N/A
Other	Addition of Reference Underlyer to Long Portfolio or Short Portfolio	Creation of a new swap contract on Security XYZ. Does not include documented changes.	Yes	if initial agreement allowed addition or removal then "No"	N/A
Other	Removal of Reference Underlyer from Long Portfolio or Short Portfolio	Partial or full termination of existing swap contract on Security XYZ	No		N/A
Other	Increase in Notional Amount for existing Reference Underlyer	Increasing long or short exposure to Security XYZ. Does not include documented changes.	Yes	If bilaterally agreed, no if a function of some corporate action is stock split	N/A
Other	Decrease in Notional Amount for existing Reference Underlyer	Decreasing long or short exposure to Security XYZ in a portfolio swap wrapper	No		N/A

Legal Disclaimer

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