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# ISDA WGMR Implementation Overview

February 2015

# Agenda

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Overview and Current Status of Margin Rules for Non-Cleared Swaps

- *Scott O'Malia, ISDA CEO*

ISDA's WGMR Implementation Committee

- *Mary Johannes, Head of US Public Policy, ISDA*

Standard Initial Margin Model

- *Tomo Kodama, Managing Director, BAML*

Key Legal and Operational Issues

- *Katherine Darras, ISDA General Counsel, Americas*

# Current Status of WGMR Rules

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- WGMR's final report on margin requirements for non-centrally cleared derivatives, September 2013
- European proposals (ESMA, EBA, EIOPA), April 2014
- Japan proposals (Japan FSA), July 2014
- US prudential regulators' proposals, September 2014
- CFTC proposals, September 2014

# Implementation Timetable

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- Margin requirements introduced from December 1, 2015
- All covered firms subject to requirement to exchange variation margin (VM) from December 1, 2015
- Four-year phase-in for initial margin (IM):
  - From December 2015: Covered entities that exceed €3 trillion in non-cleared notional outstanding (WGMR levels)...
  - Until December 2019: Covered entities above €8 billion in non-cleared notional outstanding (WGMR levels)

# ISDA Request to Regulators

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- Domestic rule-making unlikely to be finalized until early to mid-2015
  - leaves only months until December 2015 implementation deadline
- August 18, 2014 letter to WGMR:
  - Requested two-year implementation period from point the final rules are clarified and published
  - Requested phase-in of VM requirement
  - VM phase-in to mirror IM thresholds, but with an accelerated timeline
  - Avoid year-end “code freeze”

# Other ISDA Letters

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- November 24, 2014: [ISDA response to US prudential regulators' proposals](#)
- November 24: [ISDA response to CFTC's proposals](#)
- September 2014: SIMM framework sent to regulators
- August 22: [Letter to European regulators on implementation issues](#)
- August 22: [Letter to European regulators on the operational challenges in setting up required number of segregated accounts](#)

# Other ISDA Letters (cont.)

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- August 18: Letter to European regulators on documentation requirements
- August 17: Letter to European regulators on FX haircutting
- July 14: ISDA/SIFMA response to ESA consultation on risk-mitigation techniques for OTC derivatives contracts not cleared by a CCP



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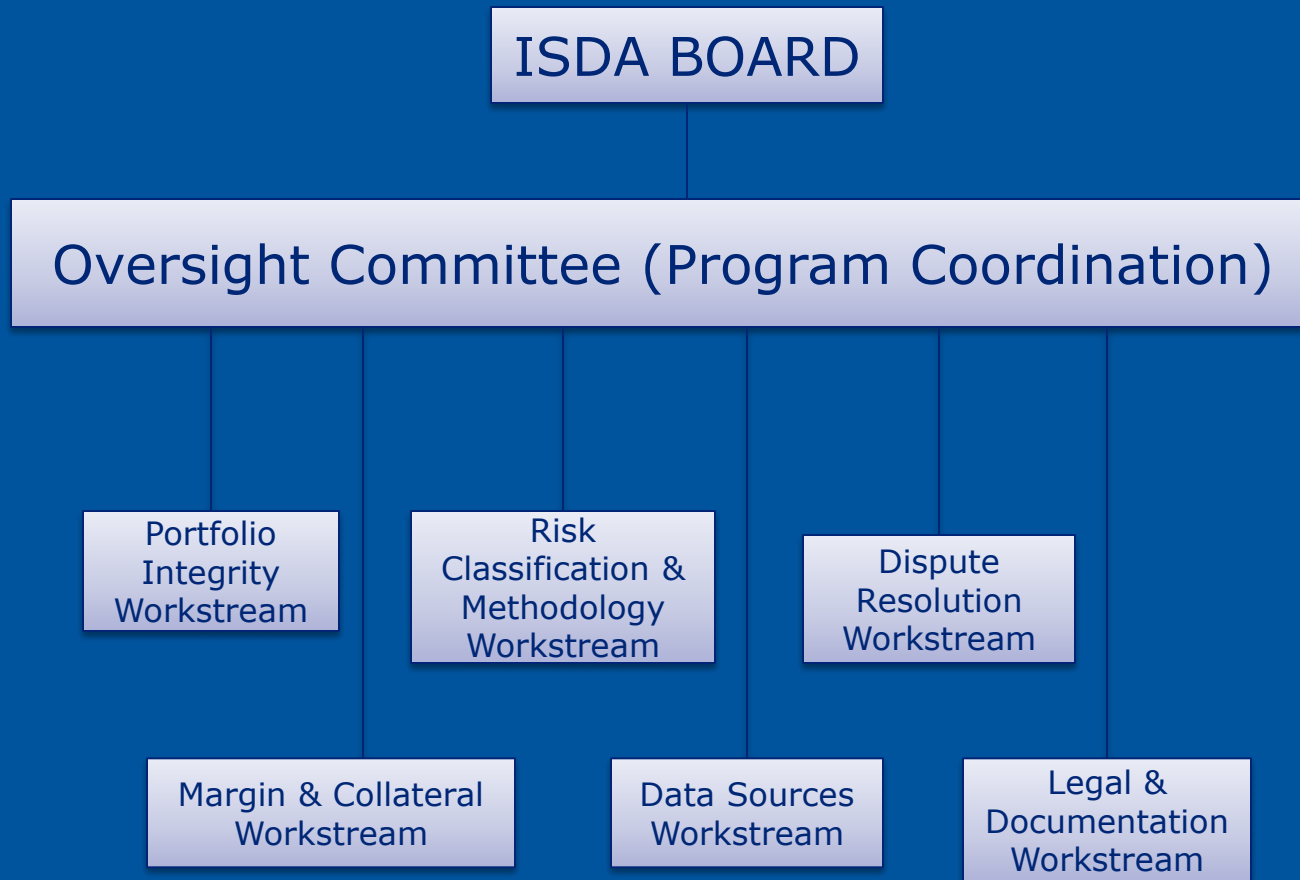
# ISDA's WGMR Implementation Committee

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# ISDA WGMR Implementation Initiative Organizational Structure



# The Workstreams

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## **Portfolio Integrity Workstream**

- in scope population of covered entities and subject trades
- portfolio reconciliation

## **Margin & Collateral Processing Workstream**

- operating framework to support margin requirements: IM and VM processing, IM segregation, and limited rehypothecation

## **Risk Classification & Methodology Workstream**

- model selection, development, backtesting, and regulatory approval

# The Workstreams (cont.)

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## **Data Sources Workstream**

- standards for mapping trades and associated risk weights to model risk buckets

## **Dispute Resolution Workstream**

- procedures for resolution of IM disputes
- review of market polling procedures for VM discrepancies
- dispute reporting procedures

## **Legal & Documentation Workstream**

- a new suite of documentation for compliance work margin requirements

# Standard Initial Margin Model (SIMM)

# Why a Standard Model?

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- Amount of initial margin required should be reduced
- Transparency in a risk-based model:
  - Allows common ground to resolve disputes around risk-based initial margin calculations
  - Managing and forecasting liquidity
  - Understanding impact of trades, novations, etc. on funding

# SIMM Model

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Agreed between committee participants and presented to regulators in 2014

## Features:

- Based on SBA (Sensitivity Based Approach) outlined in July 2014 by BCBS “Instructions for Basel III monitoring”
- Broken out into four asset classes: rates/FX, credit (qualifying and non-qualifying), equities, and commodities
- Inputs:
  - Sensitivities on risk factors (such as DV01 at 10 year tenor)
  - Applies risk weights and correlation to those risk factor sensitivities
  - Aggregates risk to recognize hedging and diversification benefits of position within an asset class

# SIMM Model

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- Characteristics:

- 1) Easy to replicate
- 2) Transparent
- 3) Quick to calculate
- 4) Extensible
- 5) Predictable
- 6) Low cost
- 7) Appropriate margin
- 8) Non-procyclical
- 9) Governance

# SIMM Model

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- Current work
  - Defining risk factors
  - Defining common mapping
  - Calibrating appropriate risk weights
  - Backtesting results





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# WGMR Legal and Documentation Overview

# Determining Which Rules Apply

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- Each counterparty relationship will need to be analyzed to determine which, if any, margin regulations apply. This analysis may need to be done in respect of the margin rules of multiple regulators.
- Once the relevant margin regulations are identified, market participants will need to determine the scope of application (*i.e.*, not applicable, VM only, or VM and IM).
- These determinations may require market participants to obtain information about their counterparties and the consolidated corporate group such counterparty is a member of, if any.

# What Information do market participants need?

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- In order for a market participant to determine which, if any, of the margin regulations apply to a particular counterparty relationship, the market participant will likely need to know:
  - 1) its status under each of the margin regulations;
  - 2) its counterparty's status under each of the margin regulations;
  - 3) its AANA under each of the margin regulations; and
  - 4) its counterparty's AANA under each of the margin regulations.
- Market participants may also need to know relationship-specific information (e.g., whether it has received a guarantee from its counterparty and where such guarantor is domiciled) to determine which, if any, of the margin regulations apply.

# Tool to obtain the necessary information

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ISDA is in the process of developing a self-disclosure form, which will be available on ISDA Amend, for parties to use to provide:

- 1) Counterparty status under various margin regulations.
  - *E.g.*, “financial end-user,” “FC,” “NFC+,” “U.S. person”
  - Highly dependent on final rules for definitions
- 2) Whether AANA thresholds have been crossed under various margin regulations.
  - AANA threshold tracking will need to be done on a group basis
  - Firms will need to provide information as to their affiliates – *e.g.*, by providing their ultimate parent’s LEI or by representing its group AANA number

Note that some information necessary to determine what rules apply and how may go beyond the self-disclosure form (*e.g.*, guarantees).

# Putting Compliant Documentation in Place

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- Market participants will generally need new collateral documentation that complies with relevant regulatory requirements.
- This new documentation will potentially need to address different and potentially inconsistent margin regulations (e.g., if each of the counterparties are subject to different margin regulations).
- While initial margin requirements will be phased in, variation margin requirements are currently scheduled to go into effect in December 2015 for the vast majority of market participants (*i.e.*, new CSAs will need to be put in place by the vast majority of the market in December of 2015).

# Cross-Border Issues

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- Regulators have yet to provide detail on how rules will apply in the cross-border context.
- In some cases, market participants will need to determine if margin rules apply to them, based on the relevant cross-border rules.
- Consider that a given financial conglomerate may have derivatives dealers that will be regulated as to margin in the US (two regulators), the EU, Japan (and potentially other countries as they adopt rules). (And such entities may each be regulated in more than one jurisdiction.)

# Contracts: What Needs to Change?

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- Credit Support Annexes and other collateral documentation will need to be revised or replaced.
- Custodial agreements (*i.e.*, tri-party agreements) will need to be established to segregate initial margin.
- New or updated netting opinions may be necessary for market participants in certain jurisdictions.
- May be a need for duplicate ISDA Master Agreements (US).

# Credit Support Documentation

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- A number of terms in standard credit support contracts (e.g., the ISDA CSA and CSD) will need to be modified to comply with the new rules.
- The following terms – among others - will likely need to be modified:
  - Collateral eligibility;
  - Collateral Haircuts;
  - Calculation and Collection timing;
  - Dispute resolution; and
  - Initial margin mechanics consistent with segregation requirement



# When Are the New Contracts Needed?

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- VM rules will be applicable to the vast majority of counterparties in 2015, while IM rules will only apply to a small group in 2015 and will be rolled out through 2019 (even then, some counterparties may be subject to VM requirements only).
- Thus, in the near-term, much of the existing documentation will need to be modified only to comply with VM requirements, not IM requirements.
- Further, not all transactions that are currently subject to a CSA will be subject to *regulatory* margin requirements (e.g., securities options, certain FX products).

# Contractual Architecture

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Given the timing of requirements, the following groups need to be addressed in the near-term:

- i. Counterparties for whom VM requirements are applicable in 2015, but not IM requirements.
  - Within this group, a further divide between such counterparties who (i) currently post (or will post) non-regulatory IM and (ii) do not currently post (and will not post) non-regulatory IM.
- ii. Counterparties for whom VM and IM requirements are applicable in 2015.

# Contractual Architecture

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The Legal and Documentation Working Group is drafting new CSA templates to cater to the documentation needs of these groups. Tentatively, there are plans in place to create:

- i. Template CSAs (both English and NY law) that include regulatory-compliant VM terms and IM terms that are largely based on the existing ISDA credit support documentation (*i.e.*, not regulated).
- ii. Template CSA/CSDs (both English and NY law) that include regulatory-compliant VM and IM terms.

New templates would include scope provisions designed to provide for side-by-side operation with existing CSAs under a single master agreement. Terms would provide that new CSAs cover regulated transactions executed after the relevant compliance date(s).

# Contractual Architecture: Transition to Regulatory IM

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Initially (after December 1, 2015), regulatory VM and any non-regulatory IM is documented under a new CSA.

- Parties with existing agreements regarding IM will likely want to preserve such agreements. For these parties, IM terms in existing CSA must effectively be duplicated into the new CSA and combined with terms appropriate for regulatory VM to accomplish this.
- An alternative considered, but not accepted at this time, would be to use existing CSAs to govern IM for new trades (e.g., splitting new trades between new and old CSAs for margin purposes).

After the transition to regulatory IM (after IM phase-in date), a second new CSA is added to the documentation suite in order to cover transactions subject to regulatory VM and regulatory IM.

Parties using English Law documentation would use a title-transfer CSA for VM and a separate Credit Support Deed for segregated IM.



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