

ISDA Margin and Collateral Processing Working Group

Suggested Operational Practices for Settlement, Release, and Updates and Reporting of Triparty and Third Party Segregated Collateral

Document Version: 1.0

This document should be considered a working document based on the industry's interpretation of the minimum standards set forth in the final policy framework on Margin Requirements for Non-Centrally Cleared Derivatives published by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (BCBS-IOSCO) in March 2015 and the subsequent final rules issued by the European Commission, the U.S. Commodity Futures Trading Commission (CFTC), and the U.S Prudential Regulators.

Important note and Disclaimer,

This document does not constitute legal, accounting, or financial advice and the document describes the potential market consensus among swap market participants who participated in the Margin and Collateral Processing Working Group. As with other guidance and market practise statements that ISDA disseminates, parties are free to choose alternate means of addressing the specific facts of their situation. Nothing in the document is contractually binding of any parties or amends any ISDA Master Agreement or ISDA Credit Support Annex.

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1 Introduction

1.1 Executive Summary

The International Swaps & Derivatives Association, Inc. (ISDA) utilized the ISDA Margin & Collateral Processing Working Group to engage market participants and develop suggested standard operating practices for the implementation of two-way Initial Margin (IM) exchange and segregation requirements put forward by BCBS-IOSCO¹.

The working group's objectives were to firstly educate IM in-scope entities and secondly facilitate a suggested operational practice for ISO15022 standards for triparty providers and third party custodians removing the need for market participants to instruct custodians via fax/custodian web portals.

The Purpose of this document *Suggested Operational Practices for Settlement, Release, and Updates and Reporting of Triparty and Third Party Segregated Collateral* is to define recommended business and technology considerations associated with implementation of the new IM rules, focusing on the implementation of the collateral segregation requirements. Users of this document will include, but not be limited to, triparty providers, third party custodians, secured parties and pledgors and their administrators, utilities and infrastructure providers, and collateral management technology providers. The document has been categorised into two main components; 1) Triparty and 2) Third Party as summarized below:

- Triparty collateral management/triparty segregation model refers to an agency service where the parties agree to the initial margin amount and a required value ("RQV") is sent to the triparty provider to fulfill the collateral requirement. The triparty provider carries out other activities, including validating eligibility, monitoring concentration limits, applying haircuts, collateral valuation, optimization, substitutions, automated settlement of collateral from the pledgor's own account (called the "longbox") to the segregated account, and reporting.
- The pledgor, secured party, and triparty provider enter into an Account Control Agreement (ACA) or equivalent agreement including a Collateral Eligibility Schedule.
- Third party custodian services refer to the traditional account structure for segregating margin, whereby a three way Account Control Agreement (ACA) or equivalent agreement is in place between the pledgor, secured party, and custodian. In contrast to the triparty structure, the pledgor, its manager, or an administrator values the collateral, selects the collateral to be pledged along with confirming eligibility and concentration limits, attributes necessary haircuts and provides settlement instructions to the custodian. The custodian only provides settlement, segregation, and reporting services.
- With the implementation of Phases 5 and 6 of the Uncleared Margin Rules, hybrid models combining the services of both triparty providers and third party custodians have been developed. There are different iterations of these models that are specific to relationships established between respective triparty providers and third party custodians, and those operating procedures may not fit to this SOP document.
- ISO15022 standards for both messaging and reporting that a triparty provider and a third party custodian will be able to consume/provide to in-scope IM entities. It also covers related

¹ Final policy framework on Margin Requirements for Non-Centrally Cleared Derivatives (March, 2015)
<http://www.bis.org/bcbs/publ/d317.pdf>

systems enhancements that each in-scope IM entity will have to incorporate into development plans.

1.2 Regulatory Summary

1. IM must be exchanged on a gross basis.
2. IM must be segregated from the proprietary assets of the Pledgor.
4. In some regulatory regimes, the Secured Party shall always provide the Pledgor with the option for individual segregation, i.e. collateral posted will be segregated from assets collected from other posting counterparties.
5. IM collected shall be immediately available to the Secured Party in the event of the Pledgor's default.
6. IM collected must be subject to arrangements that fully protect the Pledgor to the extent possible under applicable law in the event that the Secured Party enters bankruptcy.
7. Assets posted to satisfy IM requirements must be highly liquid.
8. IM should not be re-hypothecated, re-pledged or re-used.

2 Scope

This document has been categorised based on the main components of the various triparty collateral management arrangements specified below, with the view to provide guidance on messaging, reporting and other considerations in preparation for industry compliance with the Working Group on Margin Requirements (WGMR) final framework for bilateral OTC derivatives margin requirements.

Triparty and Third Party

- Standardised ISO15022 messaging
- Standardised reporting

3 Assumptions and Dependencies

In addition to those mentioned below, further relevant assumptions and dependencies related to each suggested practice have been provided along with the description of the suggested practice in Section 5 of the document. The assumptions listed in this document are subject to change and periodic revision.

- Triparty providers perform collateral valuation, optimization, and substitutions, check collateral eligibility, concentration limits, and haircuts, and segregation and reporting, as documented in an agreement for the control on the account (e.g. Account Control Agreement (ACA) or equivalent agreement) and the Eligible Collateral Schedule.
- Third party custodians will support the account arrangement needed to comply with the regulatory margin requirements.

- Third party custodians will accept pledge/release instructions from in-scope entities directly from pledgors and secured parties or from utilities or administrators on behalf of the entities' required to post IM with proper documentation, such as a Power of Attorney.
- Triparty providers will accept triparty instructions from in-scope entities directly from pledgors and secured parties or from utilities or administrators on behalf of the entities' required to post IM with proper documentation, such as a Power of Attorney
- Triparty providers, third party custodians, pledgors, and secured parties will adopt a market standard messaging infrastructure for settlement, release, and reporting.
- When intermediaries or service providers are used, a Power of Attorney or similar document may be necessary.
- A pledgor establishes a segregated account on behalf of the secured party. The collateral is delivered and returned from and to a main account to the third party segregated/collateral account.
- Both pledgors and secured parties need to ensure they manage custodian risks, including accessing intraday data and EOD reports along with initial and ongoing due diligence.

4 Suggested Operational Practices Table Sections

4.1 Triparty SOP

4.2 Triparty Workflow

4.3 Third Party SOP

4.4 Third Party Workflows

Definition of Suggested Operational Practices Tables

SOP (Suggested Operational Practice) #	Unique reference number assigned to each consideration in the document
Process or Background	High level description of each minimum consideration
Minimum Consideration Description	Recommended business and technology considerations required to comply with new margin rules
Assumptions & Dependencies	Description of key assumptions and dependencies related to each minimum consideration

4.1 Triparty SOPs

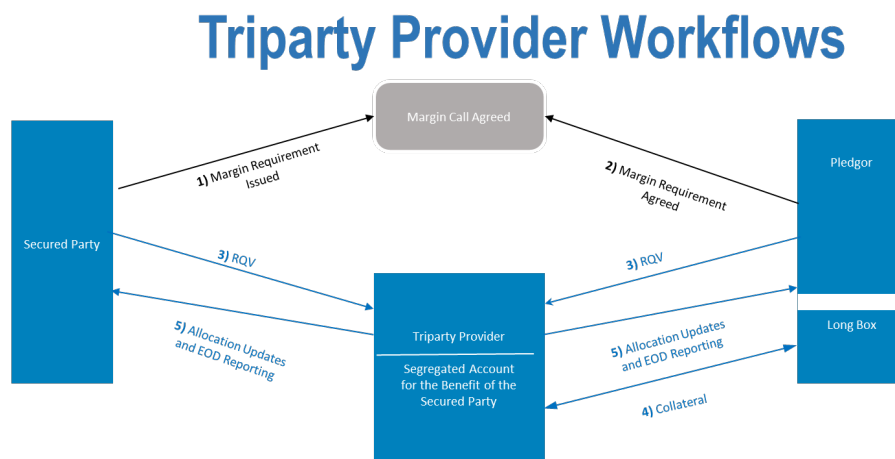
SOP#	Process or Background	Minimum Consideration Description	Assumptions & Dependencies
SOP1	<p>Instruction to move collateral: ISO15022 messages to triparty provider MT527 RQV (Required Collateral Value).</p> <p>(Note: Triparty providers also offer proprietary communication channels and formats.)</p>	<p>Pledgor and Secured Party transmit required IM amount (in full) to triparty provider.</p> <p>Bilaterally matched instructions on total requirement to be sent and triparty providers will process only on matched instructions.</p> <p>These instructions can be sent via SWIFTNet (based on MT527 message), sFTP email, or through triparty provider's portal/industry utility.</p> <p>Note: Instructions may be sent by one counterparty on behalf of both counterparties, with proper documentation such as Power of Attorney or Side Letter. This must be consistent throughout the life-cycle of the exposure.</p>	<p>Both Pledgor and Secured Party have agreed required value (RQV) amount prior to instruction.</p> <p>Pledgor and Secured Party required to build out internal functionality to ensure generation and delivery of these instructions. Detailed information can be captured through the respective triparty connectivity guidelines/ documentations.</p> <p>Triparty providers send an ISO15022 based MT558 to advise on status of MT527 such as non-matched/ matched/allocated.</p>
SOP2	<p>Status reporting: ISO15022 messages from triparty provider MT558 - Triparty Collateral Status and Processing Advice</p> <p>(Note: Triparty providers also offer proprietary communication channels and formats.)</p>	<p>Reporting the status of the IM instruction to the Pledgor and Secured Party. This is provided at the back of the respective instruction (MT527)</p> <p>Namely, received, message validation, matching status, and covered/allocated.</p>	<p>Pledgor and Secured Party required to build out internal functionality to ensure receipt and processing of these status messages.</p>
SOP3	<p>MT569, Triparty Collateral and Exposure Statement</p> <p>(Note: Triparty providers also offer proprietary communication channels and formats.)</p>	<p>Depending on client's processing needs, they can choose between intra-day and / or the end-of-day version. Similarly, choice is also between "summary" and "detailed" MT569 report.</p>	<p>MT569 to provide details of the valuation of both the collateral and the exposure.</p> <p>Secured Party required to build out internal functionality to consume report showing pledged balances.</p>
SOP4	<p>MT535, Securities report/ Statement of Holdings (Securities balances version)</p>	<p>Reporting End-of-day positions to Secured Party and Pledgor, on the same segregated account.</p>	<p>MT535, MT569, or equivalents to provide positions/balances.</p> <p>Secured Party or Pledgor required to build out internal functionality to consume report showing pledged balances.</p>
SOP5	<p>Eligible collateral</p>	<p>Triparty providers to support allocation and monitoring of negotiated collateral types.</p>	<p>Eligible collateral will be defined in the Eligible Collateral Schedule of the Account Control Agreement or equivalent agreement, bilaterally agreed between Pledgor and Secured Party.</p>
SOP6	<p>Haircuts incl. FX- mismatch</p>	<p>Triparty providers to apply haircuts as part of their allocation methodology. 8% HC resulting from FX-mismatch is an add-on regulatory defined minimum HC.</p>	<p>Haircuts will be defined in the Eligible Collateral Schedule.</p>
SOP7	<p>Concentration limits</p>	<p>Triparty providers to monitor for concentration limits, where applicable.</p>	<p>Concentration limits will be defined in the Eligible Collateral Schedule if applicable.</p>

SOP#	Process or Background	Minimum Consideration Description	Assumptions & Dependencies
SOP8	Wrong Way Risk	Triparty providers may consider to monitor for wrong way risk.	Wrong way risk provisions will be defined in the Eligible Collateral Schedule, if applicable.
SOP9	Custodial Account Opening	Relevant accounts per counterparty will need to be opened.	Legal documents for account opening will need to be executed.
SOP10	Margining and Custodial Relationships	Margining relationships must be established. Custodial relationships must be established.	Underlying CSA / CSD, CTA, and SA will need to be executed by counterparties; ACAs or equivalent agreements would need to be executed between counterparties and custodians. These are in addition to triparty collateral management agreements executed between customers and triparty providers.
SOP11	Tax documentation	Requisite for Pledgor/Secured Party depending on owner of account holder.	Tax forms for certain jurisdictions, must be in place. Please speak to your custodian.
SOP12	Connectivity Options	If ISO15022 instructions are not available from the Pledgor to the triparty provider, alternative portal options may be required.	Online / web-based or FTP processes will need to be available. Please speak to each triparty provider.
SOP13	Corporate Action reporting	Triparty provider may consider to deliver MT564 messages for all corporate actions.	Secured Party required to build out internal functionality to consume MT564 messages for all corporate actions.

4.2 Triparty Workflow

Triparty workflows include exchanges of margin calls along with sending triparty providers the Required Value (RQV).

- 1) Counterparties agree to the initial margin. Undisputed IM call delta for day T = (IM requirement for day T) – (Last agreed RQV)
- 2) Counterparties translate this into an RQV of collateral to be transferred (on a gross basis.) RQV for day T = (Last agreed RQV) + (Undisputed IM call delta for day T).
- 3) They then send the message to the triparty provider or log onto the triparty provider’s portal to enter the RQV for processing.
- 4) The triparty provider assesses the amount of collateral that needs to be moved based on the current collateral value compared to the RQV and selects the collateral based on the pledgor’s preferences to be moved from the populated long box of the pledgor to the account of the secured party. During the business day, this process can be continued in real-time, and allocation updates are made available to both the pledgor and the secured party. Because both parties agree to the eligible collateral to be posted and received within the eligibility schedule document, the triparty provider is able to allocate positions without the need for day to day selection or affirmation.
- 5) Collateral reports, including allocation updates, are available throughout the day. Position reports are available at the end of the day.



One-sided messaging from the Secured Party may be used if supported by the triparty provider.

Note:

Matching services may be conducted via email (based on authenticated message), Triparty provider portal, or utility provider.

Triparty provider reports can be provided via email, FTP, SWIFT messaging, or a utility platform, taking into account of technical limitations.

4.3 Third Party Custody – SOPs

SOP#	Process or Background	Minimum Consideration Description	Assumptions & Dependencies
SOP1	Deposit Collateral – Instructing	<p>TPC to support processing of:</p> <ul style="list-style-type: none"> Cash: MT210 Advice to Receive (if necessary for currency), MT202 to Deliver Securities: MT540 Receive Free/MT542 Deliver Free Instruction <p>These messages will be sent by Pledgor. In some rare instances, both the Pledgor and Secured Party will send messages</p>	Dependency that all TPCs can support ISO15022 MT210/202 and MT540/542 messaging.
SOP2	Deposit Collateral – Status Updates	<p>TPC to support sending of and MT296 status updates for cash and MT548 status updates on the processing of securities instructions.</p>	Dependency that all TPCs can support ISO15022MT548messaging. ²
SOP3	Deposit Collateral – Settlement Confirmation	<p>TPC to support sending of:</p> <ul style="list-style-type: none"> Cash: MT910 Credit/Debit Confirmation Securities: MT544 Receive Free/Deliver Free Settlement Confirmation. <p>These settlement confirmations will be sent to the Pledgor and the Secured Party, upon request.</p>	Dependency that all TPCs can support ISO15022 MT910 and MT544 messaging.
SOP4	Return Collateral – Authorising/Instructing	<p>TPC to support processing of:</p> <ul style="list-style-type: none"> Cash: MT202 Payment Instruction, Securities: MT542 Deliver Free Instruction. <p>There are two processes of authorisation prior to collateral release (Dual and Single)</p> <p>DUAL - The Pledgor sends MT SWIFT messages (MT202/MT210 or MT542/MT540) followed by the Secured Party sending a MT527, and then collateral is released; OR the Pledgor sends MT SWIFT messages (MT202/MT210 or MT542/MT540) followed by the Secured Party sending a MT542/MT202, and then collateral is released.</p> <p>SINGLE - Only the Secured Party instructs (MT202 or MT542), and then collateral is released. Pledgor has to still instruct the receipt of the collateral back to the pledgor main account (MT210 or MT540).</p> <p>Authorization can also be facilitated via use of a messaging utility either for Dual or Single authorization.</p> <p>Whichever method, it must be detailed within the ACA or equivalent agreement.</p>	Dependency that all TPCs can support ISO15022 MT202/MT210 and MT542/MT540 messaging.
SOP5	Return Collateral – Reporting on Authorisation Issues	<p>TPC to support sending of:</p> <ul style="list-style-type: none"> Cash: MT296 status reports² Securities: MT548 status reports If MT527 provided in case of DUAL authorization, then MT558 confirmation message is issued. <p>These messages will be sent by the TPC to the Secured Party if there is a problem with the authorisation/instruction, e.g. wrong SSI specified.</p>	Dependency that all TPCs can support ISO15022 MT548, and if dual authorization with MT527 and MT558 messaging. ²

² MT296 may be used, but it has not been formalized per ISITC market standards and not all custodians support MT296 messages.

SOP#	Process or Background	Minimum Consideration Description	Assumptions & Dependencies
SOP6	Return Collateral – Settlement Confirmation	<p>TPC to support sending of:</p> <ul style="list-style-type: none"> ▪ Cash: MT900 Debit Confirmation, ▪ Securities: MT546 Deliver Free Settlement Confirmation. <p>These settlement confirmations will be sent to the Pledgor and the Secured Party, upon request.</p>	Dependency that all TPCs can support ISO15022 MT900 and MT546 messaging.
SOP7	Statements	<p>TPC to support sending of:</p> <ul style="list-style-type: none"> ▪ Cash: MT940 and MT950 statements, ▪ Securities: MT535 and MT536 statements. <p>These End of Day reports will be sent to the Pledgor and the Secured Party, upon request</p>	Dependency that all TPCs can support ISO15022 MT940 or MT950 and MT535 or MT536 messaging.
SOP8	Custodial Account Opening Forms	Relevant accounts per counterparty would need to be opened.	Legal documents for account opening will need to be executed
SOP9	Margining and Custodial Relationships	<p>Margining relationships must be established.</p> <p>Custodial relationships must be established.</p>	Underlying CSA / CSD / CTA/ SA will need to be executed between counterparties. ACAs or equivalent agreements will need to be executed between counterparties and custodians.
SOP10	Tax documentation	Requisite for Pledgor.	Tax forms for certain jurisdictions must be in place. Please speak to your custodian.

4.4 Third Party Workflows

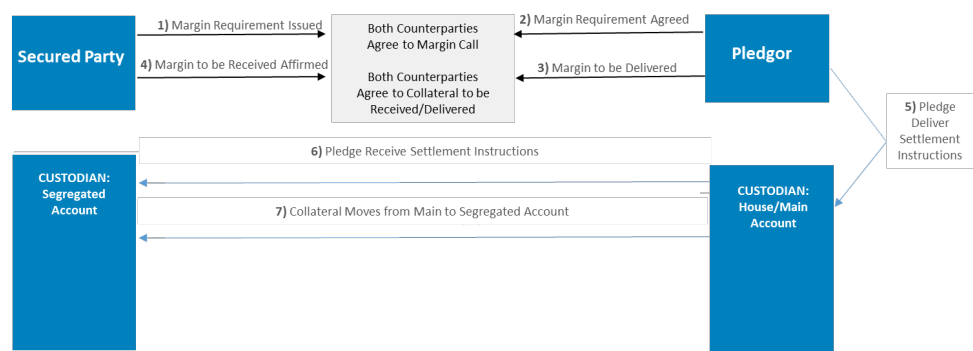
Pledge Collateral

Both counterparties agree to the initial margin and affirm the collateral to be transferred.

With the third party structure, pledgors establish accounts on behalf of the secured party at a custodian for margin segregation, and the pledgor instructs the custodian to move collateral to the segregated account on behalf of the secured party.

Please note: there could be different custodians for the house/main account and the segregated account.

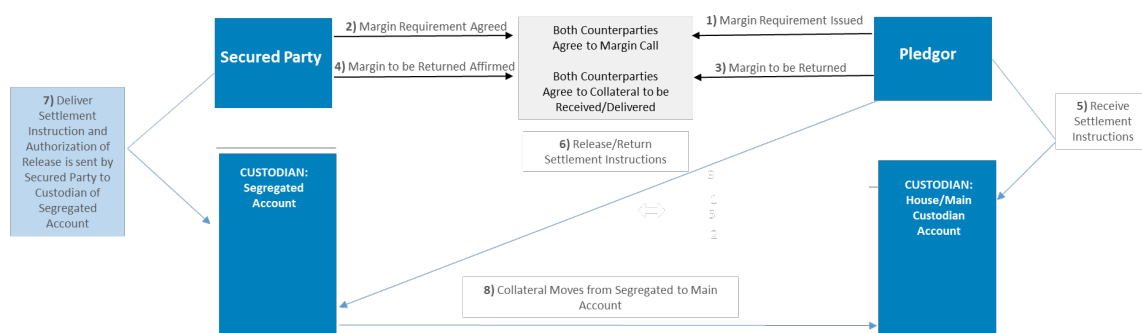
Third Party Custodian Workflows: Pledge



Release of Collateral

With the third party structure, an authorization of release is necessary to move excess collateral back to the pledgor. In the ACAs or equivalent agreements, there are two methods of release – dual authorization (both parties instruct and authorize), and single (only the secured party instructs/authorizes), and this reference in the ACA or equivalent agreements can impact workflow and settlement instruction details.

Third Party Custodian Workflows: Return



Updates and Reporting

In most cases, settlement updates and EOD Position reporting is sent from the custodian(s) to both the secured party and the pledgor. However, in a hybrid model between a triparty provider and a third party custodian working together on behalf of the pledgor or the secured party, it is important to confirm which provider is responsible for settlement updates and EOD reporting.

Triparty and Third Party

It is possible that within a counterparty pair, one counterparty may pledge via triparty and the other via third party.

5 Appendix

SWIFT Messages

Message Format	General Description/Purpose	Cash/Securities
MT202	Deliver Payment Instruction	Cash
MT210	Notice to Receive Instruction	Cash
MT296	Reject of MT210 message by Receiver	Cash
MT900	Deliverer Debit Confirmation	Cash
MT910	Receiver Credit Confirmation	Cash
MT996	Reject of MT900, MT910, or MT296 due to failed business rules validation	Cash
MT998	Reject of MT900, MT910, or MT296 due to transformation/parsing issues	Cash
MT540	Receiver Free Instruction	Securities
MT542	Deliver Free Instruction	Securities
MT544	Receiver Free Confirmation	Securities
MT546	Deliver Free Confirmation	Securities
MT548	Settlement Status - advised by Receiver or Deliverer	Securities
MT548	Reject of MT544, MT546, or inbound MT548 due to failed business rules validation	Securities
MT598	Reject of MT544, MT546, or inbound MT548 due to transformation/parsing issues	Securities
MT558	Status Updates	Both
MT527	Triparty Provider Collateral Instruction	Both
MT527	Secured Party's Authorization of Release	Both
MT569	Triparty Provider Collateral and Exposure Statement	Both
MT940	Statement of Holdings	Cash
MT950	Statement of Holdings	Cash
MT535	Statement of Holdings	Securities
MT536	Statement of Holdings	Securities