October 2020

ISDA®

Whitepaper: Collaboration and Standardization Opportunities in Derivatives and SFT Markets

CONTENTS

EXECUTIVE SUMMARY

Financial market participants around the world share a common goal and a common challenge: to increase margins and profitability by more efficiently deploying capital and other resources while maintaining strong balance sheets.

One of the important ways firms are working towards this is by standardizing and automating processes and functions. These efforts are occurring on an individual basis within institutions. They are also occurring on a collaborative basis across firms, in the form of various industry utilities and trade association initiatives.

ISDA believes an important opportunity exists to further expand these efforts. This paper explains and illustrates how and why two large, important and interconnected markets – derivatives and securities financing transactions (SFTs) – could collaborate to achieve greater standardization and improved efficiency.

Key elements of such an approach would include:

- Developing common legal definitions across the derivatives and SFT markets, documenting derivatives and SFTs under a common master agreement and procuring one set of legal opinions in jurisdictions around the world on close-out netting for both derivatives and SFTs.

- Implementing consistent solutions across the derivatives and SFT markets that enable market participants to more seamlessly adapt and migrate when key changes (such as the interbank offered rate (IBOR) transition) occur.

- Facilitating the digitization of the derivatives and SFT markets, in terms of both negotiating and documenting trades, and developing a consistent trade record for confirmations and reporting, with standardized trade content and formats.

The benefits of such an approach could be significant. These benefits would include increased operating efficiency (by reducing duplicative efforts, scaling legal work and digitizing/automating processes) and potentially reduced credit risk (by facilitating collateral payment netting and expanding close-out netting sets, which could favorably impact firms' capital).

There are of course significant challenges that market participants would confront on the road to increasing collaboration and standardization across the derivatives and SFT markets. All joint legal work, for example, would need to recognize and preserve the unique characteristics that define products in individual market segments. In addition, transition by a particular market segment to a newly derived definition of a term for use across markets would need to factor in whether and how a legacy book of business can and should be migrated to the new standard, and how that might influence adoption of the new term.

Because of the benefits that increased collaboration and standardization appear to offer, and to assist market participants in considering alignment between derivatives and SFT markets, ISDA has developed this paper.

The first part provides an overview of the repo, stock loan and derivatives markets, discusses their interconnectedness, outlines opportunities for efficiencies and describes the potential benefits of realizing such efficiencies.

The second part sets out a proposal for how this could be achieved. It provides a path for expanding the ISDA Master Agreement so it could be used to document both derivatives and SFTs. It also considers certain key issues that would need to be addressed in such an exercise, and includes a granular analysis of key terms from the different documents to identify specific potential synergies, as well as those key product terms where specificity would need to be maintained.

ISDA hopes this paper will elicit constructive dialogue and analysis among derivatives and SFT market participants on the benefits, challenges and feasibility of a more collaborative and standardized approach in these key financial segments.

INTRODUCTION

Repurchase transactions (repos) and securities lending transactions (stock loans and, together with repos, SFTs[1]) and derivatives transactions are used by similar market participants, share a number of common features and are documented under similarly structured agreements. Despite this, the SFT and derivatives markets use different terminology for the same concepts and different processes or methodologies to accomplish the same goals. This limits the ability to achieve synergies and efficiencies between these markets and potentially risks creating unintended inconsistencies across them.

While there are undoubtedly some differences that are required due to the nature of the repo, securities lending and derivatives markets, ISDA believes there is an opportunity to put in place common standards with respect to the terminology and documentation used in these markets. This, in turn, can mean that a common solution is found by automating and updating the documentation in each market. Similarly, pre- and post-trade processes can be standardized, bringing an enhanced level of efficiency across the SFT and derivatives markets.

Part 1 of this paper:

- Provides an overview of what repos, stock loans and derivatives are, how they are documented and the overall size of those markets;
- Discusses the interconnectedness of the SFT and derivatives markets;
- Describes how the SFT and derivatives markets have developed in a manner that has created the opportunity for efficiencies; and
- Describes the potential efficiencies and benefits that could be achieved through the harmonization of those markets.

Part 2 of this paper:

- Sets out ISDA's proposals on how the ISDA Master Agreement could be expanded to document SFTs in addition to derivatives; and
- Includes a high-level analysis of some legal, tax and regulatory considerations, and highlights some key points where further feedback from members would be needed.

Rather than having multiple sets of master documentation, significant market efficiencies could be achieved if market participants were able to use the ISDA Master Agreement and other ISDA documentation to transact SFTs as well as derivatives.

[1] The term SFT in this paper is not intended to have the same meaning as securities financing transactions as defined in the Securities Financing Transactions Regulation, which includes commodity loans and repos, and margin lending. It is intended to cover securities loans and repos or buy-sell back transactions relating to securities

PART 1

OVERVIEW OF REPOS, STOCK LOANS AND DERIVATIVES

Repos

What Are Repos and How Are They Documented?

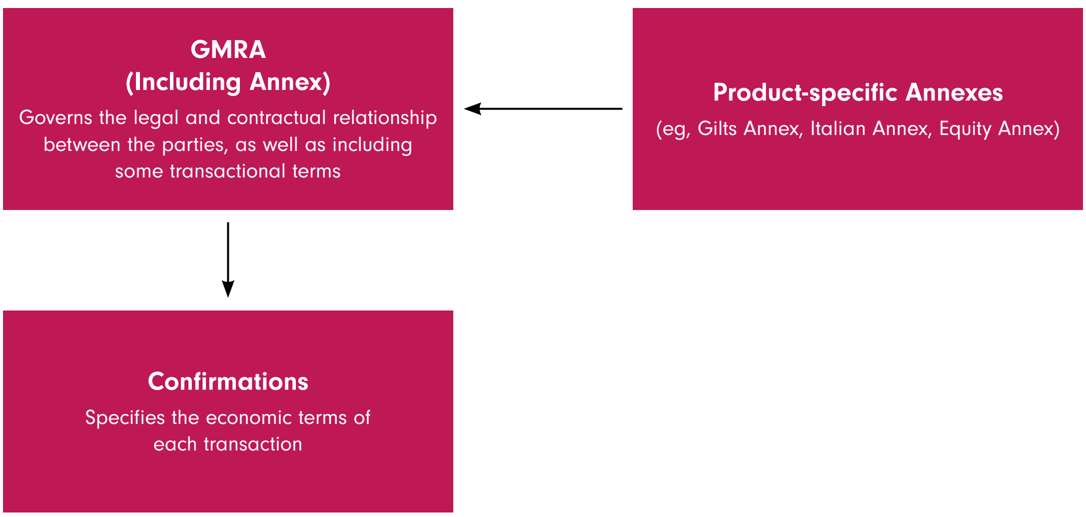
A repo is a transaction involving the sale of a security or other asset with a commitment by the seller to buy an equivalent asset back from the purchaser at a specified price, on demand or on a designated future date.

Repos function commercially as a form of secured lending. The seller of the securities raises financing on a short-term basis and the buyer receives a return on the funds transferred. The return is the difference between the price at which it buys the assets from, and sells the assets back to, the seller, with the price calculated based on interest rates for the financing. The return does not change according to market fluctuations in the value of the purchased securities.

Repos are typically documented under the Global Master Repurchase Agreement (GMRA) (English law) or Master Repurchase Agreement (MRA) (New York law). For simplicity, this paper refers only to the GMRA. The GMRA is a form of master agreement – ie, an agreement containing standard terms applicable to all transactions documented under that agreement. The GMRA comprises a pre-printed form of agreement containing standard provisions that are generic to the repo market and a negotiated annex containing elections and any supplemental terms agreed between the parties (see Figure 1). The GMRA also includes a number of additional optional annexes setting out additional or alternative terms relating to repos of equities, repos transacted by an agent on behalf of a principal, repos in the form of buy-/sell-backs and repos of certain domestic securities (eg, UK gilts and Italian securities).

Most of the terms of the repo are found within the GMRA. The remaining transaction-specific, key economic variables (eg, number of securities, repo rate and repurchase date) are recorded in a confirmation. A separate confirmation is entered into for each repo.

Figure 1: GMRA Documentation Structure



The Repo Market

Repo markets are an essential source of secured financing for banks and financial institutions, with a significant volume of that financing coming from central banks. The largest repo markets are in Europe and the US, with active repo markets in approximately 40 other countries[2].

The average size of daily outstanding notional in the European repo market in 2019 was approximately €8.3 trillion[3].

The average size of daily outstanding notional in the US repo market in 2019 was approximately $4.5 trillion, split between $2 trillion of repos and $2.5 trillion of reverse repos[4,5].

Stock Loans

What Are Stock Loans and How Are They Documented?

A stock loan is a form of transaction where securities are transferred from one party (the lender) to another party (the borrower) for a fee. The borrower is obligated to return equivalent securities, either on demand or at the end of an agreed term. Any type of securities can be used for this purpose, including shares, government bonds or corporate bonds, although shares are the most common.

The borrower pays a stock lending fee for the use of the securities and provides collateral against its obligation to re-deliver equivalent securities, in the form of cash, other securities or standby letters of credit.

The motivation for entering into a stock loan is typically the desire of the borrower to acquire the particular securities being lent (in particular, to settle short sales and avoid settlement failures) and the lender's desire to make a return on lending such securities. In this respect, stock loans differ from repos. However, when the borrower provides cash as collateral under the stock loan, the transaction looks very similar to a repo.

Stock loans are typically documented under the Global Master Securities Lending Agreement (GMSLA) (English law) or Master Securities Lending Agreement (MSLA) (New York law). For simplicity, this paper refers only to the GMSLA. Like the GMRA, the GMSLA is a form of master agreement, comprising a pre-printed form of agreement containing standard provisions that are generic to the securities lending market and a negotiated schedule containing elections and any supplemental terms agreed between the parties (see Figure 2).

As with the GMRA, most of the terms of the stock loan are included in the GMSLA. The parties will then enter into a confirmation for each individual stock loan, which records the key economic variables for that transaction (eg, number of securities, agreed term of the loan and stock lending fee).

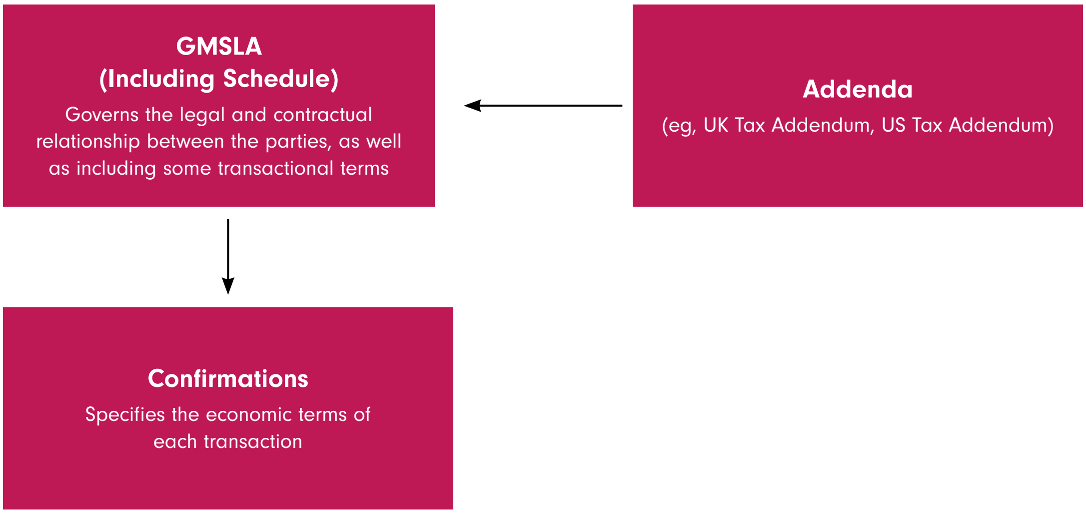
[2] 'Frequently Asked Questions on Repo' on the International Capital Market Association (ICMA) website - https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/repo-and-collateral-markets/icma-ercc-publications/frequently-asked-questions-on-repo/

[3] ICMA's semi-annual survey of the European repo market in December 2019 (published in April 2020) - https://www.icmagroup.org/assets/documents/Regulatory/Repo/Surveys/ICMA-European-repo-market-survey-number-38-conducted-December-2019-210420.pdf. This figure is based on data from the 58 most active participants in the European repo market

[4] A reverse repo is the mirror of a repo. In a reverse repo, one party purchases a security or other asset with a commitment to sell back an equivalent asset at a specified price, on demand or on a designated future date

[5] Based on data published on the Securities Industry and Financial Markets Association website

Figure 2: GMSLA Documentation Structure



The Securities Lending Market

The securities lending market is primarily focused in Europe and the US. As at December 31, 2019, the reported global on-loan balances for stock loans were approximately €2.3 trillion[6].

Derivatives

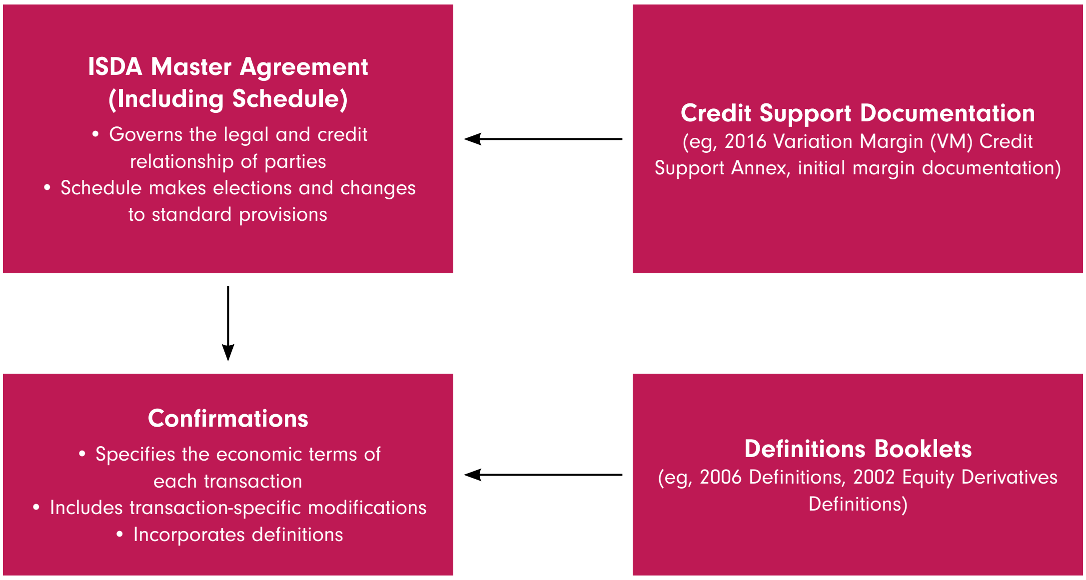
What Are Derivatives and How Are They Documented?

A derivative is a financial instrument under which the future obligations of one or more of the parties reference, or are linked to, an asset, entity, index or other variable (known as the underlying). A wide range of financial assets, indices and variables can be referenced, including equities or equity indices, fixed-income instruments, foreign currencies, commodities, weather and inflation.

In general, derivatives transactions are documented under the ISDA Master Agreement. Like the GMRA and GMSLA, the ISDA Master Agreement comprises a pre-printed form of agreement and a negotiated schedule. However, unlike the GMRA and GMSLA, the ISDA Master Agreement is not product-specific. This is reflected in its modular architecture, with relationship terms, product terms, collateral terms and economic trading terms set out in separate documents (see Figure 3). In contrast, product terms are set out in the GMRA and GMSLA (and, in the case of the GMRA, in the annexes to the master agreement).

[6] ISLA's Securities Lending Market Report – 12th Edition (February 2020) - https://www.isla.co.uk/assets/smart-pdfs/isla-securities-lending-market-report-february-2020/files/downloads/ISLA_SLReport_Feb2020_spreads.pdf

Figure 3: ISDA Master Agreement Documentation Structure



The Derivatives Markets

The largest derivatives markets are in Europe, the US and Asia. As at June 30, 2019, the outstanding notional of derivatives transactions was $640.4 trillion[7].

Interconnectedness and Overlap of the Repo, Securities Lending and Derivatives Markets

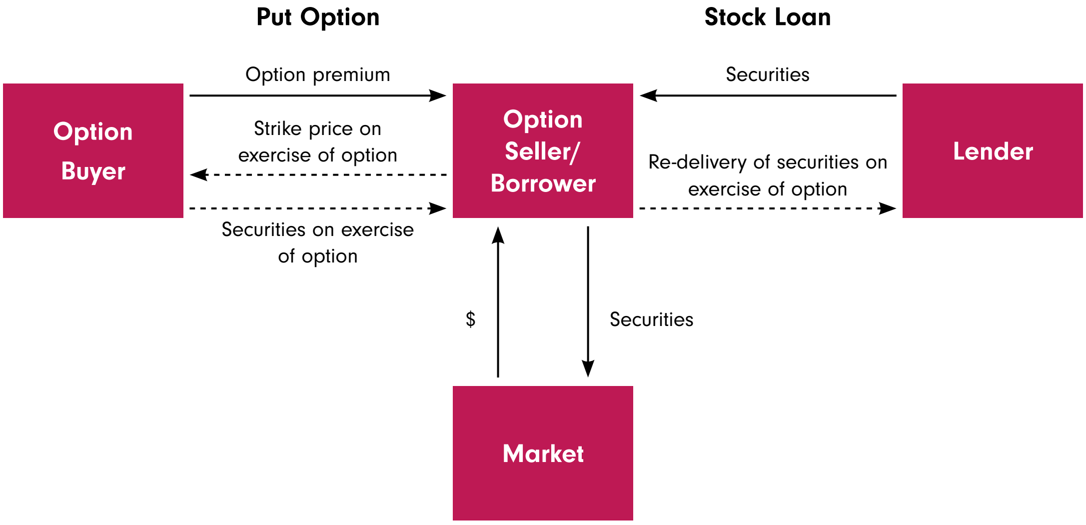
The SFT and derivatives markets already interconnect in a number of ways. The following sections list some examples of how this occurs with repos, stock loans and derivatives transactions, whether as components of the same wider transaction or as a product that enables or optimizes the entry into one of the other products.

Equity Derivatives and Stock Loans

Stock loans are used for financing, hedging and pricing purposes in respect of equity derivatives. For example, if a dealer (the option seller) enters into an equity derivative (such as a put option), a stock loan can be used to hedge the option (see Figure 4). If the option seller entered into the option alone, it would be exposed to the risk that the share price falls below the strike price of the option. However, if the option seller can also enter into a stock loan as borrower and immediately sell the securities it borrows in the market at their current price, it will have hedged this risk. The option seller may enter into further hedging transactions during the life of the transaction as the delta of the option changes.

[7] Bank for International Settlements OTC Derivatives Statistics https://stats.bis.org/statx/srs/table/d5.1?f=pdf

Figure 4: Use of a Stock Loan to Hedge a Put Option



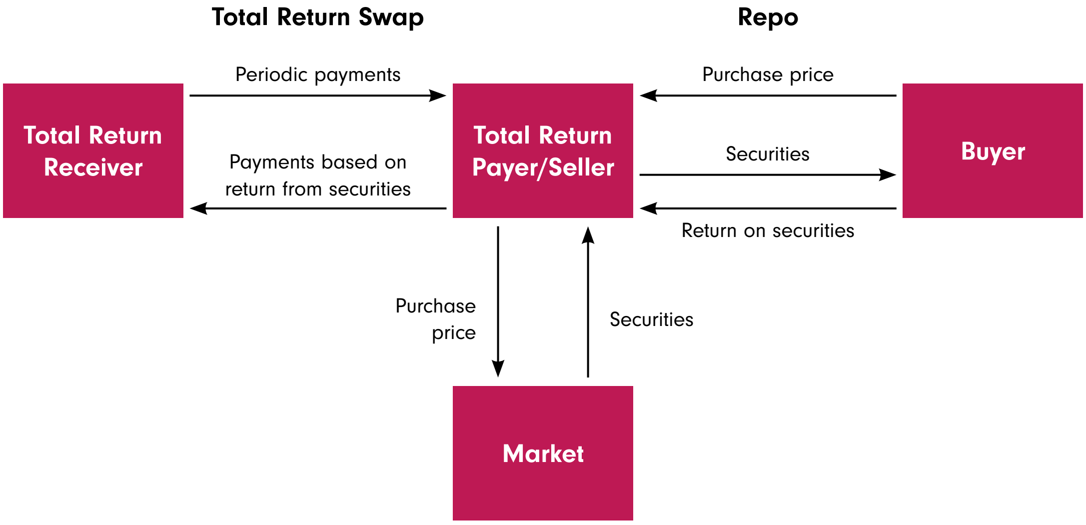
Total Return Swaps and Repos

Repos are used for financing, hedging and pricing purposes in respect of total return swaps[8]. For example, if a market participant takes a short position under a total return swap, it may finance the hedge for that position via a repo (see Figure 5). Due to the similar economic effect that can be created by total return swaps and repos, some market participants will use these instruments interchangeably[9].

[8] Similarly, certain derivatives, like repos, can also be used as investments if, for example, an investor purchases a future on an index in order to gain exposure to the share market and subsequently chooses to roll over the future. While repos are not themselves hedging instruments, they can be used to hedge some derivatives (such as floating rate agreements and floating rate swaps). See Is the Repo a Derivative? Pierre Faure, African Review of Economics and Finance, 2011

[9] A total return swap is a form of swap whereby one party makes payments based on the return of a reference asset such as a bond, equity or index and the other party makes payments based on a set rate (normally either a fixed or floating rate of interest). For example, if Party A and Party B enter into a total return swap, where the reference asset is gilts with Party A as the total return payer and Party B as the total return receiver, Party A will be synthetically short gilts and Party B will be synthetically long gilts. Under the total return swap, Party A will make payments to Party B based on the return from the gilts (including any appreciation in the value of the gilts). Party B will make periodic payments to Party A based on a fixed or floating rate, as well as payments resulting from any depreciation in the value of the gilts. In this example, the total return swap is being used as a means of Party A providing exposure to the gilts to Party B on a financed basis. This is similar to the economic purpose behind the parties entering into a repo over the gilts where Party A acts as buyer and Party B acts as seller. However, the repo will also the involve the sale of gilts by Party B to Party A at the outset and the resale of gilts from Party A to Party B at the conclusion of the transaction, so there are additional funding and asset availability considerations under a repo as compared to a total return swap. Based on their particular facts and circumstances, parties may therefore be able to choose whether to document certain transactions as repos, stock loans or derivatives, knowing that they can achieve the same or a very similar overall economic purpose

Figure 5: Use of a Repo to Finance the Hedge for a Total Return Swap



Collateral Management

The introduction of regulatory requirements to clear certain derivatives transactions and to margin non-cleared derivatives transactions, as well as capital and leverage requirements, have increased the demand for eligible high-quality liquid assets. SFTs are used by derivatives market participants to source the collateral they need to meet their margin requirements for both cleared and non-cleared transactions.

Examples of this include:

- Collateral transformation: Market participants can use SFTs to source eligible collateral, or exchange their assets for eligible collateral, to meet their regulatory margin obligations.

- Collateral optimization: SFTs are used in optimizing collateral so market participants can meet their regulatory margin obligations in a cheaper and more efficient manner.

The Case for Harmonization of the Repo, Securities Lending and Derivatives Markets

The size of each of the repo, securities lending and derivatives markets has significantly increased over the past 30 years, as each instrument has established an integral place in the financial markets[10].

As the drivers for using SFTs and derivatives transactions have begun to intersect and overlap, similar legal and commercial issues have arisen with respect to both SFTs and derivatives transactions. Additionally, these commonalities may have led to the application of similar regulations to both the SFT and derivatives markets. Unsurprisingly, each market has developed similar documentation structures and products to resolve some of these legal, commercial and regulatory issues.

[10] Repos and stock loans allow market participants to monetize their securities holdings and repos are also a common tool used by central banks to support monetary policy and financial market stability. Although originally introduced as a method of risk management for market participants, the use of derivatives has expanded significantly, with derivatives now also being used, among other things, to take synthetic positions on the performance of an asset and provide alternative forms of financing

If a uniform approach is developed for these markets, participants would be able to efficiently adopt one approach, rather than implementing multiple solutions to the same problem, depending on the relevant type of financial instrument.

As all three markets look to invest in technology to achieve operational efficiencies, it is important that such technology is built on a strong common foundation so it can operate seamlessly across these markets.

Overlapping Market Participants

Participants in the SFT and derivatives markets have traditionally overlapped. Banks (including investment banks, commercial banks and central banks), prime brokers, funds (including hedge funds, pension funds and sovereign wealth funds) and market infrastructures (such as clearing houses) are among the biggest players in both the derivatives and SFT markets.

Prime brokers are a particularly good example of this type of market participant, as they routinely enter into both SFTs and derivatives transactions with, or on behalf of, clients, and re-hypothecate client assets to facilitate trading activities on their behalf.

Given the number of services offered by prime brokers, these firms are looking for efficiencies in the way they offer those services. Along with other entities trading both SFTs and derivatives, they could benefit from less complexity in the documentation they need to enter into with their clients, as well as a streamlining of the post-trade processing and collateral management they undertake on behalf of those clients.

Similar Documentation Structure

Repos, stock loans and derivatives are all documented under master agreements, which provide framework terms that apply to all transactions between the parties. Elections are made in a schedule or annex, potentially with additional terms set out in annexes and/or definitional booklets, and individual transactions are documented under a confirmation.

Although certain terms in each master agreement (or its accompanying definitional booklets in the case of the ISDA Master Agreement) are product specific, there is significant overlap between other terms in each master agreement, particularly the relationship terms in each agreement.

The overlapping terms in the GMRA, GMSLA and ISDA Master Agreement include:

- Default and termination provisions: Each agreement contains events of default triggered by a failure to pay or deliver[11], insolvency, misrepresentation, admission by a party of its inability or intention not to perform, and breach of obligations under the agreement not already covered by other events of default. Under each agreement, following the occurrence of an event of default, the non-defaulting party may, by way of notice to the defaulting party, trigger the close-out of all outstanding transactions under the agreement and calculate a termination amount payable between the parties.

[11] Both the GMRA and GMSLA generally operate on the basis that failure to deliver securities or redeliver equivalent securities is not an event of default that could trigger termination of all transactions under that master document, but instead enables the other party to elect to close out the relevant transaction

- Representations and warranties: Each agreement contains representations (or, in the case of the GMSLA, warranties) relating to each party's status and authority and capacity to execute the agreement and any transactions thereunder.

- Notice provisions: Under each agreement, notices may be sent by post, fax or electronically. Under each agreement, the delivery rules vary depending on the means used, but broadly involve the notice's arrival within the receiver's sphere of control, except where this is not on a business day.

- Definitions: A number of generic definitions are included in each of the GMRA, GMSLA and ISDA Master Agreement. These include definitions relating to business day, insolvency, income, dividends and tax.

Both SFT and Derivatives Users Rely on Industry Opinions on Close-out Netting

Close-out netting is a key method of reducing the credit risk involved in entering into multiple transactions. It is one of the main reasons why SFTs and derivatives are documented under master agreements.

Close-out netting consists of three parts: (i) early termination of transactions following the default of a party to the agreement; (ii) valuation of the defaulted transactions; and (iii) calculation of a single termination amount with respect to all transactions under the master agreement by offsetting the value of each transaction under the agreement.

Close-out netting, in effect, allows the parties to a master agreement to treat all transactions under that agreement as a single transaction. This avoids the situation where a counterparty is subject to insolvency proceedings and the insolvency official tries to disclaim contracts that are out of the money (ie, where the insolvent party would be required to make a payment) but collect under all transactions that are in the money (ie, where the insolvent party would be owed a payment). This is commonly referred to as 'cherry picking'.

It is vital that market participants can rely on the enforceability of close-out netting provisions under each of their master agreements, both to reduce their credit risk and because such opinions allow for more favorable regulatory capital treatment.

Consequently, industry bodies in each of the SFT and derivatives markets have published legal opinions covering the enforceability of close-out netting provisions under each of their industry master agreements. Opinions are available for a significant number of jurisdictions worldwide.

Although ISDA publishes its own opinions on the ISDA Master Agreement, the International Securities Lending Association (ISLA) and International Capital Market Association (ICMA) began publishing a joint opinion on the enforceability of close-out netting under the GMRA and GMSLA in 2020. This comprises a core opinion covering both the GMRA and the GMSLA, with specific appendices for the GMRA and GMSLA, respectively. Separate opinions are published by the Securities Industry and Financial Markets Association in respect of the MRA, MSLA and Master Securities Forward Transaction Agreement (MSFTA).

Similar Regulatory Treatment of SFTs and Derivatives

There are several examples of legislation and regulatory reforms that affect both the SFT and derivatives market in a similar way. Market participants may find it beneficial from a compliance, efficiency and cost perspective to use one set of documents when complying with similar regulatory requirements.

Examples include:

Interest Rate Reform

IBORs, and in particular LIBOR, have set the benchmark rate for lending on an unsecured basis for a number of years, and are consequently referenced in significant numbers of SFTs and derivatives transactions. With the continuation of LIBOR not guaranteed beyond the end of 2021, SFT and derivatives market participants need to take action to update their documentation to include robust fallbacks. This will allow transition to alternative risk-free rates (RFRs) if an IBOR ceases to be published (or, in the case of LIBOR, is deemed to no longer be representative), and ensure any new transactions entered into reference the RFRs.

Some Overlap with Respect to the CRR

The Capital Requirements Regulation (CRR) and the US regulatory capital adequacy standards apply to both SFTs and derivatives.

Generally, the CRR requires the exposure value of derivatives for credit risk purposes to be determined in accordance with certain rules, and allows the exposure value of stock loans and repos to be determined either in accordance with the derivatives rules or in accordance with certain other rules. To the extent that the derivatives rules and certain other rules relate to netting (as opposed to, for example, requirements over the eligibility or type of collateral, or operational requirements), there is significant overlap between these rules. In particular, they require that: (i) the netting arrangement must be legally effective and enforceable in all relevant jurisdictions; and (ii) institutions must be able to provide to their regulators the most recent version of an independent, written and reasoned legal opinion to that effect.

Institutions generally rely on the industry standard opinions that establish the enforceability of netting under their GMRAs, GMSLAs and ISDA Master Agreements (or any other industry standard agreements under which they document stock loans, repos or derivatives) in order to satisfy these requirements.

Under the US capital standards, banking organizations must risk weight their exposures under derivatives, stock loans and repos under the standard approaches methodology and, with respect to most internationally active banks subject to the US capital standards, the advanced approaches methodology. As with the CRR, banking organizations are able to recognize the credit risk mitigation of netting and collateral arrangements.

Similar to the CRR, to qualify for netting treatment, a banking organization subject to the US capital standards must undertake a sufficient legal review to conclude with a well-founded basis that the agreement is enforceable in the relevant jurisdictions, and must also monitor possible changes in relevant law that may affect enforceability. The banking organization must maintain and produce to regulators written documentation of that legal review. Financial institutions may rely on industry standard opinions in connection with satisfying these requirements.

Certain Bankruptcy Related Regulations Apply to Both SFTs and Derivatives

Another example of legislation applicable to both the SFT and derivatives markets is the EU Bank Recovery and Resolution Directive (BRRD)[12]. The BRRD in general allows EU resolution authorities to maintain the critical functions of failed banks by requiring certain financial institutions located in the European Economic Area (EEA) to include bail-in provisions in their agreements, if such agreements are governed by a non-EEA law. These provisions require counterparties to recognize that the contract may be subject to the exercise of bail-in powers[13] and agree to the jurisdiction of an EEA resolution authority.

The contractual recognition of bail-in obligation applies to a broad range of financial instruments, including SFTs and derivatives transactions. Each non-EEA law governed agreement entered into by in-scope EEA financial institutions for SFTs or derivatives transactions must therefore include appropriate language that would recognize the bail-in obligation. Such agreements would include ISDA Master Agreements, GMRAs, GMSLAs and any other agreements used by in-scope entities to enter into SFTs or derivatives transactions.

In the US, the Qualified Financial Contract (QFC) Stay Rules require US global systemically important banking organizations (G-SIBs), their subsidiaries and the US subsidiaries of non-US G-SIBs (collectively known as covered entities) to include contractual restrictions on the exercise of certain default rights in their QFCs. This is aimed at mitigating the risk of destabilizing close-outs of covered entities' QFCs, which is perceived to be an impediment to the orderly resolution of a G-SIB[14].

Like the BRRD, the QFC Stay Rules apply to a broad range of financial instruments, including SFTs and derivatives transactions. Appropriate language must therefore be included in each agreement used by parties to document SFTs or derivatives transactions, including their ISDA Master Agreements, GMRAs and GMSLAs.

Regulatory Reporting

The regulatory reporting requirements applicable to SFTs under the Securities Financing Transactions Regulation (SFTR)[15], which is currently being phased in, are similar to reporting requirements for derivatives transactions under the European Market Infrastructure Regulation (EMIR)[16].

Under both regimes, parties are required to report the conclusion, modification or termination of a transaction to a trade repository by the following business day. The contents of those reports also overlap significantly. The similarity of these regulatory obligations makes it logical to streamline the processes used for reporting and develop cross-market solutions to reporting derivatives transactions and SFTs.

One example of a cross-market solution that exists today is the Master Regulatory Reporting Agreement (MRRA). Published in December 2019, the MRRA gives market participants the option to use a single template to help them manage regulatory obligations and provide services related to reporting under EMIR and the SFTR.

---

12 Directive 2014/59/EU of May 15, 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms

13 Bail-in powers include powers to write down debt owed to creditors, convert debt to equity or impose temporary stay on termination rights

14 These restrictions include requiring express recognition of the stay-and-transfer treatment of the US Federal Deposit Insurance Act and the Orderly Liquidation Authority to reduce the risk that those powers would be challenged in a foreign jurisdiction

15 Regulation 2015/2365 of November 25, 2015 on transparency of securities financing transactions and of reuse and amending Regulation 648/2012

16 Regulation 648/2012 of the European Parliament and of the Council of July 4, 2012 on derivatives, central counterparties and trade repositories

Consultations have also begun on amending the rules on what is reportable under EMIR, partly in order to bring those rules more in line with the requirements more recently introduced under the SFTR. This may bolster market support for streamlining the processes for reporting across the SFT and derivatives markets.

Potential Industry Solutions to Improve Efficiencies Between Derivatives and SFT Markets

The similarities between the SFT and derivatives markets provide a number of opportunities to introduce efficiencies to both markets through the standardization and development of processes and technological solutions. The possible solutions outlined in this section are intended to create greater efficiency, with resulting cost savings, as well as increase the potential for greater innovation across the SFT and derivatives markets.

Streamlining Common Terminology, Documentation and Definitional Booklets

Repos, stock loans and derivatives are all documented under master agreements, which include overlapping terms.

A number of definitions are common to ISDA Master Agreements, GMRAs and GMSLAs. However, the same terms are not always defined in an entirely consistent manner across all three sets of documentation, creating ambiguities and compliance challenges.

Take the definition of insolvency as an example. In the context of bankruptcy proceedings, an event of default[17] occurs under both the 2011 GMRA and the 2010 GMSLA if the administrator is appointed with respect to “all or any material part of such party’s property”[18]. In comparison, an event of default occurs under the ISDA 2002 Master Agreement if the administrator is appointed with respect to “all or substantially all of its assets”[19].

To illustrate this point, suppose a bankruptcy administrator is appointed to monitor the bankruptcy of the factories of a manufacturing company, but not the company’s holdings in other commercial real estate. In this case, the inconsistency between the insolvency definitions under both the GMRA and GMSLA and the ISDA 2002 Master Agreement could produce disparate outcomes. Under the GMRA and GMSLA, the bankruptcy of the factories is likely to constitute an event of default, as the administrator has been appointed with respect of assets that form a material part of the company’s property.

However, if the company also had a number of other real estate holdings, the bankruptcy of the factories may not be considered an event of default under the ISDA 2002 Master Agreement, as the administrator would not have been appointed with respect to ‘substantially all’ of the assets of the company. The occurrence of the bankruptcy of the factories would therefore give the entity’s counterparties the right to close out under any GMRAs or GMSLAs they had in place, but not under any ISDA Master Agreements.

[17] See paragraph 10(a)(vi) of the 2011 GMRA and paragraph 10.1(d) of the 2010 GMSLA

[18] 2011 GMRA, limb (vi) of the definition of ‘Act of Insolvency’; 2010 GMSLA, limb (e) of the definition of ‘Act of Insolvency’

[19] Section 5(a)(vii)(6), ISDA 2002 Master Agreement. The insolvency event of default under the 1992 ISDA Master Agreement is similar, although worded slightly differently. For the purposes of this example, the focus is on the ISDA 2002 Master Agreement

While certain differences may need to exist between SFT and derivatives documentation, potential areas of alignment could also include:

- Default and termination provisions;
- Representations;
- The range of governing laws and jurisdiction clauses that can be elected under each agreement; and
- Notice provisions.

A common documentation standard could reduce operational costs, as parties could program their systems to reflect one documentation standard with consistent definitions and avoid having to accommodate similar (but not exact) definitions under the relevant agreements.

The recent COVID-19 crisis has highlighted the importance of such standardization. During the pandemic, market participants had to review provisions across a number of agreements to determine how default notices could be delivered separately under both derivatives and SFT documentation. If market participants had in place a common form of notice, and a standard method for delivery of default notices for SFTs and derivatives transactions, then unnecessary complexity and the resulting operational costs could have been reduced.

A harmonized approach to updating documentation across SFTs and derivatives markets can be achieved through the use of protocols[20] or automation and negotiation platforms. This is particularly relevant where parties' SFT and derivatives documentation needs to be updated in response to legal or regulatory requirements, such as the BRRD and interest rate reform.

ISDA has used protocols for many years to enable market participants to update their agreements to reflect regulatory change. Traditionally, these protocols have been restricted to updates to ISDA Master Agreements and other derivatives documentation. However, ISDA has published some protocols that can be used to amend GMRAs, GMSLAs and other SFT documentation, in addition to ISDA Master Agreements, which could help market participants comply with the BRRD and the QFC Stay Rules.

Specifically, these protocols allow market participants to amend their SFT and derivatives contracts holistically, across counterparties (rather than renegotiating every agreement with each counterparty to include the required regulatory language)[21].

Certain future ISDA protocols are also intended to cover SFT documentation, in addition to ISDA Master Agreements. These include the ISDA 2020 IBOR Fallbacks Protocol, which market participants can use to incorporate fallbacks for certain key IBORs into existing transactions.

Industry bodies are increasingly working together to agree on coordinated approaches to regulatory change (eg, the current reforms to interest rates are being coordinated across the derivatives, SFT, loan and bond markets). As market participants develop common solutions, it makes sense for markets with similar documentation structures (such as the SFT and derivatives markets) to implement these changes on a cross-industry basis.

[20] A protocol is a multilateral contractual amendment mechanism that allows for various standardized amendments to be deemed to be made to all in-scope agreements between a market participant that adheres (ie, signs up) to the protocol and all of its counterparties that have also adhered to the protocol

[21] For example, by adhering to an ISDA bail-in protocol, a market participant will be deemed to have included contractual recognition of bail-in language in all of its in-scope SFT and derivatives master agreements that are not governed by EEA law with their counterparties that have also adhered to the protocol. This language will only be deemed to be included where one of the parties to the contract is an in-scope EEA financial institution that may be subject to resolution under the BRRD

Protocols are a simple way of implementing such cross-industry amendments. They have always provided an efficient method for updating documentation because parties are only required to adhere to one protocol to amend all in-scope agreements with other adhering parties. Protocols also eliminate any need for bilateral negotiations between parties (and the costs involved in such processes) in order to implement such updates. Extending protocols to also cover SFT documentation where relevant increases their efficiency, therefore reducing the need for extended market outreach.

Developing Technological Solutions on a Cross-market Basis

The SFT and derivatives markets are increasingly looking to rely on, and invest in, technology. The similar documentation structure for SFTs and derivatives should make it possible to develop technology on a cross-market basis. By developing technology for use by all three markets, and extending any existing technology across these markets, participants can create single solutions to issues affecting both SFTs and derivatives, and further leverage the economies of scale that technology has to offer.

Documentation and Negotiation Platforms

Although industry standard documentation is available for repos, stock loans and derivatives transactions, these documents are generally negotiated and amended on a bilateral unstructured basis. This adds time and complexity to the negotiation process and results in inconsistency across each market – often due to the drafting approach taken by each firm rather than substantive commercial disagreement.

ISDA has brought efficiencies to the process of updating documentation to reflect legal or regulatory requirements through the publication of protocols that parties can use to amend their existing ISDA Master Agreements (and, in certain cases, SFT documentation).

However, protocols are by definition a standard non-negotiable form of amendment that cannot be expected to satisfy the requirements or particularities of all market participants and may not be suitable for day-to-day contract negotiation between parties, which is largely accomplished on a bilateral unstructured basis.

ISDA has begun to address the limitations of protocols and the inefficiencies of bilateral unstructured negotiations for the derivatives market through the introduction of ISDA Create[22], an online platform for the automation, negotiation and execution of derivatives documentation. Firms can currently use ISDA Create to electronically negotiate and execute their regulatory initial margin (IM) documentation. ISDA will extend ISDA Create to other ISDA documents over time, including the ISDA Master Agreement this year, but the technology could also be applied more broadly to the negotiation and execution of repo and securities lending documentation.

A common terminology and documentation standard could increase the benefits provided by technology solutions such as ISDA Create, as it would enable easier comparison of the data produced by the relevant platform across all three markets. It would also make it easier to develop a single amendment process for regulatory updates.

[22] https://www.isda.org/2020/09/10/isda-create-infohub/

A single platform will also be simpler and require less training for staff at each institution, as well as provide a single point of entry for service providers (eg, entities looking to offer onboarding services such as assistance with anti-money laundering (AML) and know-your-counterparty (KYC) checks), thereby increasing the scalability of the solutions those service providers offer.

Application of the Common Domain Model to Other Financial Markets

ISDA has developed a Common Domain Model (CDM), which serves as a blueprint for how derivatives are traded and managed across the trade lifecycle. The market-wide adoption of the CDM would allow for more efficient processing of transactions throughout their lifecycle, including trade confirmation, reporting and settlement. The CDM will provide an authoritative source of data for those trades, thereby avoiding the current drain on resources as a result of parties needing to continually reconcile their trades. The CDM should also remove the risk of trades being reconciled incorrectly.

The CDM has the potential to cover other financial markets, including SFTs. By providing a single data representation of trades across the derivatives and SFT markets, the CDM could provide significant cost savings (through the reduction in trade reconciliation) and address the market need for an efficient solution to this issue.

With a single documentation platform and CDM for the repo, securities lending and derivatives markets, there will be a single entry point for other service providers. This allows pre-trade service providers (such as KYC and AML providers[23]) and post-trade providers (such as analytics, optimization and compression platforms, as well as regulatory reporting services) to integrate their systems with just one standard, increasing the scalability of the solutions they can provide.

Currently, the provision of such services is hampered by the fact that each market participant still operates its own version of the trade record and applies its own processes to that data – whether operational processes, such as trade confirmation and reporting, or legal processes, such as updates to documentation. This provides a high barrier to entry for third-party pre- and post-trade service providers, as it can be difficult to source the data they require from market participants. Once such data has been acquired, it then normally needs to be standardized before it can be used.

A single documentation platform and CDM would remove those barriers to entry, encouraging market participants to outsource a number of their pre- and post-trade processes to service providers. These providers can then offer their services on a more cost-effective basis because of the significant number of trades they can handle.

In the onboarding space, this has the potential to reduce costs for financial services firms and standardize the content and format of information required from their clients across all three markets, providing simpler onboarding.

In the post-trade space, this has the potential to help certain large financial institutions outsource a number of their internal processes, thereby significantly reducing their operational costs. By providing those solutions on a large scale across multiple markets, vendors should be able to reduce the costs they charge their customers, enabling users to run these processes at a lower cost than if they were performed internally.

[23] As part of their onboarding process for new customers, financial services firms are required to carry out know-your-customer checks (checks on the identity and suitability of the client, as well as the risks involved in that business relationship) and anti-money laundering checks on that client. A number of financial services firms will now outsource these checks to external companies

Collateralization of SFTs and Derivatives Transactions

Stock loans and repos are typically collateralized, either on a per-transaction or per-portfolio basis. With the introduction of regulatory requirements to collateralize derivatives transactions, a significant number of derivatives transactions are now also collateralized. This is normally conducted on a portfolio basis.

In order to reduce funding costs for market participants that are required to make or receive separate margin transfers for their portfolios of repos, stock loans and derivatives transactions on a daily basis, entities could net the daily collateral payments calculated for each portfolio (subject to regulatory requirements)[24]. Once the collateral payments payable for a counterparty pair's derivatives portfolio and SFT portfolio have been calculated, those payments could be offset so only a single collateral payment is due on any day for both portfolios.

Netting the payments due between each party will likely reduce the amount the transferring party is required to pay and remove the need for the receiving party to make any payments, thereby reducing the funding requirements of each party. It also eliminates the intraday exposure that would occur if a party makes its collateral transfers early in the day and has to wait for its counterparty to make its collateral transfers[25].

Creating a Common Set of Legal Opinions

Each industry body publishes its own opinion on the enforceability of close-out netting under the relevant master agreement for that industry. These opinions are pre-requisites for some market participants entering into any master agreement documenting SFTs or derivatives transactions. This is because market participants need to confirm an opinion is in place in order to rely on the enforceability of close-out netting under the relevant master agreement. This creates comfort over the level of credit risk against their counterparty and, for certain financial institutions, enables them to reduce their exposure and therefore the amount of credit risk capital they are required to hold.

ISDA believes that the common subject matter and similarities in the analysis required present an opportunity to create a single set of legal opinions, thereby simplifying the scrutiny that market participants would be required to perform for each new agreement. This simplification would be aided by the development of a common documentation standard, as described in earlier sections.

The rationalization process has already begun across the repo and securities lending markets with the publication of the 2020 ISLA and ICMA opinions in a combined format. This comprises a core opinion covering enforceability of netting under both the GMRA and the GMSLA, with specific appendices for the GMRA and GMSLA, respectively. However, separate opinions are still published by the Securities Industry and Financial Markets Association relating to the enforceability of netting under the MRA, MSLA and MSFTA. More can be achieved to create efficiencies, even within the SFT markets, and certainly across the SFT and derivatives markets.

[24] Although netting collateral payments carries significant benefits, it is unlikely that single pool of collateral for an entity's SFT and derivatives portfolios could be created due to regulatory constraints. This is because, according to the non-cleared margin rules in each relevant jurisdiction, market participants must collateralize the full market value of their outstanding derivatives transactions. By combining collateral pools for SFTs and derivatives transactions, this risks the market value of a party's SFT portfolio offsetting the market value of its derivatives portfolio, leading to under-collateralization of parties' derivatives transactions, which may not satisfy regulatory requirements. Therefore, as a minimum, a separate collateral pool should be held for parties' derivatives portfolios, which is distinct from the collateral for their SFT portfolios

[25] Although this proposal does provide potential benefits for market participants, its viability will need to be considered on a case-by-case basis under the regulatory requirements applicable to any pair of counterparties. A cost/benefit analysis will also need to be done regarding the operational impact of this proposal

In 2020, ISDA also expanded the coverage of its e-contract opinions to include GMSLAs. These opinions look at the enforceability of electronically confirmed contracts under the laws of various jurisdictions, in the context of transactions and agreements that may be entered into by means of electronic data exchange or other means of electronic communication.

As the enforceability of netting provisions is at the core of each set of industry opinions, it should be possible to publish one set of opinions to cover SFT and derivatives documentation. While there would be an initial cost in combining the existing industry opinions, making these opinions more accessible across all three markets could unlock significant savings for market participants.

Advocacy and Governance

One of ISDA's main goals is to make the global derivatives markets safer and more efficient. This is partly achieved through advocacy on behalf of its members on a number of issues, such as regulation and business policy.

A significant amount of regulation applies to both the derivatives and SFT markets. Industry bodies representing both markets are therefore frequently advocating on similar issues and have worked together on initiatives to address regulatory requirements, such as the development of the MRRA in 2019.

In order to increase the impact of any advocacy and governance efforts by each industry, efforts should be carried out on a coordinated basis across the derivatives and SFT markets. This would allow both industries to speak with a single voice, increasing the possibility of a regulator being able to implement the changes requested.

For example, in 2018, ISDA, ICMA and ISLA worked together to advocate for amendments to be made to EMIR to exempt transactions resulting from post-trade risk reduction services (eg, compression) from the clearing obligation. This included collaborating on the publication of a whitepaper on the benefits of post-trade risk reduction services[26] in reducing risk in the financial markets, including the SFT and derivatives markets[27]. The closer alignment of the derivatives and SFT markets could encourage more such collaboration on advocacy in the future.

[26] https://www.isda.org/a/TDmEE/EMIR-REFIT-Incentivizing-Post-Trade-Risk-Reduction-Whitepaper.pdf

[27] This resulted in the inclusion of a requirement under EMIR REFIT (Regulation 2019/834) that the European Commission, in cooperation with the European Securities and Markets Authority and the European Systemic Risk Board, assess which trades resulting from post-trade risk reduction services, if any, should be granted an exemption from the clearing obligation under EMIR

PART 2

Similar to Part 1, Part 2 refers to the English law GMRA and the GMSLA, but the proposals are intended to apply equally with respect to SFTs that would currently be documented under other master agreements such as the New York-law MRA, MSLA and MSFTA. For an entity that may currently need to enter into several sets of master documents to conduct SFTs and derivatives, this proposal would permit a single agreement to be used.

SFTs and the Existing ISDA Documentation Architecture

Core Proposal

As noted in Part 1, the ISDA documentation is modular in its approach. It provides great flexibility to document a very broad range of transactions relating to many different products or asset classes, whether high-volume standardized trades or highly bespoke and complex structured transactions.

For example, for a credit derivatives transaction between two counterparties, as well as the ISDA Master Agreement governing the general relationship between the parties, there will be a confirmation for the transaction that incorporates the 2014 Credit derivatives Definitions. Where the confirmation specifies a transaction type that is included in the credit derivatives physical settlement matrix, standard elections for that transaction type are deemed to have been made. This shortens the documentation required, and facilitates straight-through processing and clearing if applicable. The exposures under the transaction will be collateralized under a credit support annex (CSA).

For SFTs, the core documentation proposal would be for new optional additional provisions to be included in the schedule to the ISDA Master Agreement (referred to in this paper as the schedule SFT provisions) and a separate SFT definitional booklet accompanied by template confirmations[28]. These would include all of the relevant changes and terms necessary to reflect the fact that the transaction is an SFT rather than a derivative.

Any changes to the ISDA Master Agreement (and potentially the relevant credit support documentation) required for SFTs, additional generic provisions, relationship/portfolio issues and elections would be made via the schedule SFT provisions. The SFT definitional booklet would operate similarly to ISDA definitional booklets, in that it would include all common SFT transaction terms (see Figure 6).

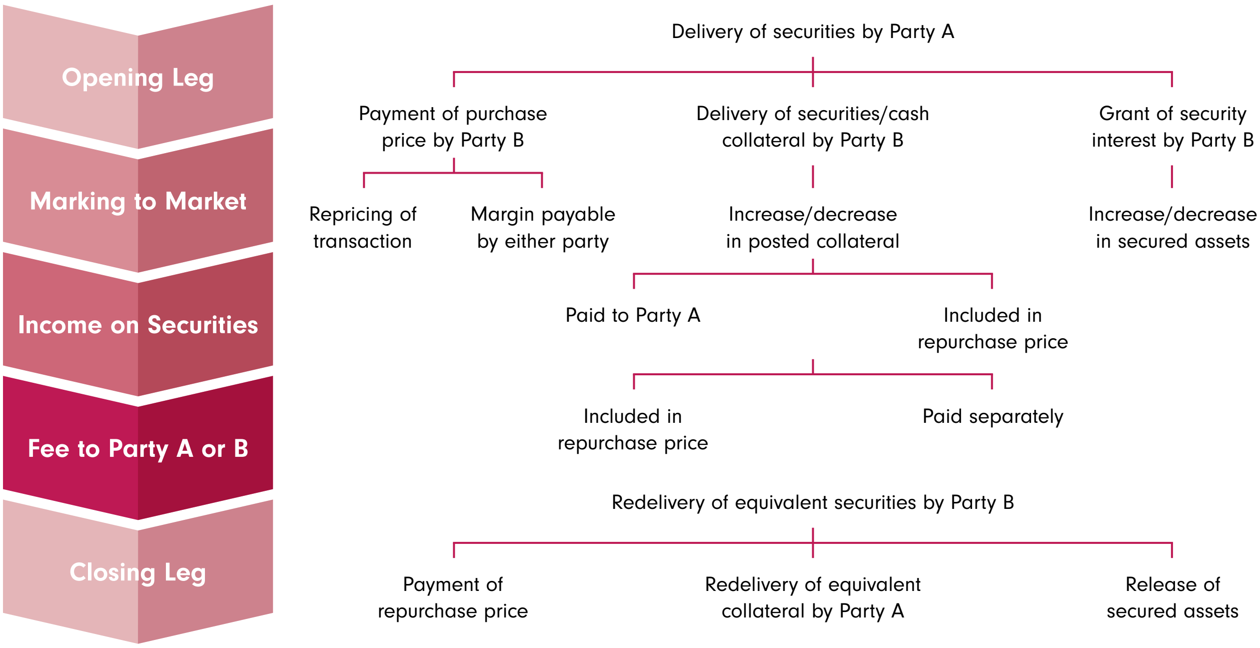
If of interest to members, some master SFT terms (similar to the approach taken for the master confirmation agreements for different types of equity derivatives transactions) could be drafted, which could then be incorporated in specific transaction confirmations.

ISDA's proposal would be to use a single set of schedule SFT provisions and a single SFT definitional booklet for both repos and securities loans, whether effected on a title transfer or secured basis[29]. Again, this should lead to streamlining of documentation, and potentially facilitate straight-through processing (see Figure 6).

[28] These templates would need to allow compliance with any applicable trade confirmation requirements – eg, Securities and Exchange Commission rule 10b-10 for US broker-dealers

[29] This refers in particular to the GMSLA – Security Interest but it is envisaged that the ISDA documentation could be used for transactions involving securities such as Korean and Japanese securities, and China A Shares held via Stock Connect, where currently bespoke changes to the GMRA/GMSLA are sometimes made to cater for SFTs involving such securities. Also, the New York law documents to the extent that they are regarded as involving secured lending

Figure 6: An SFT Transaction



Advantages of Core Proposal

The use of the ISDA Master Agreement documentation for SFTs would avoid the need for multiple sets of master documentation. This could be of great benefit not just to the dealer community but also to prime brokers, and to agent lenders that currently lend securities to dealers under a broad range of different stock lending and repo documentation.

The modular architecture of the ISDA Master Agreement documentation could facilitate greater optionality and flexibility for documenting SFTs compared to the master documentation for SFTs available today.

Currently, the product terms in SFT master agreements are hard-wired into the master agreement itself, which can be problematic if parties wish to adopt operational practices (eg, confirmations of transactions and timing for payment of manufactured dividends) that differ from those specified in the relevant master agreement. Where bespoke stock loan and repo transactions are negotiated, this often involves creating a standalone GMRA or GMSLA for the particular transaction, with extensive amendments to the template GMRA or GMSLA. This leads to cumbersome documentation, and results in separate netting on default.

In the GMRA and GMSLA, matters such as representations, events of default and close-out mechanisms are very similar, which has allowed a common netting opinion to be produced that covers both agreements. However, the current approach to documentation may lead to separate repo and stock lending documents being put in place between two counterparties to effect similar transactions, and separate close-out amounts being calculated following an event of default. Sometimes, cross-default provisions are inserted in the GMRA and GMSLA, and/or a master netting agreement is in place with respect to the close-out amounts under each document, but this adds additional cost and complexity. This is magnified where counterparties have also entered into master repo and/or stock loan documentation governed by New York law.

As well as consolidating terms, concepts and provisions between stock loans and repos under the GMRA and GMSLA, documenting SFTs under the ISDA Master Agreement would achieve similar consolidation between terms, concepts and provisions for derivatives and SFTs. Matters such as events of default are similar between the GMRA, GMSLA and ISDA Master Agreement, but there are some differences that do not appear to be driven by legal or commercial considerations. The ISDA architecture is more flexible than the GMRA/GMSLA in some respects – one example being the availability of different model clauses for choice of courts (or other dispute forums) and governing law.

The advantages of the consolidation would include greater efficiencies in documentation negotiation and management, netting benefits, and streamlining of the process of commissioning and updating legal opinions on which the industry can rely. The ISDA netting and collateral opinions would include SFTs within their scope, which would involve ISDA commissioning extensions to the existing opinions. Negotiation of documentation for both derivatives and SFTs could potentially be achieved through the application of ISDA Create, ISDA's document automation and negotiation platform.

The consolidation would also allow updates to documentation in light of legal, regulatory and market developments to be rolled out consistently for different products at the same time. Currently, changes to the ISDA Master Agreement, GMRA and GMSLA are introduced on differing timescales, depending on the relative priorities in the various markets. The ISDA documentation also caters for termination events, illegality and force majeure, which are not really addressed in the GMRA and GMSLA.

Increasingly, protocols have been or are being used to address both ISDA and non-ISDA documentation (for example, the BRRD and IBOR Fallbacks Protocol). Having both SFTs and derivatives under ISDA documentation would mean that updates to both types of product can more easily be addressed by a protocol, including associated legal opinions. Where optionality is needed, ISDA Amend can facilitate the relevant elections.

Aspects for Consideration

Clearly, there is an extent to which consolidation of key features between derivatives and SFTs will not be possible, in particular where differences are needed to maintain key economic features of the transactions.

Margining

One example may be margining of SFTs and derivatives. The concept of posting margin to fully collateralize one party's current exposure to the other under an SFT is the same as under the credit support arrangements set out in a CSA. In both cases, the value of equivalent distributions on securities and interest amounts on cash, if remaining unpaid, is taken into account in calculating the credit support balance (under the ISDA CSA), the collateral (under a GMSLA) and the margin (under a GMRA).

One possibility would therefore be to use a CSA to cater for two-way margining under a repo and the posting of collateral by the borrower under a stock loan. However, the exposure under a derivatives transaction, as defined in the CSA, looks to the replacement cost of the transaction, which is normally based on the present value of future cash flows.

This is different from the methodology in the GMRA and GMSLA, which is based on marking to market the value of the securities that have been repo'd out or loaned, and which builds in some optionality, such as the election for daily re-pricing of repos rather than margining. This methodology for calculating margin for SFTs can be maintained alongside the current exposure approach for derivatives.

However, even if margin requirements for derivatives and SFTs are calculated separately, more harmonized documentation could facilitate netting of payment flows with respect to margin transfers for derivatives and SFTs (where permitted under applicable regulations).

Mini Close-out

Both the GMRA and GMSLA generally operate on the basis that failure to deliver securities or redeliver equivalent securities is not an event of default that could trigger termination of all transactions under that master document, but enables the other party to elect to close out the relevant transaction. In practice, this is an important economic feature of SFTs and would be retained via the SFT schedule provisions and/or SFT definitional booklet.

Close-out of All Transactions

The processes for closing out and valuing transactions under the ISDA Master Agreement and the GMRA/GMSLA are very similar. The main difference is that, due to the nature of the transactions, the GMRA and GMSLA methodology for determining the early termination amount is primarily driven by valuing the securities that have been transferred under the SFT. This valuation can be based on costs incurred by the non-defaulting party in selling or buying the relevant securities[30].

In contrast, the calculation of the close-out amount under an ISDA Master Agreement is primarily based on the replacement cost of the derivatives being closed out and considers the replacement or unwinding of hedges. The close-out amount calculation gives the determining party considerable discretion, but subject to the overriding principle of acting in good faith and in a commercially reasonable manner to achieve a commercially reasonable result.

Even if the existing methodology is retained in whole or in part for valuing SFTs on early termination and calculating the net balance payable, it will still be possible to achieve netting with the close-out amount on derivatives. This could be achieved either by treating the early termination amount on the SFTs as an additional limb of the close-out amount under the ISDA Master Agreement, or by a clause in the SFT schedule provisions to net across the net balance payable with respect to the SFTs and the close-out amount for the derivatives.

Other Provisions

There are many other types of provisions/concepts that can be consolidated more easily (for example, events of default, termination events and representations[31] and warranties). The way in which greater harmonization may be achieved between derivatives and SFT documentation by using the ISDA Master Agreement for both types of transactions is set out in further detail in the Appendix.

[30] In the case of the MSLA/MFSTA, where there is a pledge of securities collateral, any applicable law requirements for enforcement of security would need to be respected

[31] Some representations may serve particular regulatory purposes for certain products, and so could be retained for those products

Greater consolidation could involve introducing more functionality for SFTs, such as the inclusion of termination events on illegality or force majeure, which are currently addressed in the ISDA documentation but not in the GMRA or GMSLA.

Core feedback points include:

- Do members agree with covering both repos and securities loans under a single set of SFT ISDA terms?
- Do members have other views on documentation architecture?
- Do members agree with retaining existing margin calculations for SFTs, rather than adapting existing ISDA CSA terms?
- Do members wish to retain separate methodology for valuing and calculating the net balance payable on early termination of SFTs, rather than using the existing close-out amount methodology under the ISDA Master Agreement for SFTs?

Content of SFT Schedule Provisions and SFT Definitional Booklet

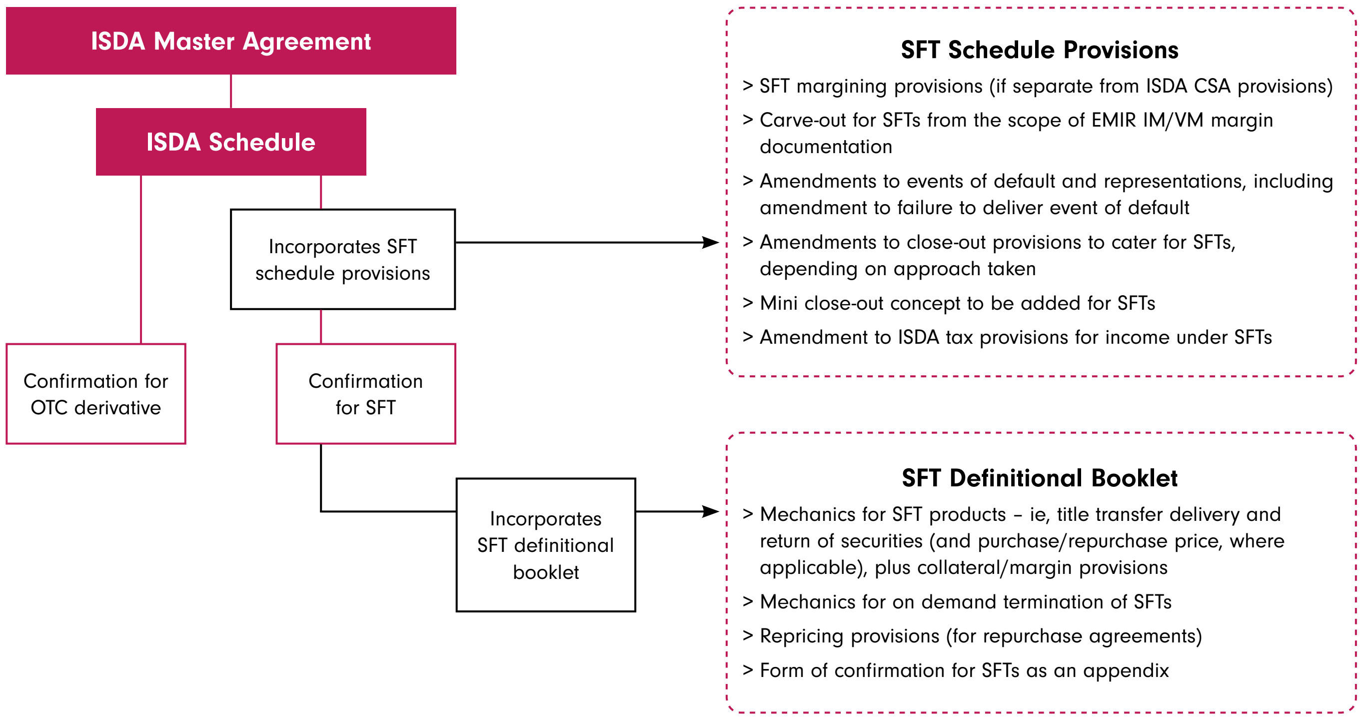
Between them, the SFT schedule provisions and the SFT definitional booklet would cater for the different varieties of SFTs that are currently contemplated under the GMRA and GMSLA (see Figure 7). They would also potentially cater for certain transactions that are not currently contemplated under the GMRA and GMSLA, such as delivery by value repos.

The broad types of transaction that would be covered include:

- Delivery of securities or similar assets from Party A to Party B outright against cash payment, with a future obligation for Party B to redeliver equivalent assets to Party A against cash payment;
- Delivery of securities or similar assets from Party A to Party B outright against non-cash assets (title transfer), with a future obligation for Party B to redeliver equivalent assets to Party A against redelivery of equivalent non-cash assets;
- Delivery of securities or similar assets from Party A to Party B outright, against the posting of cash or securities by Party B as collateral (on a secured basis) to secure Party B's future obligation to redeliver equivalent assets to Party A.

The documentation could, if requested by members, also cater for payment of cash from Party A to Party B against posting of cash or securities or similar assets (on a secured basis) to secure Party B's future obligation to make a cash payment to Party A.

Figure 7: The SFT Schedule Provision and Definitional Booklet



The appendix details each of the key provisions of the GMRA and GMSLA, compares the equivalent position (if any) under the ISDA Master Agreement, including the CSA, and considers how each provision not already covered in the ISDA Master Agreement could be addressed under the SFT schedule provisions or the SFT definitional booklet.

Matters to be addressed include:

- Provisions for the delivery and return of securities, and payment of the purchase and repurchase price for securities.
- Provisions dealing with income and dividends arising from securities that are the subject of the SFT.
- Any SFT-specific provisions for margining/collateral. This could involve (among other things):
    - Including a carve-out for SFTs from the scope of IM/variation margin (VM) documentation. Adoption of the SFT schedule provisions would not require amendment of existing IM/VM documents, and the carve-out would be achieved in the SFT schedule provisions in a similar way to how transactions under legacy CSAs can be excluded in the VM/IM CSAs.
    - Catering for SFT margining on a per loan/transaction or a portfolio basis.
    - Catering for the different ways in which different types of SFT deal with market fluctuations (eg, repricing).

- Carve-outs from derivatives-specific documentation and existing protocols (eg, the definition of covered transaction for the purposes of the EMIR protocol, ISDA cleared derivatives documentation, etc), in addition to the carve-out from IM/VM margin documentation referred to above. In future, the scope or application of new protocols would, where applicable, depend on the product type of transactions being amended.

- Provisions catering for the close-out of SFTs. There is a decision to make as to whether the GMRA/GMSLA close-out mechanics should be preserved or whether there is appetite for the SFT provisions to align with the close-out mechanics used in the ISDA Master Agreement. If separate close-out mechanics are used with respect to SFTs, then provisions for master close-out following an event of default or termination event would also be included.

- Potentially, adapting the existing provisions of the ISDA Master Agreement on deducting or withholding for tax and tax representations.

Core feedback points include:

- Do members want a single event to trigger a close-out for both derivatives and SFTs, or should there be flexibility to close out independently (effectiveness would need to be considered by opinion counsel)?

Legal, Tax and Regulatory Considerations

In principle, the change to documenting SFTs under the ISDA Master Agreement should not affect the treatment of SFTs under existing laws and regulations. From the analysis carried out to date, it appears that applicable laws and regulations adopt a functional approach to defining SFTs – ie, by describing the nature of such transactions. They do not mandate that SFTs are (or define SFTs as transactions that are) documented under any particular type of master agreement such as the GMRA/GMSLA.

However, industry participants should take their own advice as appropriate with respect to laws and regulations applicable to their business, and also to relevant contractual documentation, such as the terms of trust deeds and investment management agreements that may confer limited rights on an investment manager to enter into SFTs for a fund or similar client.

Documenting an SFT under an ISDA Master Agreement should also not cause it to be considered a derivative for the purposes of existing laws and regulations. Whether a particular transaction is a derivative will depend on its nature, not the type of documentation used. For example, a derivative is defined for the purposes of EMIR as a financial instrument as set out in (4) – (10) of the second Markets in Financial Instruments Directive, and those categories do not include SFTs. Similarly, the definition of swap in section 1a(47) of the US Commodity Exchange Act effectively excludes an SFT from that definition in accordance with sub-paragraphs (B)(v) and (B)(vi). This exclusion from the definition of swap also has the effect of excluding SFTs from the definition of security-based swap in section 3(a)(68) of the Securities Exchange Act of 1934.

The following sections highlight a few areas of legislation and regulation that apply to SFTs to illustrate the principle that the change in documentation should not result in any substantive change in treatment.

Regulatory Capital

The EU Capital Requirements Directive[32] and Capital Requirements Regulation[33] contain various provisions relating to financial instruments, including derivatives. SFTs are not financial instruments as such – although where they relate to securities, those securities would be financial instruments. There are also specific provisions relating to repurchase transactions, securities or commodity lending or borrowing transactions and other capital market driven transactions other than derivatives.

The change of documentation would not affect the characterization and treatment of SFTs for the purposes of this legislation. Similarly, the change of documentation would not affect the characterization and treatment of SFTs under the various US capital regimes (which differ based on the type of US regulated entity involved).

SFTR and Reporting of SFTs

The SFTR includes, in the definition of SFTs, repurchase transactions, buy-/sell-back transactions, securities lending and securities borrowing. These definitions relate to a certain type of transaction as described in the definition, and there is no reference in the definitions to the type of documentation used. While the reporting fields used for reporting SFTs under the SFTR require identification of the type of master agreement under which the SFT was effected, it would be possible to report the master agreement as being an ISDA Master Agreement.

A title transfer repo or stock loan is a title transfer collateral arrangement for the purposes of article 15 of the SFTR, and a title transfer financial collateral arrangement for the purposes of the Financial Collateral Directive[34]. A change in documentation would not affect this.

Efficient Portfolio Management by Funds

According to the undertakings for collective investment in transferable securities (UCITS) directive[35], UCITS are permitted to engage in stock lending and repo transactions for the purposes of efficient portfolio management. As implemented in the UK, the relevant definitions of stock lending and repo are not dependent on the type of documentation under which the stock loan or repo is effected. Documenting the SFTs under an ISDA Master Agreement would not make the transactions derivatives instruments for the purposes of the rules relating to the use of derivatives instruments by UCITS.

Under US rules, a US-registered investment company would generally only be able to lend securities if it is permitted by its organizing documents, disclosed to investors in the fund's prospectus or statement of additional information, and subject to approval and oversight by its board of directors. A change of documentation would not affect this.

Core feedback points include:

- Do members agree with ISDA's high-level assessment of the legal, regulatory and tax position with respect to documenting SFTs under an ISDA Master Agreement?

[32] Directive 2013/36/EU

[33] Regulation 2013/575/EU

[34] Directive 2002/47/EC

[35] Directive 2009/65/EC

Practical Considerations

It is envisaged that members, participating in working groups, would be involved in working through some key issues expected to potentially arise for members in adopting ISDA's proposals.

This could include:

- Any implications for record-keeping, regulatory reporting and compliance from the change, particularly if existing relationships or transactions are migrated to the new documentation;
- Implications for cleared SFTs;
- Accounting implications, particularly if existing relationships or transactions are migrated to the new documentation.

Core feedback points include:

- What other issues would members encounter with respect to documenting SFTs under an ISDA Master Agreement?
- Do members wish to form working groups to analyze some of these issues and develop operational best practices?

CONCLUSION AND NEXT STEPS

Over the years, the SFT and derivatives markets have evolved in ways that are similar yet not completely consistent. Both markets have put in place analogous documentation structures, but these documents use different terminology to reflect the same intended outcomes.

Both markets rely on the use of legal opinions to ensure compliance with certain regulatory requirements. While some of this work is now being conducted jointly by both markets, there is certainly room for further alignment. As both markets move towards digitization, it may make sense from a cost-implementation perspective to develop cross-market technological solutions.

Missing the opportunity to create common standards with respect to the terminology and documentation of SFTs and derivatives would ultimately diminish the value of mechanisms that were put in place by market participants to facilitate effective use of SFT and derivatives transactions.

There are various means by which these markets can be further aligned to create more efficiencies for mutual market participants. As a standard-setting organization, it is ISDA's role to highlight inefficiencies and identify additional ways in which cross-market alignment can be improved to benefit ISDA members and financial markets in general.

Proposals like this do disturb the current order of things, breaking with the status quo. However, there are two distinct and important trends that require a top-to-bottom review of the current contractual structure. The first is the steady trend to optimize and centralize the management of collateral to improve operational efficiency and cost. The second is the move to a digital environment. Automation will drive cost efficiency, and there is an opportunity to provide scalable solutions on a global level as the industry considers the transition to digital contracts and a fully automated lifecycle.

Now is the time for the type of discussion outlined in this paper.

APPENDIX

Key Provisions Comparison: GMRA, GMSLA and ISDA Master Agreement

This Appendix sets out the key provisions of the 2011 version of the Global Master Repurchase Agreement (GMRA), co-published by the Securities Industry and Financial Markets Association and International Capital Market Association, and the January 2010 version of the Global Master Securities Lending Agreement (GMSLA), published by International Securities Lending Association. It also draws out the differences in how the GMRA, GMSLA and the ISDA 2002 Master Agreement and related credit support annexes (CSAs)[36] address similar concepts[37]. Due to the different architecture of the ISDA documentation, product-specific provisions are addressed in the definitional booklets, provisions in the schedules to the ISDA Master Agreement and/or confirmations. High-level proposals have therefore been included for catering (or not catering) for the relevant GMRA/GMSLA provisions in the new SFT schedule provisions and/or SFT definitional booklet.

The comparison is divided into the following sections:

- Core transaction mechanics
- Provisions catering for management of a transaction during the lifecycle
- Representations and warranties
- Default and termination
- Consequences of an event of default/termination event
- Other
- Boilerplate provisions

This comparison is not comprehensive. In particular, the comparison does not include the GMSLA provisions on fees to lenders, use of letters of credit as collateral under a GMSLA, and corporate actions with respect to borrowed securities.

[36] While the concept of ISDA CSAs is generally referred to, the analysis below makes specific reference on several occasions to the 1995 Credit Support Annex (governed by English law) (1995 CSA) and, where relevant, the 2016 Credit Support Annex for Variation Margin (VM) (governed by English law) (2016 VM CSA). No detail relating to the ISDA documentation produced to cater for the posting of regulatory initial margin has been included

[37] At this stage, this comparison has not been conducted in relation to the GMSLA Security Interest over Collateral 2018 version (2018 Pledge GMSLA)

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
1. Core Transaction Mechanics			
Transactions/loans	The GMRA applies to the sale/repurchase of securities (referred to as transactions) against payment of a purchase price/ repurchase price[38]. A transaction involves an initial sale from the seller to the buyer against payment of a purchase price, with a corresponding sale from the buyer to the seller against payment of a repurchase price at the end of the transaction.	The GMSLA caters for the transfer of securities (referred to as a loan) against the transfer of collateral in form of securities, cash or letters of credit[39], rather than a purchase price. A loan involves an initial transfer (loan) from the lender to the borrower in exchange for an initial transfer of collateral from the borrower to the lender. At the end of the loan, borrowers have an obligation to (re)deliver securities equivalent to those borrowed, and lenders have an obligation to deliver collateral equivalent to that provided to it by the borrower[40].	The ISDA Master Agreement is product-agnostic and so does not contain any product-specific terms. Collateral or margin[41] terms can be added using the appropriate ISDA CSAs, and product terms are contained in asset class-specific definitional booklets. These mechanics would be included in the securities financing transaction (SFT) definitional booklet (including, for example, purchase price and repurchase price).
Title transfer	All transfers of securities under the GMRA are title transfer[42].	All securities and collateral are transferred by way of title transfer[43].	These mechanics would be included in the SFT definitional booklet, leveraging existing ISDA title transfer provisions in ISDA CSAs/product definitions.
Simultaneous delivery vs. payment	The transfer of securities and the payment of the purchase price are required to be made simultaneously, unless otherwise agreed[44].	Deliveries/payments are required to be made simultaneously, unless otherwise agreed[45]. However, parties can waive the right to a corresponding payment or delivery from the other party to be made simultaneously, where this is due to market practice or practical difficulties[46].	These mechanics would be included in the SFT definitional booklet.
Condition precedent	Parties may agree via annex I to introduce a condition precedent enabling a party to withhold its payments and deliveries where an event of default has occurred and is continuing in relation to the counterparty[47].	Parties can withhold delivery/payment where arrangements have not been made by the other party to ensure that a corresponding delivery/payment due will be made[48].	The ISDA Master Agreement[49] provides a condition precedent for a party to withhold performance where an event of default or potential event of default has occurred with respect to the other party. For consideration is whether to include wording similar to that in the GMSLA in the SFT schedule provisions or SFT definitional booklet.
Type of securities	The GMRA does not cover equities and net paying securities (ie, those that require a withholding tax deduction)[50]. Optional wording exists in annex I to permit the coverage of net paying securities[51]. This is described further in the sub-section entitled Tax Provisions in the Other section.	There are no equivalent restrictions under the GMSLA.	The ISDA Master Agreement does not restrict the type of securities that can be the subject of a transaction. This would not change in the SFT schedule provisions. With respect to net paying securities, this is described further in the sub-section entitled *Tax Provisions* in the *Other* section.

[38] GMRA, Paragraph 1(a)-(b). For convenience, this schedule does not distinguish between transactions in the form of repos or buy-sell back transactions

[39] GMSLA, Paragraph 1.1-2

[40] GMSLA, Paragraph 4.2

[41] The terms collateral and margin are used interchangeably herein

[42] GMRA, Paragraph 6. Contrast this with the US Master Repurchase Agreement where transactions may be considered secured lending

[43] This is unless the 2018 Pledge GMSLA is used

[44] GMRA, Paragraph 6(c)

[45] GMSLA, Paragraph 1.1

[46] GMSLA, Paragraph 4.3

[47] GMRA, Paragraph 6(j)

[48] GMSLA, Paragraph 8.6

[49] ISDA Master Agreement, Section 2(a)(iii)

[50] GMRA, Paragraph 1(b)-(c)

[51] GMRA, Annex I, Paragraph 1(b)

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
Confirmation of Transaction			
Form of confirmation	The GMRA sets out a description of what is to be included in each confirmation[52] and a template – the form of confirmation at annex II[53].	The GMSLA is not prescriptive as to form and does not outline information to be included.	The ISDA Master Agreement is not prescriptive as to the form of confirmation. A form of template confirmation or confirmations would be appended to the SFT definitional booklet in the same way as for other asset classes.
Ordinary Course Termination			
Timing of termination	Transactions will either terminate on a fixed repurchase date or, if the transaction is an on demand transaction (ie, no fixed repurchase date), upon notice by either the buyer or the seller[54]. Termination will occur after the minimum period customarily required for settlement or delivery of money or equivalent securities of the relevant kind from the date of demand.	Loans will either terminate at the end of a fixed period or, if there is no fixed period, upon notice by the borrower or the lender. If the lender terminates by notice, the notice period must be equal to the standard settlement time for the securities concerned, and the borrower must redeliver by the end of this period[55]. Except in the case of a fixed-term loan, the borrower may terminate and redeliver at any time[56].	Derivatives transactions under the ISDA Master Agreement typically end on a date agreed by the parties as part of the transaction, and so there are no general provisions for dealing with open-ended transactions. This feature would be catered for in the SFT definitional booklet.
Obligations on termination	Upon termination, the buyer must transfer to the seller equivalent securities against the payment of the repurchase price by the seller, less any amount payable and unpaid by the buyer to seller in respect of income[57].	Upon termination, the borrower must deliver securities equivalent to those borrowed[58]. The lender has an equivalent obligation in respect of collateral[59].	As with the opening leg of transactions/ loans, this feature would be catered for in the SFT definitional booklet.
2. Provisions Catering for Management of a Transaction During the Lifecycle			
Margin Provisions			
What is margined?	At a high level, for repurchase transactions, the security selected for the transaction is a term of the trade, and the exposure that needs be margined is the difference between the current value of the bond and the repurchase price at the relevant time under the repo, taking into account the applicable margin ratio. Margin is calculated on an aggregated basis for *all transactions* outstanding (ie, in relation to an overall net exposure[60]) and may be payable by either the buyer or seller. However, parties can exclude transactions from the aggregated calculation and instead margin those transactions separately[61].	Under a securities loan, the exposure to be collateralized is the full market value of the security being lent (plus an amount of margin representing an agreed percentage of the value of the security). The GMSLA permits parties to elect in the schedule to calculate collateral either: (i) on an aggregated basis[62]; or (ii) on a loan-by-loan basis[63]. Collateral is only payable by the borrower to the lender.	Under the ISDA Master Agreement, margining terms are contained in the ISDA CSAs. If an ISDA CSA is applied by the parties to an ISDA Master Agreement, margin obligations under that ISDA CSA would apply to all transactions entered into under the ISDA Master Agreement, unless any transactions are specifically carved out[64]. There is a decision to make about whether SFTs should also fall under the scope of margining provisions in the ISDA CSA or whether separate margining provisions would be included in the SFT schedule provisions. Some of the considerations that are relevant to this decision have been set out in subsequent rows.

[52] GMRA, Paragraph 3(b)
[53] GMRA, Annex 2
[54] GMRA, Paragraph 3(d)
[55] GMSLA, Paragraph 8.1
[56] GMSLA, Paragraph 8.2
[57] GMRA, Paragraph 3(f)
[58] GMSLA, Paragraph 8.3
[59] GMSLA, Paragraph 8.4
[60] GMRA, Paragraph 4(c)
[61] GMRA, Paragraph 4(i)
[62] GMSLA, Paragraph 5.4
[63] GMSLA, Paragraph 5.5
[64] For the ISDA CSAs designed to cater for regulatory margin, the scope of transactions to which the margining provisions apply is limited only to those to which the margining regulations apply

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
Mechanism for calculating required margin	If either party has a net exposure to the other, it may by notice require the other party to make a margin transfer equal to that net exposure[65]. A net exposure will arise by reference to the respective transaction exposures, amounts of income payable between the parties but unpaid, and the sum of net margin already provided between the parties. Transaction exposure[66] is determined by using one of the following two approaches, specified by the parties via annex I[67]: • The function of the repurchase price and the applicable margin ratio, less the market value of the equivalent securities at the relevant time (which may be adjusted by reference to a margin percentage)[68]; or • The repurchase price, less the adjusted value of the equivalent securities (which is a function of the market value of such equivalent securities (which may be adjusted by reference to a margin percentage) at the relevant time and the relevant haircut applicable to such equivalent securities)[69]. The margin ratio is the market value of the securities at the purchase date divided by the purchase price or such other proportion agreed by the parties. Parties may choose a different margin ratio for any or all transactions, as well as different types of securities entered into under the GMRA[70]. Net margin takes into account: (i) cash margin paid to each party (including accrued interest on cash margin that has not been paid to the other party); and (ii) the market value of margin securities posted between the parties.	The lender may on any business day make a demand for the delivery of further collateral (if a collateral deficiency exists), or the borrower may on any business day make a demand for the return of excess collateral[71]. A deficiency or excess will arise by reference to the aggregate market value of posted collateral and the aggregate of the required collateral value. The amounts due and payable between the parties but unpaid are also taken into account. If the income record date has occurred in respect of any securities equivalent to loaned securities/non-cash collateral, then the amount or market value of income payable in respect of such securities is also considered (if agreed between the parties). The required collateral value is the market value of securities equivalent to the loaned securities and the applicable margin. Margin is a percentage of the market value of each form of acceptable collateral, specified in the schedule. Posted collateral is the aggregate market value of the collateral delivered to or deposited with the lender (excluding any equivalent collateral repaid or delivered).	Under the 1995 CSA, margin obligations arise in circumstances that, on a given valuation date, the credit support amount for a party is not equal to the value of the credit support balance for that party, subject to any applicable minimum transfer amounts (discussed in later sections). Credit support balance/exposure Under the 1995 CSA, the credit support amount includes the relevant party's exposure, which is the amount that would be payable to/by that party if all transactions under the ISDA Master Agreement were terminated pursuant to a termination event with one affected party on a particular valuation date[72]. Consequently, the concept of exposure under the ISDA Master Agreement relies on a present value calculation in respect of the transactions subject to margining. For SFTs, exposure is (predominantly) based on known values – the repurchase price (GMRA) and the market value of the loaned securities (GMSLA). Given this, it may not be necessary to apply the ISDA concepts of credit support amount/ exposure to SFTs, as the added flexibility offered by these concepts may not be necessary. The credit support amount is also: • Affected by independent amounts[73]; and • Reduced by thresholds. Credit support balance The credit support balance includes: • The aggregate of all eligible credit support transferred/received between the parties; plus • Any distributions and all proceeds of any such eligible credit support or distributions; plus • Any equivalent distributions or interest amount not transferred already. The concept of a credit support balance is substantially equivalent to similar concepts in the GMRA and GMSLA, and would be applied to SFTs either by building it into separate margining provisions within the SFT schedule provisions or by relying on the existing ISDA CSA provisions.

65 GMRA, Paragraph 4(a)
66 GMRA, Paragraph 2(xx)
67 GMRA, Annex I, Paragraph 2(d)
68 GMRA, Paragraph 2(xx)(A)
69 GMRA, Paragraph 2(xx)(B)
70 GMRA, Paragraph 4
71 GMSLA, Paragraph 5.4-5
72 ISDA 1995 CSA, Paragraph 11(c)
73 For the 2016 VM CSA, this concept is not relevant

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
Future exposure	There are no equivalent concepts under the GMRA. Instead, a cushion against the risk of the purchased securities falling in value and the buyer becoming under-collateralized is provided through the margin ratio mechanism.	There are no equivalent concepts under the GMSLA. Instead, a cushion against the risk of the loaned securities falling in value and the lender becoming under-collateralized is provided through the requirement for margin.	The credit support amount includes the concept of an independent amount, which can be specified in respect of each party. The effect of specifying an independent amount in respect of a party is to increase the amount of margin that party must post to the other (ie, to increase the credit support amount). It is effectively an add-on to current exposure to cater for potential future exposure that is not factored into the exposure calculation.
Quantitative reference points for a margin transfer	There are no equivalent concepts under the GMRA.	There are no equivalent concepts under the GMSLA.	Thresholds ISDA CSAs typically permit parties to include a threshold in respect of the other. This represents an amount of exposure that the other party is happy not to take collateral in respect of. Minimum transfer amounts (MTAs) Parties may also specify MTAs, which operate to prevent a party from having to make a transfer if the amount is below a certain level (once the amount of such transfer is above that level, the full amount needs to be transferred)[74]. There are no features equivalent to thresholds and MTAs in the GMRA and GMSLA, but their application would be facilitated for parties in the SFT schedule provisions.
Eligible collateral	There is no concept of a pre-agreed pool of eligible collateral from which the parties can choose in order to satisfy their margining obligations (although this would normally be agreed separately from the GMRA). Rather, the definition of margin securities requires that they be securities of a type and value reasonably acceptable to the party calling for the relevant margin transfer.	The definition of collateral permits the parties to specify in paragraph 1 of the schedule the types of collateral that are acceptable to the lender.	The definition of eligible credit support permits the parties to choose which types of collateral are acceptable for the purposes of satisfying margining obligations. This would not be changed in the SFT schedule provisions.
Repricing	Instead of margining, parties may agree to reprice a transaction by adjusting the purchase price or identity/amount of securities to eliminate exposure[75].	There is no equivalent concept under the GMSLA.	There is no equivalent concept under the ISDA Master Agreement or the ISDA CSAs[76], as matters such as this would be addressed in the confirmation for the relevant transaction/applicable definitions. This would be catered for in the SFT definitional booklet in relation to repurchase transactions.

[74] ISDA CSAs also provide for parties to specify a rounding convention in relation to delivery amounts and return amounts, which would also be catered for in the SFT schedule provisions

[75] GMRA, Paragraph 4(j)-(l)

[76] Although this concept does exist for mark-to-market cross-currency swaps in the 2006 ISDA Definitions

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
Satisfying a margin call	A margin call is satisfied by making a margin transfer[77] of either cash or securities reasonably acceptable to the receiving party[78]. The party making the transfer may decide on the combination of cash and securities, provided that when the receiving party had previously posted cash or securities as margin that have not been returned, it can require the margin transfer to be satisfied by delivery of such cash or securities[79]. If a party is unable to transfer equivalent margin securities, then it must immediately pay cash margin equal to the value of those securities[80]. If this failure persists for two business days, the other party may require the transferring party to pay a cash equivalent amount equal to the default market value of the equivalent margin securities that the receiving party determines[81].	A margin call is satisfied by making a repayment and/or delivery of equivalent collateral[82] (if lender to borrower) or providing further collateral[83] (if borrower to lender). Where aggregated margining applies[84], unless the parties have elected otherwise, the GMSLA provides that requirements to deliver equivalent collateral or provide further collateral can be netted to allow for a single net delivery of collateral between the parties. Where parties margin on an aggregated basis, and a party is required to deliver further collateral or redeliver equivalent collateral to the other party, the GMSLA also provides for the allocation of such delivery or redelivery to individual loans, so that at the maturity of each loan, the equivalent collateral to be delivered by the lender to the borrower is ascertainable.	Under the ISDA CSAs, margin calls are satisfied by the relevant party making a transfer of eligible credit support to the other party. This feature would be retained/included for SFTs.
Failures to deliver	*See* sub-section entitled *Failure to Deliver and Mini Close-out* under *Other*	*See* sub-section entitled *Failure to Deliver and Mini Close-out* under *Other*	*See* sub-section entitled *Failure to Deliver and Mini Close-out* under *Other*
Income payments	Where income is paid in relation to securities purchased by the buyer, the buyer must transfer to the seller an amount equal to that income payment[85]. A similar provision applies to any income paid in relation to margin securities (ie, securities held by the seller)[86]. Income is broadly defined as including, with respect to any security at any time, all interest, dividends or other distributions thereon.	Where income is paid in relation to securities and collateral, the receiving party must transfer an equivalent amount to the other party. These provisions largely mirror those of the GMRA. Income is broadly defined as including any interest, dividends or other distributions of any kind whatsoever with respect to any securities or collateral[87].	In the 1995 CSA, the transferee is required to transfer to the transferor any distributions (or equivalent distributions) and interest amounts received on collateral by the transferee, provided that no delivery amount would be created or increased by such transfer. This feature would be retained/included for SFTs. Apart from interest amounts on collateral, there are no income provisions in the ISDA Master Agreement/CSA, as any such payments would be addressed in the confirmation of a transaction referencing a security (or the applicable definitions)[88].
Indemnity for failure to redeliver equivalent non-cash collateral	The GMRA does not contain an indemnity equivalent to that set out in the GMSLA	The GMSLA provides for an indemnity from the lender to the borrower in respect of losses suffered by the borrower if the borrower has called for the delivery of equivalent non-cash collateral prior to an income record date and the lender fails to transfer it[89].	There is no equivalent concept under the ISDA Master Agreement. This would be catered for in the SFT schedule provisions in relation to securities loans.

[77] GMRA, Paragraph 2(dd)

[78] GMRA, Paragraph 4(a). Please note that securities defines both the scope of the securities that can be the subject of repo, as well as that which can be provided as margin

[79] GMRA, Paragraph 4(d)

[80] GMRA, Paragraph 4(h)(i)

[81] GMRA, Paragraph 4(h)(ii)

[82] GMSLA, Paragraph 5.4/5(b)

[83] GMSLA, Paragraph 5.4/5(c)

[84] GMSLA, Paragraph 5.5

[85] GMRA, Paragraph 5(a)

[86] GMRA, Paragraph 5(b)

[87] GGMSLA, Paragraph 2

[88] For example, the treatment of dividends in the equity derivatives definitions

[89] GMSLA, Paragraph 6.4, which applies unless otherwise elected in schedule

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
Substitution	The GMRA permits the seller, if the buyer agrees, to substitute securities equivalent to purchased securities for different securities that have a market value at such date at least equal to the market value of the equivalent securities transferred to seller. With respect to margin securities, either party can request the substitution of any of those equivalent margin securities with new margin securities having a market value at such date at least equal to that of such equivalent margin securities. The substitution shall be effected only if the other party agrees[90].	The GMSLA permits the borrower to substitute collateral it has provided to the lender with alternative collateral acceptable to the lender[91], provided this would not trigger a margin obligation[92].	Similar substitution provisions are contained in the ISDA CSA for margin. Under the 1995 CSA, the transferor may, with the consent of the transferee, substitute eligible credit support for new credit support. This feature would be retained/included for SFTs.
3. Representations and Warranties			
Representations	The GMRA contains a standard selection of representations by each party, and these are repeated each time any transaction is entered into or transfers occur under that transaction. Among other things, these relate to: • The party having the authority to execute the agreement and enter into the transactions; • That it enters into the GMRA on its own behalf; • That entering into the GMRA will not violate any law or regulatory requirement[93]. It contains a unique representation that states (unless there is a written agreement to the contrary) it is not relying on any advice from the other party external to the GMRA, and that it fully understands the terms of and risks associated with entering into the agreement[94]. This is often included in part 5 of an ISDA schedule as an additional representation (see part 5[(m)] of the template schedule appended to the ISDA Master Agreement).	The GMSLA contains a series of warranties (rather than representations as contained in the GMRA). These are made on a continuing basis. The content of these warranties broadly corresponds with the representations of the GMRA, and relate to: • The authority and capacity of the parties to enter and perform obligations under the agreement; • The ability of the parties to make outright transfers of securities; and • That parties are acting as principal[95]. It contains a unique warranty, made by the borrower, to the effect that it is not entering into a loan for the primary purpose of obtaining or exercising voting rights in respect of the loaned securities[96].	The ISDA Master Agreement's basic representations in relation to an entity's status, powers and authority align with those under the GMRA and GMSLA[97]. The ISDA Master Agreement contains additional representations relating to: • Absence of event of default or potential event of default; • Absence of litigation; and • Tax representations. The unique warranty in the GMSLA would be included within the SFT schedule provisions, but otherwise retaining the ISDA Master Agreement's suite of representations. The ISDA Master Agreement also contains 'agreements that parties will furnish specified information, maintain authorizations, comply with laws, notify the other where tax becomes payable and pay stamp duty. In the GMRA and GMSLA, similar tax provisions[98] are found elsewhere, and the other agreements are largely covered by the representations/warranties in those documents. This point would not be separately addressed in the SFT schedule provisions.

[90] GMRA, Paragraph 8
[91] GMSLA, Paragraph 5.3
[92] GMSLA, Paragraph 5.4 or 5.5 as applicable
[93] GMRA, Paragraph 9
[94] GMRA, Paragraph 9(g)
[95] GMSLA Paragraphs 13-14
[96] GMSLA, Paragraph 14(e)
[97] ISDA Master Agreement, Section 3(a)
[98] GMRA, Paragraph 11; GMSLA, Paragraph 12

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
Agency	Parties are separately able to elect to execute the GMRA as an agent if needed through the agency annex[99], resulting in a separate GMRA with each underlying principal.	As under the GMRA, parties are able to elect to execute the GMSLA as an agent[100], resulting in a separate GMSLA with each underlying principal.	While the ISDA Master Agreement does not include template wording catering for the situation that the agreement is executed by an agent acting for underlying principals, such wording is often included by parties, and example wording is available in the ISDA Clause Library. For consideration is whether agency is addressed in the SFT schedule provisions separately from the wording in the ISDA Clause Library.
4. Default and Termination			
Events of default	The GMRA contains the following events of default[101]: • Failure to pay the purchase price on the purchase date or the repurchase price on the repurchase date; • If specified as applicable in annex I, failure to deliver purchased securities on the purchase date or equivalent securities on the repurchase date, in either case within the standard settlement time for delivery of those securities; • Failure to pay any sum due in circumstances where the mini close-out provisions have been applied; • Failure to comply with the margin maintenance provisions; • Failure to pay manufactured dividends; • An act of insolvency occurs in relation to the relevant party; • Representations are incorrect or untrue in any material respect; • Admission by a party of its inability to, or intention not to, perform obligations under the GMRA; • Being declared in default by or being suspended from membership of any securities exchange or being prohibited from dealing in securities by any competent authority, on the grounds of failure to meet requirements relating to financial resources or credit rating; and • Failure to perform any other obligation(s) under the agreement that is not remedied after a 30-day grace period.	The GMSLA contains the following events of default, which largely mirror those contained in the GMRA: • Failure to pay or repay cash collateral, or to deliver collateral; • Failure to make manufactured payments in respect of loaned securities or non-cash collateral (grace period of three days)[102]; • Failure to pay any sum due under the mini close-out provisions upon the due date; • An act of insolvency; • A warranty is incorrect or untrue in a material respect; • Admission of an inability to, or intention not to, perform; • Transfer of all or any material part of the assets of the lender or borrower to a trustee by a regulatory authority; • Action taken in respect of a party by a securities exchange or regulatory authority on the grounds that it has failed to meet any requirements relating to financial resources or credit rating; and • Breach of any other obligation (grace period of 30 days). The different approaches taken by the GMRA and GMSLA to failures to deliver are covered under the sub-section entitled *Failure to Deliver and Mini Close-out* under *Other*.	The ISDA Master Agreement contains events of default that largely align with those contained in the GMRA and GMSLA, with the addition of those that are listed below[103]: • Credit support default; • Default under specified transaction; • Cross default[104]; and • Merger without assumption. The ISDA Master Agreement's events of default would be retained and supplemented in the SFT schedule provisions as applicable with those of the GMRA and GMSLA. Regarding the different approaches taken by the GMRA and GMSLA to failures to deliver, see the sub-section entitled *Failure to Deliver and Mini close-out* under *Other*.

[99] GMRA, Annex I

[100] GMSLA, Agency Annex

[101] GMRA, Paragraph 10(a)

[102] GMSLA, Paragraph 10.1(b)

[103] ISDA Master Agreement, Section 5(a)

[104] Please note that cross default would only apply where parties elected for its inclusion

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
Termination events	The GMRA contains provisions largely corresponding to the tax event termination event in the ISDA Master Agreement[105].	Termination events are not contemplated by the GMSLA.	The ISDA Master Agreement's termination events cater for the termination of certain or all transactions in circumstances where no fault is attributable. If an event giving rise to a termination event is also an event of default, it will be treated as an event of default[106]. The applicability of termination events would be retained with respect to transactions entered into under the SFT schedule provisions, which would involve introducing illegality and force majeure as termination events for SFTs.
Notice of event of default	The GMRA requires that each party immediately notify the other of an event of default, or an event that upon service of a notice would be an event of default, which occurs in relation to it[107].	The GMSLA requires that each party notify the other of an event of default, or an event that would become one upon service of a notice, which occurs in relation to it[108].	A similar effect is achieved by virtue of the ongoing representation at section 3(b) of the ISDA Master Agreement[109], which relates to absence of an event of default or potential event of default. This would not be changed in the SFT schedule provisions.
5. Consequences of an Event of Default/Termination Event			
Event of default and designation of termination date	The event of default will not (unless automatic early termination on insolvency has been elected[110]) trigger a termination of the agreement unless the non-defaulting party gives notice designating an early termination date and such event of default is continuing at that time[111]. This notice must – by not more than 20 days' notice to the defaulting party specifying the relevant event of default – designate an early termination date in respect of all outstanding transactions[112].	There is no event of default unless a default notice is served (unless automatic early termination on insolvency has been elected[113]). The termination date is not designated by either party, but is instead the time that the relevant event of default occurs (which itself is triggered by the default notice described earlier).	Events of default Unless automatic early termination on insolvency has been elected[114], when an event of default has occurred and is continuing, the non-defaulting party may designate a date (not earlier than the effective date of the notice) as an early termination date and terminate all outstanding transactions[115]. The notice period must be no more than 20 days. This architecture (which is equivalent to that in the GMRA) would be retained for transactions entered into under the SFT schedule provisions. Termination events If a termination event other than force majeure occurs, the affected party must promptly notify the other party, specifying the nature and each affected transaction. It must provide any information about that termination event as the other party is likely to require. In the case of force majeure, each party should make all reasonable efforts to promptly notify the other, again specifying the nature of the termination event and providing reasonably required information[116].

Continued on next page

[105] GMRA, Paragraph 11
[106] ISDA Master Agreement, Section 5(c)
[107] GMRA, Paragraph 10(m)
[108] GMSLA, Paragraph 10.2
[109] ISDA Master Agreement, Section 3(b)
[110] GMRA, Paragraph 10(b); GMRA, Annex I
[111] GMRA, Paragraph 2(r)
[112] GMRA, Paragraph 10(b)-(c)
[113] GMSLA, Paragraph 10.1(d)
[114] ISDA Master Agreement, Section 6(a)
[115] ISDA Master Agreement, Section 6(a)
[116] ISDA Master Agreement, Section 6(b)

Continued from previous page

			Following a termination event, the exact process depends on the specific termination event[117] (for example, illegality and force majeure are subject to a waiting period[118]). This architecture would be retained for transactions entered into under the SFT schedule provisions.
Effect of designation of early termination date/termination date	The occurrence of an early termination date triggers the acceleration of both parties' payment and delivery obligations in relation to outstanding transactions and repayment of margin. These accelerated obligations are then cash-valued in the base currency and set off against one another to produce an obligation to pay a net amount on the early termination date[119]. This is covered further in the *Components of Close-out* section.	When a written notice of an event of default is given, both parties' payment and delivery obligations are accelerated and cash-valued in the base currency. The different sums due by each party to the other are then set off against each other to produce a net amount[120]. This is covered further in the *Components of Close-out* section.	Following termination, all existing and future obligations in relation to the terminated transactions are extinguished and replaced by a single obligation to pay a net sum[121]. This net sum is calculated pursuant to section 6(e)[122]. There is a decision to make about whether to apply the provisions of section 6(e) to SFTs under the SFT schedule provisions. This is covered further in the *Components of Close-out* section.
Close-out statement	The non-defaulting party must provide the defaulting party with a statement showing in reasonable detail the calculations made to arrive at the net amount and specifying the balance payable.	There is no obligation on the non-defaulting party to provide the defaulting party with a calculation statement.	Parties are required to provide a statement showing the calculation of an early termination amount, including details of how the figure was established and the account information for payment[123]. For the SFT schedule provisions, all terminations (ie, even for mini close-outs) would require the non-defaulting party to serve this calculation statement.
Which party determines?	The non-defaulting party.	The non-defaulting party[124].	For events of default, the non-defaulting party. For termination events, either the affected party or both parties, depending on the event. This would not be changed in the SFT schedule provisions.
Reference date for termination amounts/ values	The default valuation time is on or about the early termination date[125].	In contrast with the GMRA, the default valuation time is the close of business in the appropriate market on the fifth dealing day after the date on which the event of default occurs or, in the case of automatic early termination, the fifth dealing day after the day on which the non-defaulting party first became aware of the occurrence of such event of default[126].	Each close-out amount is determined as of the early termination date or the next commercially reasonable date[127], which provides additional flexibility as compared with the GMRA and GMSLA. There is a decision to make about whether this additional flexibility is required for the SFT schedule provisions given the assumption that SFTs should be easier to value than derivatives transactions.

117 ISDA Master Agreement, Section 6(b)
118 ISDA Master Agreement, Section 5(d)
119 GMRA, Paragraph 10(d)(ii)
120 GMSLA, Paragraph 11.2(b)
121 ISDA Master Agreement, Section 6(c)
122 ISDA Master Agreement, Section 6(e)
123 ISDA Master Agreement, Section 6(d)
124 GMSLA, Paragraph 11.3
125 GMRA, Paragraph 10(f)
126 GMSLA, Paragraph 11.3(b)
127 ISDA Master Agreement, Section 14

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
Components of close-out	The non-defaulting party determines the following in respect of all transactions[128]: • The default market value of equivalent securities and equivalent margin securities to be transferred (which, per the definition of default market value, will include any coupon payments accrued but not yet paid); • The amount of any cash margin (including interest accrued) to be transferred; • The repurchase prices to be paid by either party; • The cash equivalent amounts to be paid by either party. On the basis of these determinations, the non-defaulting party calculates what is due from each party to the other and sets these amounts off to produce a net amount. For ease of comparison, the components of these amounts are broken out in rows (i) to (vii).	The non-defaulting party determines the following in respect of all loans[129]: • The default market value of equivalent securities and equivalent non-cash collateral to be delivered; • The amount of any cash collateral to be repaid (including interest accrued); and • The amount of any other cash to be paid by each party. On the basis of these determinations, parties must calculate what sum is due from each party to the other, and these amounts are set-off to produce a net amount[130]. For ease of comparison, the components of these amounts are broken out in rows (i) to (vii).	The calculation of the final amount due occurs by taking the sum of the close-out amounts in respect of each terminated transaction together with the unpaid amounts owing to the non-defaulting party (determined by the non-defaulting party) less any unpaid amounts owed to the defaulting party. There is a decision to make about whether to apply the provisions of section 6(e), including the concept of close-out amount (covered in row (v) of this section), to SFTs under the SFT schedule provisions. Proposals are set out in each row accordingly. For ease of comparison, the components of these amounts are broken out in rows (i) to (vii).
(i) Amounts due but unpaid as at reference date	Any amounts due between the parties, including income payments, that had not been paid would be included within amounts due from each party to the other under the agreement set out in paragraph 10(d)(ii). This could also include costs associated with replacement of transactions and unwinding of hedges where a mini-close out had occurred before the early termination date. Interest that has accrued on any such amounts is also payable within the net amount (this is separate to interest payable on the termination amount, which is addressed later)[131].	Any amounts due between the parties, including income payments and any interest accrued, that had not been paid would be included within the acceleration of obligations set out in paragraph 11.2[132]. This could include interest, overdraft and costs incurred as a result of late delivery of equivalent securities or equivalent collateral, including buy-in costs[133].	Any amounts that had become due and not been paid[134], as well as interest on those amounts, would become unpaid amounts for the purposes of the early termination amount calculation[135]. The same approach would be taken to equivalent amounts due under SFTs for the purposes of the SFT schedule provisions.
(ii) Acceleration of post-reference date payment obligations	Under the GMRA, if an early termination date occurs, the repurchase date for each transaction is brought forward to the early termination date, such that each repurchase price is payable as of such early termination date[136].	The parties' payment obligations are accelerated to require performance at the time the event of default occurred (the termination date)[137].	The ISDA Master Agreement uses the concept of close-out amount to value future payment and delivery obligations. The concept of close-out amount and its potential application to SFTs is discussed in row (v) of this section.

Continued on next page

[128] GMRA, Paragraph 10(d)(i)

[129] GMSLA, Paragraph 11.2(a)

[130] GMSLA, Paragraph 11.2

[131] GMRA, Paragraph 10(d)(ii); Paragraph 12

[132] GMSLA, Paragraph 11.2

[133] GMSLA, Paragraph 9.3

[134] The 2016 VMSA clarifies that no unpaid amount will be determined with respect to any unsatisfied delivery amounts and return amounts. Rather, these will be reflected in the close-out amount calculations

[135] ISDA Master Agreement, Section 14, definition of unpaid amount

[136] IGMRA, Paragraphs 10(c) and (d)(i)

[137] GMSLA, Paragraph 11.2

Continued from previous page

			As the obligations in the GMRA and GMSLA do not require a present value calculation in relation to these amounts, a nearer equivalent in the ISDA architecture would be the way cash collateral is treated under the ISDA CSAs. Following an event of default, cash collateral would form part of the credit support balance, the value of which will be deemed to be an unpaid amount for the purposes of the early termination amount calculation. A similar mechanism could apply with respect to the SFT schedule provisions.
(iii) Acceleration of post-reference date obligation to return securities	Under the GMRA, if an early termination date occurs, any obligation to deliver equivalent securities, and any obligation to deliver equivalent margin securities, is brought forward to the early termination date. The securities are valued at their default market value and converted into a cash amount.	Under the GMSLA, if an event of default occurs, any obligation to deliver equivalent securities, and any obligation to deliver equivalent non-cash collateral, is brought forward to the termination date. The securities are valued at their default market value and converted into a cash amount.	Following an event of default, securities collateral is valued and forms part of the credit support balance, the value of which will be deemed an unpaid amount for the purposes of the early termination amount calculation. A similar mechanism could be applied with respect to the SFT schedule provisions.
(iv) Requirement to return/repay all cash margin and all other cash amounts	Cash margin (including interest accrued) to be transferred and cash equivalent amounts to be paid shall become due at the early termination date.	Cash collateral (including interest accrued) to be repaid and any other cash amounts to be paid are accelerated for the purposes of the termination date.	Following an event of default, cash collateral forms part of the credit support balance, the value of which will be deemed an unpaid amount for the purposes of the early termination amount calculation. A similar mechanism could be applied with respect to the SFT schedule provisions.
(v) Termination of future payment obligations and determination of their present value	There is no equivalent concept under the GMRA.	There is no equivalent concept under the GMSLA.	The ISDA Master Agreement uses the concept of the close-out amount as the means of valuing transactions, which requires an assessment of the present value of future cashflows and delivery obligations under each transaction that is being terminated. As under the GMRA and GMSLA, external sources are contemplated as providing valuations for securities in order to determine the close-out amount. Parties are encouraged to reference quotations, market data and information from internal sources when explaining in detail how their calculations were achieved[138]. Commercial reasonableness is key when establishing whether the procedures reaching the valuation are sufficient[139]. These are calculated on or as soon as practicable following the early termination date[140]. There is a decision to make about whether to apply the concept of close-out amount to any element of the close-out calculations for SFTs under the SFT schedule provisions. For SFTs, as valuations of securities do not require the same flexibility as may be required for (often illiquid) derivatives transactions, it may not be necessary to apply the close-out amount concept to SFTs.

[138] ISDA Master Agreement, Section 6(d)(i)

[139] ISDA Master Agreement, Section 14

[140] ISDA Master Agreement, Section 6(d)(i)

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
(vi) Conversion of all resulting cash amounts into a single currency	All sums not denominated in the base currency shall be converted to the base currency at the spot rate[141], which for the purposes of the termination calculation is to be obtained by the non-defaulting party by reference to a pricing source or quoted by a bank[142].	For the purposes of this calculation, any sum not denominated in the base currency shall be converted into the base currency at the spot rate prevailing at such dates and times determined by the non-defaulting party acting reasonably[143].	All resulting cash amounts are converted into the termination currency equivalent of those amounts. This requires the determining party to select a foreign exchange agent in good faith (or, if both parties are determining parties, the agent must be agreed) to conduct the conversion at 11.00am in the city in which such foreign exchange agent is located[144]. This would not be changed in the SFT schedule provisions.
(vii) Accrual of interest from the final determination of net termination amount until payment	Interest will accrue on the net amount from the early termination date to, but excluding, the date of payment[145].	The GMSLA only caters for interest on the net amount if the net amount is not paid on the business day after account is taken[146].	Equivalent provisions to those set out in the GMRA in respect of interest are set out in the ISDA Master Agreement[147]. This would not be changed in the SFT schedule provisions.
Calculating value of securities	There are different options for valuing the securities: actual sale proceeds/purchase costs; quotes from market makers; and fair market value determined by the non-defaulting party. The default market value in respect of equivalent securities or equivalent margin securities is determined as follows: • If the non-defaulting party has sold/ bought identical securities from the same issuance, the net proceeds/ purchase price (less expenses etc); • If the non-defaulting party has received offers/bids in respect of securities of the relevant description from two or more market makers or regular dealers in the appropriate market in a commercially reasonably size, with a customary pricing methodology, the price quoted (after deducting reasonably anticipated expenses) and adjusted in a commercially reasonable manner by the non-defaulting party to reflect accrued but unpaid coupons not reflected in the quotes obtained. The non-defaulting party may determine a net value in respect of the relevant securities and treat that net value as the default market value if it has: • Endeavored but been unable to sell or purchase securities or obtain quotations; • Determined that it would not be commercially reasonable to sell or purchase securities at the prices bid or offered, or obtain or use the relevant quotations.	There are different options for valuing the securities: actual buy-in/sale price; quotes from market makers; and fair market value determined by the non-defaulting party. The default market value in respect of equivalent securities or equivalent margin securities is determined as follows: • If the non-defaulting party has purchased receivable securities or sold deliverable securities, it may elect to treat as the default market value the net proceeds of sale or net purchase costs; • If the non-defaulting party has received an offer securities or bid securities quotations from two or more market makers in a commercially reasonable size, it may elect to treat the price quoted (or the mean if there is more than one quote) as the default market value. Alternatively, the non-defaulting party may determine the net value of the relevant securities and treat the net value as the default market value[149] if, acting in good faith, it has: • Endeavored but been unable to sell or purchase securities or to obtain quotations; or • Determined that it would not be commercially reasonable to sell or purchase securities at the prices bid or offered or obtain such quotations, or that it would not be commercially reasonable to use any quotations that it has obtained.	With respect to valuing securities, the ISDA CSA mechanism involves the valuation agent determining the bid price of the relevant securities[151]. For the SFT schedule provisions, the features common to the default market value calculations in the GMRA and GMSLA would be added in.

Continued on next page
Continued on next page

141 GMRA, Paragraph 10(d)(ii)

142 GMRA, Paragraph 2(ss), definition of spot rate

143 GMSLA, Paragraph 11.2(b)

144 ISDA Master Agreement, Section 6(e) and Section 14, definition of termination currency equivalent

145 GMRA, Paragraph 10(d)

146 GMSLA, Paragraph 11.2(b) and Paragraph 15

147 ISDA Master Agreement, Paragraph 9(h)(ii)(2)

149 GMSLA, Paragraph 11.4-5

151 1995 CSA and 2016 VM CSA, Paragraph 10, definition of value

Continued from previous page Continued from previous page

	The net value is a fair market value reasonably determined by the non-defaulting party and derived from pricing sources (including trading prices) and based on pricing methods the non-defaulting party considers appropriate, less transaction costs that would be incurred or reasonably anticipated in connection with the purchase or sale of such securities[148].	The net value is an amount that, in the reasonable opinion of the non-defaulting party, represents the fair market value with regard to pricing sources and methods as appropriate. If, at the default valuation time, the non-defaulting party determines that it is not reasonably practicable to determine a commercially reasonable net value of the securities, the non-defaulting party may determine its net value as soon as is reasonably practicable after the default valuation time[150].	
Adjustments for payments/ deliveries in case of automatic early termination on insolvency	There is no equivalent concept under the GMRA.	There is no equivalent concept under the GMSLA.	Where an early termination date occurs pursuant to automatic early termination on insolvency (where it has been elected), the early termination amount is subject to adjustments to reflect payments or deliveries made by one party to the other during the period from the relevant early termination date to the date for payment determined under section 6(d)(ii)[152]. This would not be changed in the SFT schedule provisions.
When is the net amount payable?	On the business day following the date of the early termination statement[153].	Payment by the owing party must be made on the next business day after set-off has been effected[154].	Either: i) For events of default, on the day on which notice of the amount payable is effective; and ii) For termination events, on the day which is two local business days after the day on which notice of the amount payable is effective (or, if there are two affected parties, after the day on which the statement provided pursuant to clause (i) by the second party to provide such a statement is effective)[155]. This would not be changed in the SFT schedule provisions.
Expenses and other costs	The defaulting party will be liable for the non-defaulting party's expenses in connection with the default, together with interest thereon[156]. The non-defaulting party is also entitled to costs associated with replacement transactions or unwinding of hedges.	The defaulting party is liable to the non-defaulting party for legal and other professional expenses incurred as a result of the event of default, together with interest thereon[157].	The defaulting party is liable for the expenses of the non-defaulting party incurred in connection with the event of default[158]. This would not be changed in the SFT schedule provisions.

148 GMRA, Paragraph 10(e)(iii)
150 GMSLA, Paragraph 11.6
152 ISDA Master, Section 6(e)(iii)
153 GMRA, Paragraph 10(g)
154 GMSLA, Paragraph 11(2)(b)
155 ISDA Master Agreement, Section 6(d)(ii)
156 GMRA, Paragraph 10(d)(iii)
157 GMSLA, Paragraph 11.7
158 ISDA Master Agreement, Section 11

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
Other remedies	No remedies, except those set out in the agreement, may be sought by either party in respect of any event of default[159].	No remedies, except those set out in the agreement, may be sought after an event of default[160].	The provisions of the GMRA and GMSLA contrast with those of the ISDA Master Agreement, which notes that, except as specifically provided, the remedies and rights provided by the ISDA Master Agreement are not exclusive of those provided by law[161]. However, parties to the ISDA Master Agreement agree that neither party may recover additional damages as a consequence of a termination of the agreement[162]. This would not be changed in the SFT schedule provisions.
Consequential loss	The GMRA does not generally permit recovery of consequential loss[163], but does permit costs associated with replacement transactions or unwinding of hedges where a transaction is closed out early to be recovered. This applies not just where an event of default has occurred, but also in the context of the mini close-out provisions, referred to in the *Other* section.	The GMSLA does not generally permit recovery of consequential loss[164], but permits recovery of expenses (including buy-in costs) resulting from any failure to deliver on time[165] (not just where an event of default has occurred).	The ISDA Master Agreement caters for costs of replacement transactions and hedging in the concept of close-out amount[166]. There is a decision to make about whether to apply the concept of close-out amount to SFTs under the SFT schedule provisions. If this is concept is not applied, the SFT schedule provisions would replicate as far as possible the positions in the GMRA and GMSLA.
6. Other			
Failure to deliver and mini close-out	Parties may elect (in the annex) for a failure by the seller to deliver the purchased securities on the purchase date (or the buyer failing to deliver equivalent securities on the repurchase date) to constitute an event of default. If it is not an event of default, the non-defaulting party may require the failing party to pay cash margin to cover any transaction exposure. If the failure continues, the non-defaulting party may, by notice to the other, elect for a mini close-out of the relevant transaction[167]. Similar provisions exist catering for failures by either party to transfer equivalent margin securities, where such failure is on account of any reason relating to the securities or the clearing system through which the securities are to be transferred and the transferring party has made all reasonable efforts to make the transfer[168].	Under the GMSLA, a failure by the lender to lend the securities in the first place is not an event of default. A failure by the borrower to deliver equivalent securities is also not an event of default. Rather, the lender can decide to continue the loan or elect for a mini close-out and terminate it in accordance with the GMSLA termination provisions. A failure by the lender to deliver equivalent non-cash collateral is also not an event of default – the borrower can decide to continue the loan or elect for a mini close-out. Where there is a failure to deliver by either party as described, the party responsible for that failure is liable for any interest, overdraft or similar costs and expenses incurred by the other party. This must be paid within one business day of a demand of transferee[169].	Under the ISDA Master Agreement (and CSA), failure to deliver collateral constitutes a potential event of default[170] with respect to all transactions. Failure to deliver under a transaction may constitute a potential event of default with respect to all transactions, but only if, under the relevant confirmation or definitions, the obligation to deliver is non-conditional and not subject to any specific fallback provisions. The SFT schedule provisions would amend the failure to deliver event of default to preserve the optionality in both the GMRA and GMSLA.

159 GMRA, Paragraph 10(j)
160 GMSLA, Paragraph 10.3
161 ISDA Master Agreement, Section 9(d)
162 ISDA Master Agreement, Section 6(e)(v)
163 GMRA, Paragraph 10(k)-(l)
164 GMSLA, Paragraph 10.4
165 GMSLA, Paragraph 9.3
166 ISDA Master Agreement, Paragraph 14
167 GMRA, Paragraph 10(h) and (i)
168 GMRA. Paragraph 4(h)
169 GMSLA, Paragraph 9.3
170 ISDA Master Agreement, Section 5(a)(i)

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
Set-off	The GMRA includes a contractual set-off clause that provides that the net amount payable to the payee following an event of default may, at the option of the non-defaulting party, be set off against any amount payable from the payee party to the paying party under any other agreement between them[171].	The GMSLA provides, at the option of the non-defaulting party, for the set-off of any amount payable by one party to the other following an event of default against any amount payable by the other party under any other agreement or instrument between the parties[172].	The early termination amount payable is subject to a right of set-off. This means that the net value owed will, at the option of the non-defaulting party, be set off against any other amounts payable to the payer to the payee. The non-defaulting party may, in good faith, estimate the value of an unascertained obligation[173]. Parties would also be able to set-off termination amounts in respect of SFTs, whether because any termination amount in relation to SFTs is included within the definition of early termination amount, or (if an alternative approach is taken) the ISDA set-off provision is amended in the SFT schedule provisions.
Tax provisions	Under the GMRA, the general position is that all money payable is to be paid without withholding or deduction for any taxes or duties[174]. In circumstances where any taxes are payable, the paying party is required to pay such additional amounts as will result in the net amounts receivable by the other party being equal to such amounts as would have been received by it had no taxes or duties been required to be withheld or deducted. However, in these circumstances, the paying party may elect to terminate the relevant transaction by notice[175]. In which case, the receiving party can elect to continue the transaction and indemnify the paying party against the gross-up payment[176]. This is the case even if the optional wording to cover net paying securities has been included in annex I.	Under the GMSLA, the general position is that all payments are to be made without any deduction or withholding for or on account of any tax unless required by applicable law. If the paying party is required to deduct/ withhold, that party shall: • Notify the other party; • Pay or otherwise account for the full amount required to be deducted or withheld to the relevant authority; and • Pay to the other party such additional amount as is necessary to ensure the net amount actually received by the recipient will equal the amount the recipient would have received had no such deduction or withholding been required[177]. However, the payer will not be required to pay any additional amount to the recipient to the extent it would not be required to be paid for the failure by the recipient to comply with or perform any obligation to deliver certain requested tax forms. With respect to income, however, the position under the GMSLA is that the payer must pay to the other party such amounts as agreed between the parties or, failing such agreement, the amount the lender would have received assuming such securities were not loaned to the borrower. This may require specific provision in the SFT schedule provisions.	Under the ISDA Master Agreement, the general position is that all payments will be made without any deduction or withholding for tax, unless such deduction or withholding is required by applicable law. If a party is required to withhold, that party (X) will have to (among other things): • Notify the other party (Y); • Pay to the relevant authorities the full amount required to be deducted/ withheld; and • If the relevant tax is an indemnifiable tax, pay to Y such additional amount as is necessary to ensure the net amount actually received by Y would be the amount Y would have received had no deduction or withholding been required (a gross-up payment). However, X would not be required to make such gross-up payment where it would not have been required but for: • The failure of Y to comply with or perform any agreement contained in section 4(a)(i), (iii) or 4(d) – ie, a failure of Y to deliver certain requested tax forms; or • The failure of a tax representation made by Y to be accurate and true (subject to certain provisos, including a change in the law after a transaction is entered into). If there is a change in tax law or regulatory practice, the party suffering the adverse financial consequence may have the ability to terminate for a tax event.

Continued on next page

[171] GMRA. Paragraph 10(n)
[172] GMSLA, Paragraph 11.8
[173] ISDA Master Agreement, Section 6(f)
[174] GMRA, Paragraph 6(b)
[175] GMRA, Paragraph 11(c)
[176] GMRA, Paragraph 10(d)
[177] GMSLA, Paragraphs 12.1-12.3

Continued from previous page

			With respect to payments other than in respect of income, these provisions are broadly speaking similar to those set out in the GMRA and GMSLA, and they would not change for the purpose of the SFT schedule provisions. With respect to payments of income/ distributions, no express provision is made in the 1995 CSA with respect to distributions being received net rather than gross by the transferee. However, the transferee is only required to pay to the transferor what it receives. Consequently, specific provisions for this may need to be built into the SFT schedule provisions, and the choice between the approach taken in the GMRA and that taken in the GMSLA would also be built in.
7. Boilerplate Provisions			
Notices	Notices or communications may be sent by post, by fax or electronically under the GMRA[178]. Delivery rules vary depending on the means used, but broadly involve the notice's arrival within the receiver's sphere of control[179], except where this is not on a business day[180].	Notices or communications may be sent by post, by fax or electronically under the GMSLA. Delivery rules vary depending on the means used, but broadly involve the notice's arrival within the receiver's sphere of control, except where this is not on a business day[181].	The ISDA Master Agreement provisions regarding notices[182] largely mirror those in the GMRA and GMSLA, although the ISDA Master Agreement also provides for the ability to send notices by telex[183]. This would not be changed in the SFT schedule provisions.
No waivers	The GMRA provides that no express or implied waiver of any event of default by either party constitutes a waiver of any other event of default, and no exercise of any remedy will constitute a waiver of a party's right to exercise another. Failure to provide notice will not constitute a right to do so at a later date[184].	The GMSLA similarly provides that no failure or delay by a party to exercise a right or power will operate as a waiver. Again, a partial exercise of any right does not preclude any other or further exercise of that right or another right[185].	The ISDA Master Agreement also does not permit the failure, delay or partial exercise of a right to operate as a waiver in respect of that right or others[186]. This would not be changed in the SFT schedule provisions.
Governing law and jurisdiction	The GMRA is governed by English law and requires parties to submit to the exclusive jurisdiction of the English courts (including in respect of any non-contractual obligations arising out of the agreement)[187].	The GMSLA is also governed by English law[188] and the parties must submit to the exclusive jurisdiction of the English courts (including in respect of any non-contractual obligations arising out of the agreement)[189].	By contrast with the GMRA and GMSLA, parties are able to select via the schedule which law the ISDA Master Agreement is governed by[190]: either English Law or New York Law[191]. The election in the schedule then affects the courts that must be used to institute proceedings in[192]. Contrary to the GMRA and GMSLA, the ISDA provides for parties to submit to the non-exclusive jurisdiction of either the New York or English courts[193]. Further options are catered for in the 2018 ISDA Choice of Law and Governing Law Guide. This would not be changed in the SFT schedule provisions. However, the SFT schedule provisions would be made compatible with the French and Irish law governed ISDA Master Agreements.

[178] GMRA, Paragraph 14(a)-(b)
[179] GMRA, Paragraph 14(b)
[180] GMRA, Paragraph 14(b)
[181] GMSLA, Paragraph 20.1
[182] ISDA Master Agreement, Section 12(a)
[183] ISDA Master Agreement, Section 12(a)(ii)
[184] GMRA, Paragraph 18
[185] GMSLA, Paragraph 22
[186] ISDA Master Agreement, Section 9(f)
[187] GMRA, Paragraph 17
[188] GMSLA, Paragraph 23.1
[189] GMSLA, Paragraph 23.2-3
[190] ISDA Master, Section 13(a)
[191] ISDA Master, Schedule, Part 4(h)
[192] ISDA Master, Section 13(b)
[193] ISDA Master, Section 13(b)

Provision	GMRA	GMSLA	ISDA Master Agreement/ ISDA CSA
Recording	Parties agree that each may electronically record all telephone conversations between them[194].	Parties agree that each may electronically record all telephone conversations between them[195].	In the ISDA Master Agreement, parties may elect to include a provision to the same effect as the GMRA and GMSLA via the schedule[196]. This would not be changed in the SFT schedule provisions.

[194] GMRA, Paragraph 20

[195] GMSLA, Paragraph 2

[196] ISDA Master Agreement, Schedule, Part 4(n)

ABOUT ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 925 member institutions from 75 countries. These members comprise 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 website: www.isda.org.
Follow us on Twitter, LinkedIn, Facebook and YouTube.