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T-H ALERT TO BUY SIDE CLIENTS

3 June 2019

Planning for Phase 5 Initial Margin Requirements for Uncleared Swaps

Monday, June 3rd, 2019 is the first day in the June, July, August calculation period for determining the average daily aggregate notional amount (AANA) under U.S. uncleared margin rules to assess whether a market participant is in-scope for the Phase 5, September 1, 2020 initial margin compliance date. We encourage clients to begin to calculate their AANA numbers to determine whether any of their trading vehicles exceed the USD 8 billion material swaps exposure threshold across all of their relevant uncleared swaps, security-based swaps, foreign exchange forwards and foreign exchange swaps. We also encourage clients who have not already done so to engage now in dialogue with their regulated counterparties about this process and to review the ISDA published initial margin documentation.

The uncleared margin rules promulgated in multiple jurisdictions around the globe require that regulated swap dealers exchange initial margin (IM) on uncleared swap transactions with certain types of counterparties that have uncleared swap positions exceeding a certain threshold. These IM requirements are in addition to the already required exchange of variation margin (VM). The uncleared margin rules established by the CFTC and U.S. prudential regulators (the U.S. UMR), as well as in other jurisdictions, have been phased-in over a period of 5 years. The compliance date of September 1, 2020 under the U.S. UMR is the fifth and final phase and it requires swap dealers to exchange IM with any financial end user that, together with any relevant affiliates, has relevant swap notionals exceeding USD 8 billion and therefore has material swaps exposure.

ISDA has published a helpful step-by-step work sheet to guide market participants in the calculation of their AANA numbers that can be downloaded here: https://www.isda.org/2019/05/29/calculating-phase-five-aana-for-us-regulations/.

ISDA has published various forms of IM documentation for use by market participants in order to comply with the U.S. UMR as well as the uncleared margin rules of the EU, Japan, Australia, Hong Kong, Singapore, Switzerland and Canada. The IM documentation published by ISDA is intended to be used in conjunction with a market participant's existing ISDA and Credit Support Annex (CSA) documents. We encourage clients to become familiar with the IM documentation available and to develop a view of their preferred documentation structure. For many market participants, gone are the days of having an ISDA Master Agreement with a Schedule and a

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single CSA to document a swaps trading relationship. For an in-scope Phase 5 client, it will become common place for swaps trading documentation with a counterparty to include an ISDA Master Agreement with a Schedule, a legacy or VM CSA and an IM CSA, as well as account control agreements.

Addressing IM rules will be a more involved process than addressing VM rules for a variety of reasons. First, the IM rules are more complex and the implementation of the IM rules involves a significant number of business and credit decisions. By contrast, for many clients, the VM rules imposed requirements that were not significantly different from then-existing contractual arrangements and, often, the implementation of the VM rules required minimal business or credit input. Secondly, the documentation necessary to implement the IM rules is more complex. For example, the ISDA 2018 Credit Support Annex for Initial Margin (IM) is 36 pages in length compared to the ISDA 1994 New York Credit Support Annex's 14 pages. Thirdly, regulatory IM is required to be segregated with a third-party custodian, necessitating the establishment of a custody arrangement if one does not already exist. It should be noted that existing custody relationships may need to be updated and clients may be required to be on-boarded under new custodial relationship(s), which involves due diligence and operational setup that may take a significant amount of time. Finally, due to the sheer volume of documentation and on-boarding required as a result of having many market participants come into scope in Phase 5, both custodians and swap dealer counterparties have begun citing dates well in advance of September 2020 as deadlines for finalizing compliant documentation. We encourage Phase 5 clients to start discussions now with custodians and swap dealer counterparties to avoid any potential trading disruptions.

If you have any questions regarding initial margin rule compliance or the uncleared margin rules please contact one of the following or your usual T-H contact:

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