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# Documentation 'processes' overwhelming market participants

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**Banking & Finance analysis: Antony Bryceson, principal at AB Trading Advisors, says there is a growing feeling that the 1 March 2017 deadline for documenting, and hence achieving regulatory compliance with, the new variation margin (VM) requirements, is unachievable.**

## Original news

SIFMA AMG and IAA publish letter on variation margin requirements, LNB News 25/01/2017 167.

The US Securities Industry and Financial Markets Association's Asset Management Group (SIFMA AMG) has submitted a follow-up letter regarding its request for a transitional period for VM implementation. The letter provides additional information in support of AMG's 16 December 2016 letter requesting six-month transitional relief from the 1 March 2017 variation margin requirements and additional transitional relief for foreign exchange (FX) clients.

### Why did the associations send the letter?

The SIFMA Asset Management Group and the Investment Adviser Association sent the recent letter entitled 'Uncleared Swap Margin Requirements—Request for Transitional Relief from March 1, 2017 Variation Margin Implementation' to the specified regulatory bodies because there is a growing feeling that the 1 March 2017 deadline for documenting, and hence achieving regulatory compliance with, the new VM requirements, is unachievable.

The new VM requirements in Australia, Hong Kong and Singapore go live on 1 March 2017, with a six-month transitional period during which compliance is on a best efforts basis. There is a growing feeling that a similar transitional period of regulatory forbearance is necessary in relation to the European rules under the European Market Infrastructure Regulation (EMIR) and the VM rules in the United States.

### What are the issues relating to implementing the VM by 1 March 2017?

The issues are not to do with ambiguity in interpreting the various VM requirements (although there may be some who would welcome more clarity on certain issues). Rather, compliance is primarily evidenced by the content of the underlying documentation between two parties to relevant uncleared swaps. Existing agreements need to be amended, or new agreements put in place, prior to 1 March 2017. This involves many thousands of documentation 'processes', which are overwhelming market participants.

### What are the problems relating to agreeing regulation-compliant CSAs in time?

Parties to uncleared swaps almost universally document those transactions under an ISDA master agreement (ISDA agreement), frequently with a credit support annex (CSA) to the ISDA agreement to document collateral obligations.

Existing CSAs need to be amended to introduce terms to evidence compliance with the new VM rules, such as same day delivery of collateral, daily valuations, thresholds (which otherwise act to negate a party's right to receive the full amount of VM) and minimum transfer amounts (whereby a maximum of €500,000, or its equivalent in another currency, is permitted).

A really major change is that, whereas previously a buy side entity may have had the right to require its counterparty to deliver collateral to it, most did not actually exercise that right. The new VM rules require that collateral must actually be exchanged between parties, which is a significant conceptual change.

ISDA have produced a very good new VM compliant CSA called the ISDA 2016 Credit Support Annex for Variation Margin (VM) (2016 VM Credit Support Annex). This is a very useful template for documenting compliance with the VM rules.

Many existing CSAs are being amended with provisions taken from the 2016 VM Credit Support Annex to 'upgrade' them to become VM compliant.

Prime brokerage (PB) models are being amended to provide that, for uncleared swaps margined using a PB margining system, VM deliveries between the PB and its customer are recorded in a specific VM cash account or ledger. In many cases, prime brokers are creating an additional PB-specific CSA, which adds another layer of complexity to the documentation process.

This is all very detailed and complicated, and the documentation needs to be reviewed by persons with appropriate technical experience. Even if one were to take the approach of simply signing the documentation and hoping for the best, this path is not open to the many buy side market participants who are themselves directly subject to the VM requirements, and who need to make sure that the documentation is compliant from their perspective, not just from the dealer's perspective.

Some dealers have arguably not been proactive enough in anticipating their counterparties' compliance requirements, which has caused further back-and-forth and delays in the process of finalising amendments/documentation acceptable to both sides.

Another very real issue is that each agreement—each one of those thousands of CSAs and PB agreements—is different and the re-documenting process really needs to be done in a tailored way. Some dealers have been sending out draft documentation which is simply too generic and hence inappropriate for the task in hand. Thus comes resistance from those dealers' counterparties—discussions ensue, time goes on, a new documentation solution may be proposed, time goes on…and so on.

The letter requesting transitional relief appropriately refers to 'umbrella agreements'. An umbrella agreement is an ISDA agreement, which caters for multiple different sub-funds. Just putting aside the valid issues raised in the letter, umbrella agreements introduce a further layer of drafting and documentation complexity, which need time and attention to get right.

In summary, certain dealers have been realising, as time goes on, that their 'one size fits all' documentation solution is not, after all, 'one size fits all'.

The ISDA 2016 Variation Margin Protocol, which was touted by ISDA as being a useful tool for amending documentation, is itself complicated. As of 2 February, only 527 entities had adhered (ie signed up) to this protocol, whereas, as an indicator of market size, more than 14,000 entities have adhered to the ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol.

## What will happen to asset managers if the 1 March 2017 deadline isn't extended and they haven't managed to be in a position where they are compliant with the VM requirements?

Say your prayers and/or run! Seriously, only new trades entered into on or after 1 March 2017 need to be VM compliant, so counterparties may not be able to enter into new trades with each other.

Counterparties may be prioritised—those who parties need to trade with—and there is likely to be a focus on making sure that those sets of documentation are finalised promptly.

*Antony Bryceson is a market-leading practitioner. He has specialised in a range of derivatives, securities and trading matters for the past 15 years and is qualified as a solicitor in both England and Wales, and Hong Kong. Before founding AB Trading Advisors in 2014, Antony led teams of lawyers at Simmons & Simmons LLP and latterly Sidley Austin LLP for 11 years. At both firms, he advised hedge funds, family offices, trading firms and other clients on a broad range of derivatives, funds and regulatory matters. AB Trading Advisors is a specialist advisory firm focused on counterparty documentation, compliance infrastructure and regulatory advice.*

*Interviewed by Kate Beaumont.*