

ISDA Regulatory Margin Self-Disclosure Letter

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Do you need to take action?

Yes, if your fund has a trading relationship which may become subject to the uncleared derivatives margin rules and regulations in a jurisdiction where your fund or its counterparty is located (including Canada, the European Union, Japan, Switzerland or the United States), you may need to exchange information with your fund's counterparties in order to determine if and when compliance with one of the new regulatory margin regimes will be necessary. This can be done by completing and submitting the International Swaps and Derivatives Association, Inc. ("ISDA") Regulatory Margin Self-Disclosure Letter (the "Self-Disclosure Letter").

The ISDA Amend tool for online submission of information under the Self-Disclosure Letter is due to be available from last Friday (28th October) on the IHS Markit website.

Brief summary

In furtherance of the objectives under the international framework and global standards for margin requirements for over-the-counter derivative transactions that are not required to be centrally cleared ("Uncleared Swaps") promoted by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (BCBS/IOSCO), several jurisdictions including Canada, the European Union, Japan, Switzerland and the United States have adopted regulations which subject Uncleared Swaps to regulatory initial and variation margin requirements.

The application of the Uncleared Swap margin requirements primarily depends on the regulatory status of the subject market participant, various regulatory categorisations and details applicable to the subject market participant's counterparty, the aggregate average notional amount ("AANA") of Uncleared Swaps which the subject market participant and its counterparty engage in over a given period of time and the application of any regulatory exemptions ("Required Information").

The Self-Disclosure Letter provides an effective means for market participants to exchange Required Information between themselves and thus to determine whether, when and how they will need to comply with Uncleared Swap margin requirements in the relevant jurisdiction(s).

What is the Self-Disclosure Letter designed to achieve?

In order for a subject market participant to ensure its compliance with the relevant Uncleared Swap margin rules and regulations, it will need to be able to answer the following questions:

- i. What is the subject market participant's regulatory status under the regulatory regime to which it is subject?
- ii. How is the subject market participant's counterparty categorised under that same regulatory regime? Which particular margin requirements apply to the subject market participant, i.e., collecting regulatory margin, posting regulatory margin or both?
- iii. Do the applicable margin requirements extend to initial margin and variation margin, or just variation margin?

iv. When does the subject market participant need to start posting and/or collecting initial and variation margin (as applicable)?

v. Which transactions will be subject to initial and/or variation margin (as applicable)?

For example:

A major US bank which is regulated by the US prudential regulators and which is classified as a covered swap entity under (and is therefore directly subject to) the prudential rules and regulations enters into an Unclear Swap with a Cayman hedge fund. Since the US bank is regulated by the prudential regulators, the margin collateral requirements specified in the prudential rules would apply to the US bank (and hence by application to its counterparty, the Cayman fund) and the relevant Uncleared Swap.

To ensure compliance with the prudential rules and regulations, the US bank would need to seek information from the Cayman fund in order to establish how it should classify the Cayman fund under the prudential rules and regulations. In other words, the US bank would need to establish whether the Cayman fund is a financial end user, whether it is classified as a US person or a foreign person, what is the Cayman fund's AANA and whether there are any exemptions which may apply to the Cayman fund and the relevant Uncleared Swap. Using the Self-Disclosure Letter, the Cayman fund can submit Required Information to the US bank and thus enable the US bank to determine which Uncleared Swap margin requirements apply, and when they apply.

Structure of the Self-Disclosure Letter

Principal and Recipient

The party submitting Required Information using the Self-Disclosure Letter is defined as the "Principal", while the party receiving Required Information is defined as the "Recipient".

General Biographical and Jurisdiction or Regulator-Specific Information

The Self-Disclosure Letter consists of two main parts: (i) Principal's general biographical information; and (ii) jurisdiction or regulator-specific information.

In the general biographical information section of the Self-Disclosure Letter, the Principal is required to provide such data as the name of the legal entity, its Legal Entity Identifier (LEI), its address, contact information and branch information (if applicable). General biographical information needs to be provided by all Principals who use the Self-Disclosure Letter to supply Recipients with Required Information.

In the jurisdiction or regulator-specific sections of the Self-Disclosure Letter, the Principal would need to disclose the following information:

- the Principal's status under applicable Uncleared Swap margin regulations (e.g., "financial end-user", "FC", "NFC+", etc.);
- the Principal's cross-border status under applicable Uncleared Swap margin regulations (e.g., "U.S. person", "third country entity", etc.);
- the Principal's AANA in a particular year; and
- the application of exemptions (if any) under applicable Uncleared Swap margin regulations.

For purposes of the jurisdiction or regulator-specific sections, the applicable regulations will mean the regulations applicable to the Recipient. Thus, the Recipient would need to advise the Principal as to which jurisdiction or regulator-specific sections should be completed by the Principal to enable the Recipient to make necessary determinations. In other words, required jurisdiction or regulator-specific sections will correspond to the jurisdictions where the Recipient is organised and regulated under applicable Uncleared Swap margin regulations.

To continue the example given above, the US bank would need to instruct its counterparties (including the Cayman fund) to provide information specified in the section entitled “United States Information” and subsection “Prudential Regulators”.

Covered Jurisdictions

The Self-Disclosure Letter, as currently published, covers the following jurisdictions and contains the respective jurisdiction or regulator-specific sections: Canada Information, EU Information, Japan Information, Switzerland Information and United States Information. However, it is expected that additional jurisdiction sections will be covered under the Self-Disclosure Letter once regulators in other jurisdictions finalise their national Uncleared Swaps margin rules and regulations.

How should the Self-Disclosure Letter be delivered?

ISDA and IHS Markit have recently developed the online tool ISDA Amend 2.0 Self-Disclosure Letter (“ISDA Amend SDL”) which enables market participants to exchange Required Information in an efficient way. The ISDA Amend SDL tool is available on the IHS Markit website. Notable features of the ISDA Amend SDL tool include:

- logical functionality which allows market participants to provide Required Information by answering fewer questions;
- a “modular” approach, i.e., parties can select only those modules which are applicable to them for purposes of Uncleared Swap margin regulations. To achieve this, a dealer will have an opportunity to pre-set jurisdictional modules which the dealer needs to be completed by its counterparties in order for the dealer to make necessary regulatory determinations;
- warning flags/permission blocks on conflicting pre-populated information and warning flags/permission blocks on missing jurisdictional information required by dealers; and
- ISDA Amend SDL will use (to the extent possible) current information which market participants have already submitted using ISDA Amend when completing other ISDA protocols (e.g., the ISDA August 2012 DF Protocol, the ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol).

Is there a deadline for completion of the Self-Disclosure Letter?

Completion of the Self-Disclosure Letter is not subject to a particular deadline. Instead, it is expected that swap dealers/major market participants organised in jurisdictions covered by the Self-Disclosure Letter either have already or will shortly begin to contact their counterparties to request the provision of Required Information prior to upcoming compliance dates.

The regulatory implementation timetable in certain jurisdictions has already begun as of 1st September 2016, with the largest derivatives users (based on volume of Uncleared Swaps) being first subject to the new margin rules. For all other market participants, variation margin requirements will become effective as of 1st March 2017 and initial margin requirements will be phased in over a four year period.

Upcoming AB Briefs will cover regulatory margin requirements, as well as forthcoming documentation changes, in more detail.