



# **The New Execution & Clearing Regime**

## **Documentation: Master Netting Agreements, the Future of the ISDA Master Agreement and Clearing Documentation and Processes**

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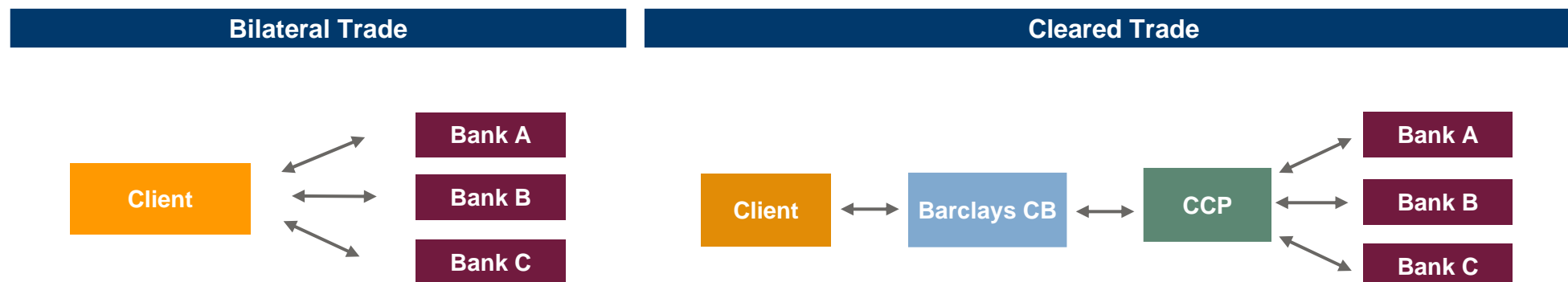
# Introduction

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- The Bilateral versus Cleared Trade
- The Matched Principal and FCM models of clearing
- The choice of documentation
- The Capital drivers
- Other challenges to the ISDA
- Timelines

# Bilateral vs Cleared Trade

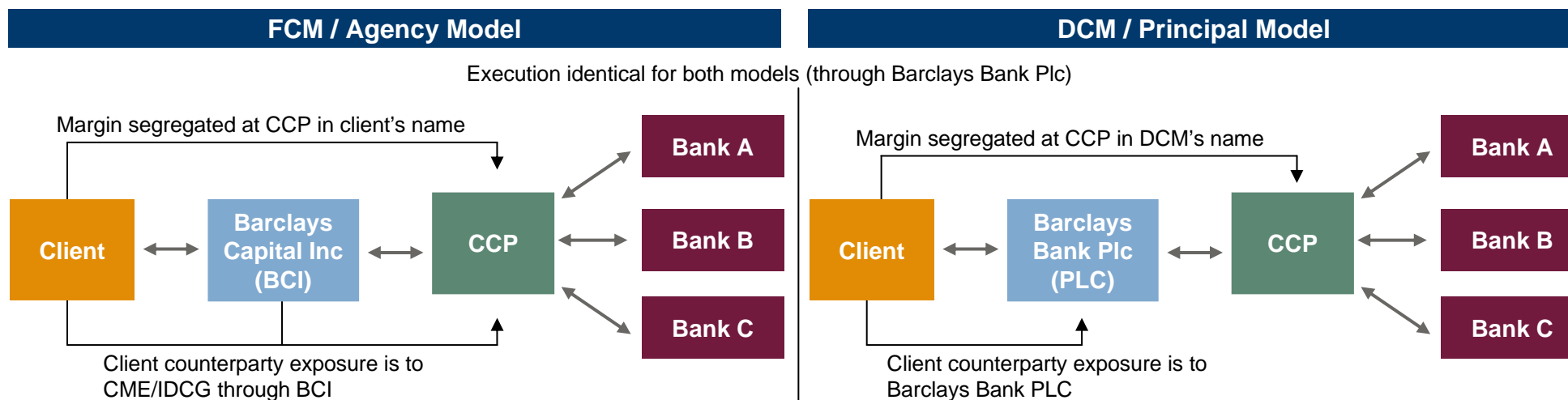
The introduction of OTC Clearing has changed the relationship model



- Voice Execution bilaterally agreed upon with Client & Dealer
- Counterparty Exposure is to multiple trading partners
- Must have ISDAs in place with all trading partners
- Margin requirements based on Dealer methodologies
- Initial Margin (IM) held at dealer or third party custodian
- Operational Model is not efficient:
  - ▶ Unwinds / Assignments to close out positions
  - ▶ Multiple Wires & Collateral calls
  - ▶ Inconsistent marks & valuations

- Voice Execution bilaterally agreed upon with Client & Dealer
- Counterparty Exposure is limited to one counterparty
  - ▶ Margin requirements are based upon CCP margin methodologies
  - ▶ Initial Margin (IM) is held in a segregated account at the CCP
  - ▶ Variation Margin (VM) passes through to CCP
- Operational Model is efficient
  - ▶ Offsetting trades needed to close out positions for Credit trading. Unwinds / Assignments no longer needed.
  - ▶ Reduces the number of wires and collateral calls
- In the event of a clearing broker default, the client's segregated margin at the CCP can be used to port (transfer) the client's positions to another clearing broker at the same CCP

# Cleared Trade: Agency and Principal Model



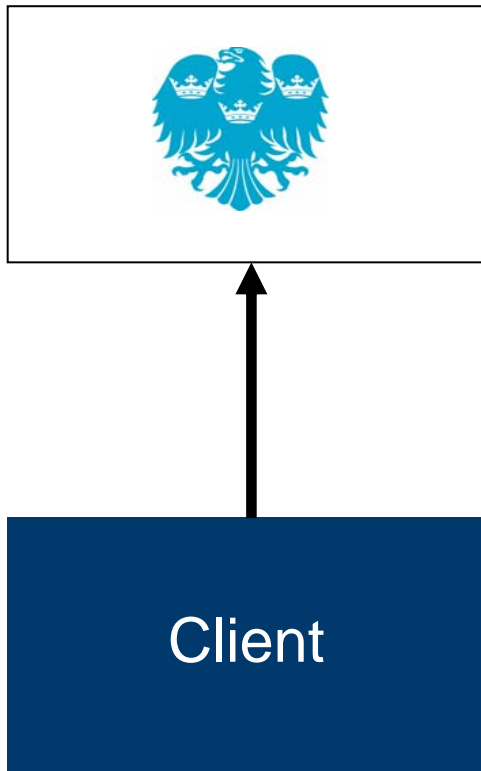
FCM access offers protections including margin collateral being held in the US, portability of client collateral and positions, and arrangements governed under New York State law

While exposure under the DCM model is legally to BBPLC for both trade and collateral, this is protected via the "Deed of Assignment"

Key Facts	Agency Model	Principal Model
Barclays Execution Entity	Barclays Bank Plc (PLC)	Barclays Bank Plc (PLC)
Barclays Clearing Entity	Barclays Capital Inc (BCI)	Barclays Bank Plc (PLC)
Counterparty Exposure	LCH (US)/CME/IDCG through Barclays Capital Inc	Barclays Bank PLC
Legal Documentation	Futures Based	ISDA Based
Give-up Agreements	Yes	Yes
CCP Offering	LCH (US), CME, ICE Trust	LCH, ICE Clear
Margin Protection	Client Net Omnibus	Individual Seg at LCH, partial seg at ICE Clear

# Combined executing broker/clearing broker model

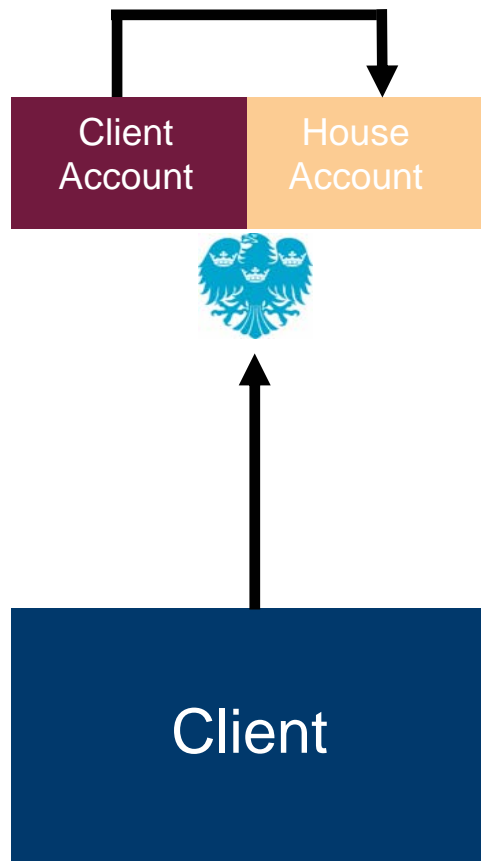
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- ▶ Dealer agrees to put on a trade with the Client
- ▶ Governed by an amended ISDA Master Agreement
- ▶ Parties agree that the trade is to be “cleared”

# Combined executing broker/clearing broker model

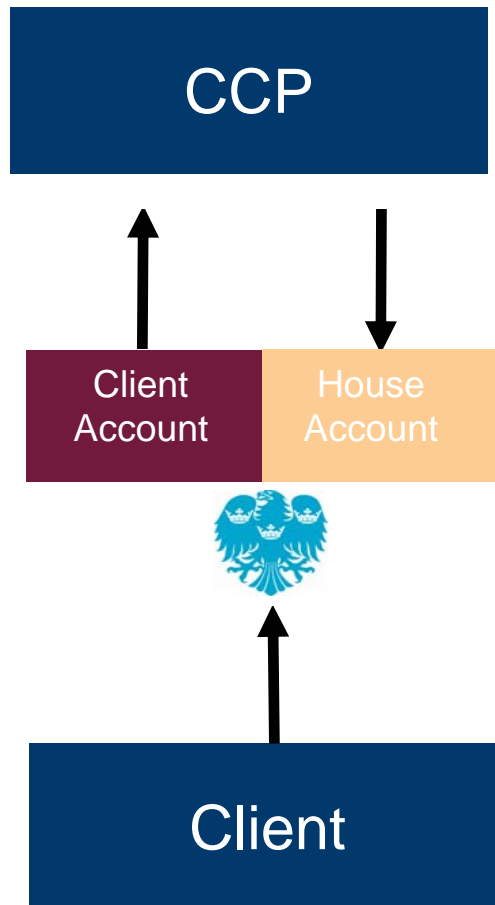
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- ▶ Dealer books a mirror trade between its “client” and “house” accounts
- ▶ Dealer submits details of mirror trade to CCP to be cleared

# Combined executing broker/clearing broker model

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- ▶ Upon registration at CCP, the position booked between dealer's house and client accounts is cancelled
- ▶ Replaced by two back-to-back cleared trades
  - between dealer's client account and CCP
  - between CCP and dealer's house account

# Documentation Platform for OTC

Confirmations

**2003 ISDA  
Credit  
Derivatives  
Definitions**

**ISDA.**  
International Swaps and Derivatives Association, Inc.

Introduction, Standard Paragraphs and Closing for a Confirmation of a Swap Transaction

\_\_\_\_\_  
(Signature)

\_\_\_\_\_  
(Printed Name of Party A)

\_\_\_\_\_  
(Printed Name of Party B)

\_\_\_\_\_  
(Date)

The purpose of this (documented) this "Confirmation" is to confirm the terms and conditions of the Swap Transaction entered into between us on the (Date) (Date) specified below.

The definitions and provisions contained in the 2003 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc., are incorporated into this Confirmation. In the event of any inconsistency between these definitions and provisions and this Confirmation, this Confirmation will prevail.

This Confirmation constitutes a "Confirmation" as defined in its, and supplements, forms part of and is subject to the 2003 ISDA Master Agreement dated as of (Date) as amended and supplemented from time to time (the "Master Agreement") between Party A (Party "A") and Party B (Party "B"). All provisions contained in the Master Agreement govern this Confirmation except as expressly modified herein.

**2006 ISDA  
Definitions**

**ISDA®**

INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

(Multicurrency — Cross Border)

**ISDA®**  
International Swaps and Derivatives Association, Inc.

**MASTER AGREEMENT**

dated as of \_\_\_\_\_

\_\_\_\_\_ and \_\_\_\_\_

have entered and/or anticipate entering into one or more transactions (each a "Transaction") that are or will be governed by this Master Agreement, which includes the schedule (the "Schedule"), and the documents and other confirming evidence (each a "Confirmation") exchanged between the parties confirming those Transactions.

Accordingly, the parties agree as follows: —

**1. Interpretation**

(a) **Definitions.** The terms defined in Section 14 and in the Schedule will have the meanings therein specified for the purpose of this Master Agreement.

(b) **Inconsistency.** In the event of any inconsistency between the provisions of the Schedule and the other provisions of this Master Agreement, the Schedule will prevail. In the event of any inconsistency between the provisions of any Confirmation and this Master Agreement (including the Schedule), such Confirmation will prevail for the purpose of the relevant Transaction.

(c) **Single Agreement.** All Transactions are entered into in reliance on the fact that this Master Agreement and all Confirmations form a single agreement between the parties (collectively referred to as this "Agreement"), and the parties would not otherwise enter into any Transactions.

**2. Obligations**

(a) **General Conditions.**

(i) Each party will make each payment or delivery specified in each Confirmation to be made by it, subject to the other provisions of this Agreement.

(ii) Payments under this Agreement will be made on the due date for value on that date in the place of the account specified in the relevant Confirmation or otherwise pursuant to this Agreement, in freely transferable funds and in the manner customary for payments in the required currency. Where settlement is by delivery (that is, other than by payment), such delivery will be made for receipt on the due date in the manner customary for the relevant obligation unless otherwise specified in the relevant Confirmation or elsewhere in this Agreement.

(iii) Each obligation of each party under Section 2(a)(i) is subject to (1) the condition precedent that no Event of Default or Potential Event of Default with respect to the other party has occurred and is continuing, (2) the condition precedent that no Early Termination Date in respect of the relevant Transaction has occurred or been effectively designated and (3) each other applicable condition precedent specified in this Agreement.

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**SCHEDULE  
to the  
Master Agreement**

dated as of \_\_\_\_\_

between \_\_\_\_\_ and \_\_\_\_\_  
(Party A) (Party B)

Part I. Termination Provisions.

(i) "Specified Early" means in relation to Party A for the purpose of: —  
Section 5(a)(i), \_\_\_\_\_  
Section 5(a)(ii), \_\_\_\_\_  
Section 5(b)(i), \_\_\_\_\_  
Section 5(b)(ii), \_\_\_\_\_

and in relation to Party B for the purpose of: —  
Section 5(a)(i), \_\_\_\_\_  
Section 5(a)(ii), \_\_\_\_\_  
Section 5(b)(i), \_\_\_\_\_  
Section 5(b)(ii), \_\_\_\_\_

(ii) "Specified Termination" will have the meaning specified in Section 14 of this Agreement unless another meaning is specified here \_\_\_\_\_

(iii) The "Cross Default" provisions of Section 5(a)(i) will not apply to Party A \_\_\_\_\_  
will not apply to Party B \_\_\_\_\_

If each provision applies: —  
"Specified Termination" will have the meaning specified in Section 14 of this Agreement unless another meaning is specified here \_\_\_\_\_

(Bilateral Form - Transfer)<sup>1</sup> (ISDA Agreement Subject to English Law)<sup>2</sup>

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**CREDIT SUPPORT ANNEX**

to the Schedule to the  
**ISDA Master Agreement**

dated as of \_\_\_\_\_

between \_\_\_\_\_  
(Party A) and (Party B)

This Annex, supplements, forms part of, and is subject to, the ISDA Master Agreement referred to above and is part of its Schedule. For the purposes of this Agreement, including, without limitation, Sections 10(a), 2(a), 3 and 4, the credit support arrangements set out in this Annex constitute a Transaction (for which this Annex constitutes the Confirmation).

**Paragraph 1. Interpretation**

Capitalized terms not otherwise defined in this Annex or elsewhere in this Agreement have the meanings specified pursuant to Paragraph 2(a) and all references in this Annex to Paragraphs are to Paragraphs of this Annex. In the event of any inconsistency between this Annex and the other provisions of this Schedule, this Annex will prevail, and in the event of any inconsistency between Paragraph 1(b) and the other provisions of this Schedule, Paragraph 1(b) will prevail.

<sup>1</sup> This document is not intended to create a paper or other security interest over the assets transferred under its terms. Please consult your legal counsel to ensure compliance with the requirements of applicable law in your jurisdiction.

<sup>2</sup> This Credit Support Annex has been prepared for use with ISDA Master Agreements subject to English law. It may be amended to reflect other applicable law. It is intended to be used in conjunction with the ISDA Master Agreement, which shall govern the interpretation of this document. It is not intended to be used in conjunction with any other ISDA Master Agreement. It is not intended to be used in conjunction with any other ISDA Master Agreement. It is not intended to be used in conjunction with any other ISDA Master Agreement.

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# Cleared Trading Documentation

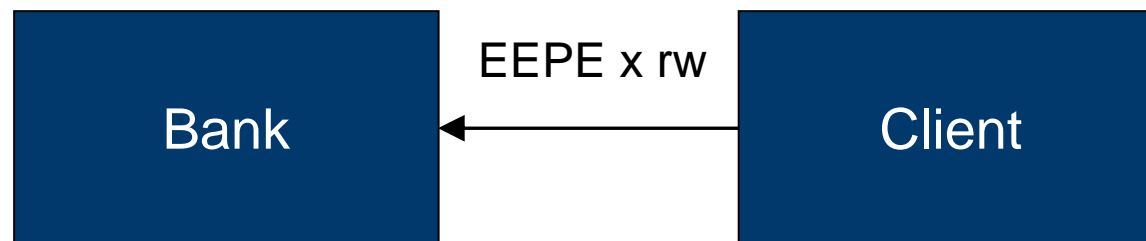
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- Can be based upon the ISDA model
- Significant amendments required to reflect the rules of the CCP
- An alternative is to use “futures” style documentation
- Either approach needs to capture core requirements relating to the treatment of collateral and porting, in conjunction with the CCP rules
- Trading through CCPs also introduces additional sources of laws which define the relationship between the parties, such as idiosyncratic insolvency laws (e.g., those introduced under the Companies Act 1989 in the UK)
- Various drivers will influence the future model of participation in CCPs and the client facing documentation
- One of those factors is likely to be capital.....why?

# OTC business Basel 2

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## Current treatment



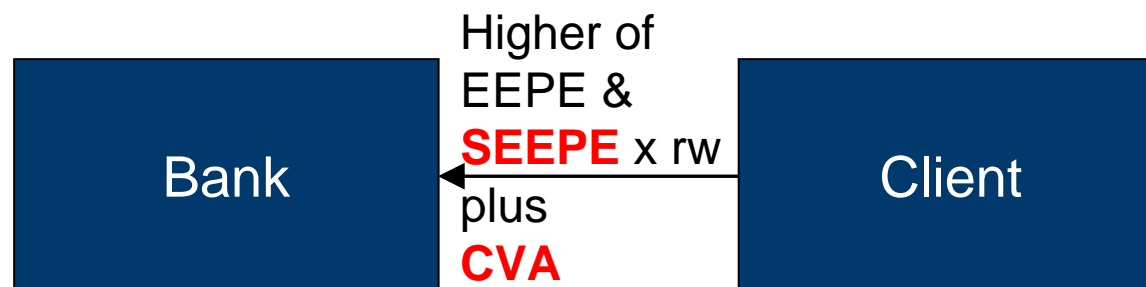
The bank is exposed to the client's non-performance. This is calculated (for example) under an EEPE waiver.

The charge considers the MtM, a Monte-Carlo simulation of exposure based on the underlying market risk factors and the frequency and level of re-margining. This is risk weighted.

# OTC business Basel 3

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## Future treatment

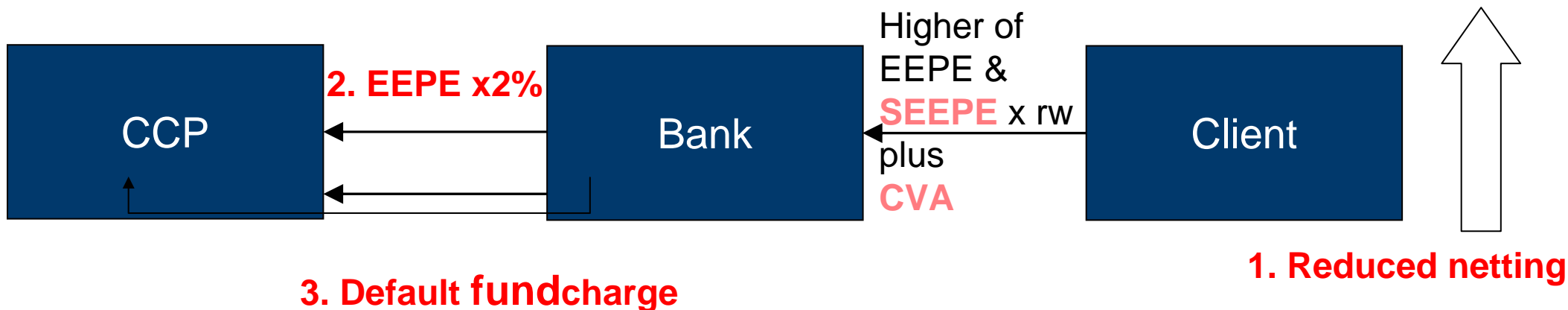


Basel 3 introduces Stress EEPE based charges and a charge for the client's credit quality volatility (CVA) to recognise the risk of raising market based credit provisions.

Basel 3 counterparty risk charges are anticipated to be approx 3 times higher than the Basel 2 equivalent.

# Cleared OTC business Basel 3

Proposed treatment introduces 3 sources of increased capital requirement



The proposals leave the client facing trade as OTC, still subject to SEEPE and CVA. In fact due to reduced netting arising from trades being taken out of ISDA documents and being included in exchange documents, this relationship is likely to have higher EEPE, SEEPE and CVA.

The charges against the CCP will be based on the client and house trades (i.e. for 1 bilateral swap between clearing bank and client, there will be 2 swaps with the CCP, 1 house and 1 client). This is calculated as EEPE x 2%, whilst the rw is low the EEPE is additive to the pre-existing OTC position.

The CCP is likely to have a higher CEM based default fund charge. This is charged as 100% capital (1250% risk weight). This is additive to the pre-existing Basel 3 OTC charges

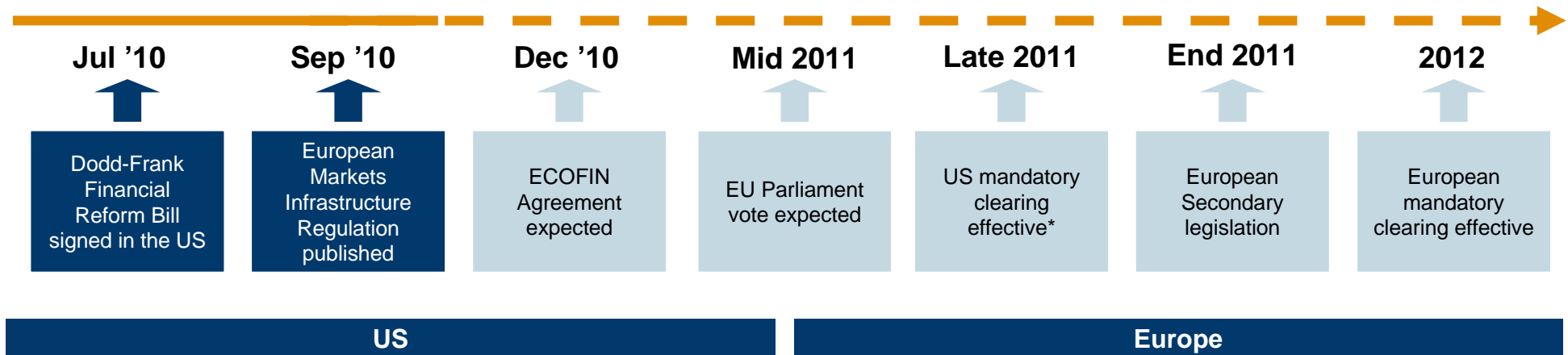
# Master Netting Agreements

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- The Banking Consolidation Directive
- The risk of fragmentation and disaggregation of trading risk
- Increased direction in trading books
- Other changes on the horizon?

# Market Landscape

## Timeline to OTC Clearing



- US Financial reform bill (Dodd-Frank) was signed into law in the US on 21<sup>st</sup> July 2010
  - ▶ Swap dealers and major swap participants required to clear swaps through a clearing house
  - ▶ Transactions to be executed on a central exchange
  - ▶ Requires reporting of swap transactions to regulators in a timely manner

\* US mandatory clearing will be required the latter of 360-days from the date of signing Dodd-Frank, or 60-days after the SEC/CFTC have completed the rule writing

- European Markets Infrastructure Regulation was published on 15<sup>th</sup> September 2010
  - ▶ Mandates most investors to clear OTC derivatives through a clearinghouse
  - ▶ Cleared and non-cleared OTC derivatives to be reported to a trade repository
  - ▶ Notable for its similarities with Dodd-Frank in the US

NB: European Legislation is currently only a proposal – it is subject to change as it goes through the political process

# Disclaimer

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