

# ISDA Cash as Eligible Collateral Sub-Working Group

## **Suggested Operational Practices for Posting Cash as Initial Margin To Be Reinvested into a Money Market Fund**

Document Version: 1.0

This document should be considered a working document based on the industry's interpretation of the minimum standards set forth in the final policy framework on Margin Requirements for Non-Centrally Cleared Derivatives published by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (BCBS-IOSCO) in March 2015 and the subsequent final rules issued by the European Commission, the U.S. Commodity Futures Trading Commission (CFTC), and the U.S Prudential Regulators.

Important note and Disclaimer,

This document does not constitute legal, accounting, or financial advice and the document describes the potential market consensus among swap market participants who participated in the Cash as Eligible Collateral Sub-Working Group. As with other guidance and market practise statements that ISDA disseminates, parties are free to choose alternate means of addressing the specific facts of their situation. Nothing in the document is contractually binding of any parties or amends any ISDA Master Agreement or ISDA Credit Support Annex.

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## 1 Introduction

### 1.1 Executive Summary

The International Swaps & Derivatives Association, Inc. (ISDA) utilized the ISDA Margin & Collateral Processing Working Group’s Cash as Initial Margin Sub-Working Group to engage market participants and develop suggested standard operating practices for posting cash as initial margin with the intention to reinvest into another form of eligible collateral such as a money market fund using automated/straight-through processing (“STP”) workflows.

The working group’s objectives were to discuss the potential methods to effectuate cash to be accepted as initial margin and reinvested to a money market fund using a Third Party Custodian (“TPC”) segregated account structure. Triparty provider structures will not be included in this document.

The Purpose of this document *Suggested Operational Practices for Posting Cash as Initial Margin – To Be Reinvested into a Money Market Fund* (“SOP”) is to define recommended business and technology considerations associated with implementation of the new IM rules. Users of this document will include, but not be limited to, secured parties and pledgors and their administrators, utilities and infrastructure providers, third party custodians, and collateral management technology providers. Although the group discussed the two workflows – posting cash as initial margin to be reinvested into a money market fund within the segregated account and also posting a money market fund directly from main account to the segregated account, the focus of this SOP is posting cash and reinvesting into a money market fund.

The first edition of this document will focus on money market funds as a reinvestment, and additional types of eligible collateral may be considered in the future.

## 1.2 Regulatory Overview

Cash and money market funds are both listed as eligible collateral for IM within global regulatory regimes, however the *Margin and Capital Requirements for Covered Swap Entities*<sup>1</sup> (“USPR rule”) and the *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*<sup>2</sup> (“CFTC rule”) (collectively, “US rules”) require cash to be reinvested to eligible collateral “within a time period reasonably necessary to consummate such purchase after the cash collateral is posted as initial margin.”

Further, while not required by any other regulatory regime, reinvesting cash into a money market fund may also reduce custodian risk in the event of a custodian bankruptcy because cash posted as collateral is attributed to the custodian’s balance sheet and securities such as money market funds are not.

## 2 Scope

This document has been categorised based on the main components of the workflow: posting cash to be reinvested into a money market fund using automated/STP workflows.

### **Posting Cash to be Reinvested**

- Standardised ISO15022 messaging
- Standardised reporting

Although discussed in the working group, posting money market funds directly from a main account to a segregated account may be detailed in this document in the future. Due to potential challenges with recordkeeping on behalf of the pledgor and the secured party by the custodian and the transfer agent and lack of clarity regarding procedures in the case of a pledgor default, the workflow will not be included.

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<sup>1</sup> 80 Fed. Reg. 74840 (November 30, 2015)

<sup>2</sup> 81 Fed. Reg. 636 (January 6, 2016)

### 3 Assumptions and Dependencies

In addition to those mentioned below, further relevant assumptions and dependencies related to each suggested practice have been provided along with the description of the suggested practice in Section 4 of the document. The assumptions listed in this document are subject to change and periodic revision.

- Custodians will support the account arrangement needed to comply with the regulatory margin requirements.
- Secured parties and pledgors and their administrators, utilities and infrastructure providers, third party custodians, and collateral management technology providers will adopt a market standard messaging infrastructure for margin call affirmation, allocating applicable haircuts, settlement, release, and reporting.
- For firms that utilize a memo pledge recordkeeping process, market standard messaging infrastructure will be used.
- Margin calls and collateral affirmations will take place upstream of the settlement, status, confirmation, release, and reporting SOPs. Cash to be reinvested within the segregated account will be affirmed with haircut considerations, if applicable.
  - Cash as Initial Margin to be reinvested into money market funds within the segregated account.
    - When reinvesting into a money market fund, this workflow ensures the beneficial owner/secured party is kept in the records of the custodian performing the sweep reinvestment and the transfer agent will maintain the recordkeeping of the custodian purchasing money market fund shares not including details regarding the pledgor or secured party.
    - Sweep times/cut-offs for cash to money market fund workflows within a segregated account will be determined by the custodian and money market fund.
- Collateral settlements as cash and then transformed to a money market may create a mismatch with custodian position/holdings reports and collateral management systems and may also create challenges with STP of collateral release messaging. It is recommended to:
  - Track both collateral settlements along with collateral held; or
  - Track the collateral settlement and perform an ‘internal transfer’ or ‘internal substitution’ that will change the cash posted, accounting for a haircut if necessary, to the money market fund cusip collateral value.
  - Use settlement instructions corresponding to cash messages (MT202/MT210).

## 4 Suggested Operational Practices Table

### Definition of Suggested Operational Practices Table

<b>SOP (Suggested Operational Practice) #</b>	Unique reference number assigned to each consideration in the document
<b>Process or Background</b>	High level description of each minimum consideration
<b>Minimum Consideration Description</b>	Recommended business and technology considerations required to comply with new margin rules
<b>Assumptions &amp; Dependencies</b>	Description of key assumptions and dependencies related to each minimum consideration

#### 4.1 Cash as Initial Margin to be Reinvested - SOPs

SOP#	Process or Background	Minimum Consideration Description	Assumptions & Dependencies
SOP1	Deposit Collateral - Instructing	<p>TPC to support processing of:</p> <ul style="list-style-type: none"> <li>Cash: MT210 Advice to Receive (if necessary for currency), MT202 to Deliver</li> </ul> <p>These messages will be sent by the Pledgor and Secured Party.</p>	Dependency that all TPCs can support ISO15022 MT210/202 messaging.
SOP2	Deposit Collateral – Status Updates	<p>TPC to support sending of and MT296 status updates.</p>	Dependency that all TPCs can support ISO15022 MT296 messaging.
SOP3	Deposit Collateral – Settlement Confirmation	<p>TPC to support sending of:</p> <ul style="list-style-type: none"> <li>Cash: MT910 Credit Confirmation</li> </ul> <p>These settlement confirmations will be sent to the Pledgor <b>and</b> the Secured Party.</p>	Dependency that all TPCs can support ISO15022 MT910 messaging.
SOP4	Reinvestment by Custodian	<p>TPC reinvests cash into eligible collateral money market fund(s) including ISIN(s), per standing instructions within GCA, ACA, Sweep Letter, Letter of Instruction, Authorization and Direction Form, or equivalent custody document.</p>	Dependency that all TPCs can accommodate reinvestment to a form of eligible collateral money market fund(s) via standing instructions. Documentation of eligible MMF must be agreed to by pledger and secured party, and changes may be made only with consent by both parties.
SOP5	Return Collateral – Authorising/Instructing	<p>TPC to support processing of:</p> <ul style="list-style-type: none"> <li>Cash: MT202 Payment Instruction,</li> </ul> <p>These messages will be sent by the Secured Party.</p> <p>There are two processes of authorisation prior to collateral release (Dual and Single)</p> <p>DUAL - The Pledgor sends MT SWIFT messages (MT202/MT210) followed by the Secured Party sending an MT527, and then collateral is released; OR The Pledgor sends MT SWIFT messages (MT202/MT210) followed by the Secured Party sending an MT202, and then collateral is released.</p> <p>SINGLE - Only the Secured Party instructs (MT202), and then collateral is released.</p> <p>Authorization can also be facilitated via use of a messaging utility either for Dual or Single authorization.</p> <p>Whichever method, it must be detailed within the ACA.</p>	Dependency that all TPCs can support ISO15022 MT202/MT210.

SOP#	Process or Background	Minimum Consideration Description	Assumptions & Dependencies
SOP6	Return Collateral – Reporting on Authorisation Issues	<p>TPC to support sending of:</p> <ul style="list-style-type: none"> <li>Cash: MT296 status reports</li> <li>If MT527 provided in case of DUAL authorization, then MT558 confirmation message is issued.</li> </ul> <p>These messages will be sent by the TPC to the Secured Party if there is a problem with the authorisation/instruction, e.g. wrong SSI specified.</p>	Dependency that all TPCs can support ISO15022 MT296, and if dual authorization with MT527 and MT558 messaging.
SOP7	Return Collateral – Settlement Confirmation	<p>TPC to support sending of:</p> <ul style="list-style-type: none"> <li>Cash: MT900 Debit Confirmation,</li> </ul> <p>These settlement confirmations will be sent to the Pledgor <b>and</b> the Secured Party.</p>	Dependency that all TPCs can support ISO15022 MT900 messaging.
SOP8	Statements	<p>TPC to support sending of:</p> <ul style="list-style-type: none"> <li>Cash: MT940 and MT950 statements</li> </ul> <p>These settlement confirmations will be sent to the Pledgor <b>and</b> the Secured Party.</p>	Dependency that all TPCs can support ISO15022 MT940/950 messaging.

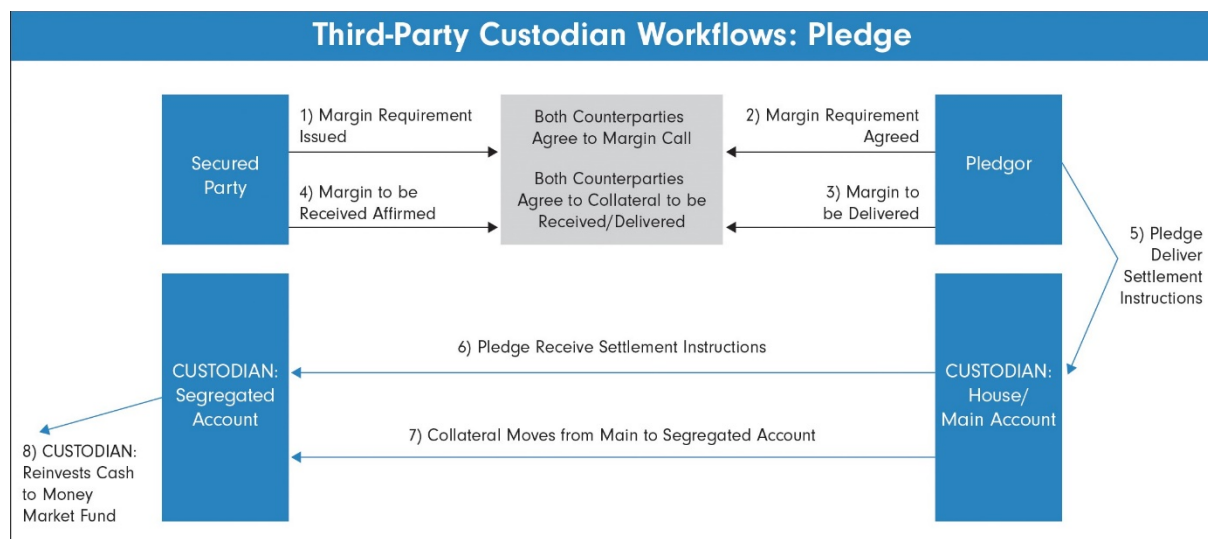
## 4.2 Third Party Workflows

### Pledge Collateral

Both counterparties agree to the initial margin and affirm the collateral to be transferred.

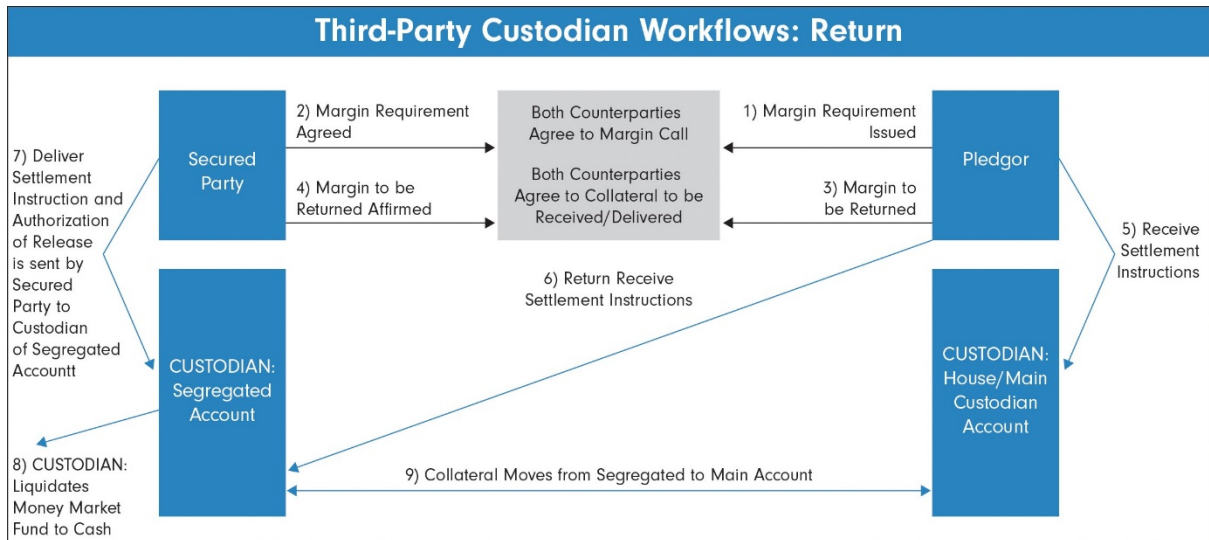
With the third party structure, counterparties set up accounts at a custodian for margin segregation, and the pledgor instructs the custodian to move collateral to the segregated account on behalf of the secured party, and the custodian reinvests the cash to a money market fund previously agreed to by both the pledgor and secured party.

Please note: there could be different custodians for the house/main account and the segregated account.



## Release of Collateral

With the third party structure, an authorization of release is necessary to move excess collateral back to the pledgor. In the ACAs, there are two methods of release – dual authorization (both parties instruct and authorize), and single (only the pledgee instructs/authorizes), and this reference in the ACA can impact workflow and settlement instruction details. Before cash is returned to the pledgor, the custodian must liquidate the money market fund shares to cash.



## Appendix

### SWIFT Messages

<b>Message Format</b>	<b>General Description/Purpose</b>
MT202	Deliver Payment Instruction
MT210	Notice to Receive Instruction
MT296	Reject of MT210 message by Receiver
MT527	Secured Party's Authorization of Release
MT558	Status/Confirmation of Settlement Message
MT940	Cash Statement
MT950	Cash Statement
MT900	Deliverer Debit Confirmation
MT910	Receiver Credit Confirmation
MT996	Reject of MT900, MT910, or MT296 due to failed business rules validation
MT998	Reject of MT900, MT910, or MT296 due to transformation/parsing issues