An introduction to the 2022 ISDA Securities Financing Transactions Definitions and Schedule Provisions

ISDA publishes new documentation to allow repos and stock loans to be documented under the ISDA Master Agreement framework

Introduction

On 28 February 2022, ISDA published the 2022 ISDA Securities Financing Transactions Definitions and the ISDA Securities Financing Transactions Schedule Provisions (together, the "ISDA SFT Documentation"). The ISDA SFT Documentation is designed to allow securities financing transactions to be documented under the ISDA Master Agreement framework. This article provides a high-level overview of the new ISDA SFT Documentation.

A version of this article was first published as a News Analysis article on LexisPSL.

What are SFTs?

A securities financing transaction ("SFT") is one of the following types of transactions:

- A repurchase transaction ("repo"). This involves the sale of a security or other asset by one party (the seller) to another party (the buyer) with a simultaneous commitment by the seller to buy an equivalent asset back from the purchaser on a future date and at a specified repurchase price. A repo is a form of collateralised financing, providing short-term funding to the seller. The buyer will receive a return on the cash it provides to the seller, owing to the price difference between the initial sale price and the repurchase price.
- A securities lending transaction ("stock loan"). This involves the outright transfer of a security from one party (the lender) to another party (the borrower) with a simultaneous commitment by the borrower to return equivalent securities on a future date. The borrower will provide collateral against its obligation to return equivalent securities and will pay a fee to the lender for entering the transaction. Stock loans are typically entered so the borrower can obtain the relevant securities, rather than for funding purposes.

What is the background to publication of the ISDA SFT Documentation?

SFTs are distinct from derivatives transactions. This distinction is reflected in a number of ways, including the different operational practises followed by market participants in relation to their transactions (e.g. as regards trade execution and collateralisation) and different regulatory

treatment in some areas[1] (for instance, derivatives fall within the scope of the "financial instruments" definition in the Market in Financial Instruments Directive but SFTs do not). Derivatives and SFTs also tend to be documented under different master agreements. Specifically, derivatives transactions are typically documented under the ISDA Master Agreement whereas:

- Repos are typically documented under the Global Master Repurchase Agreement published by the International Capital Markets Association (the "GMRA"); and
- Stock loans are typically documented under the Global Master Securities Lending Agreement published by the International Securities Lending Association (the "GMSLA").

The SFT and derivatives markets are nevertheless closely linked and share certain similarities. For instance, market participants trading derivatives will also frequently enter SFTs (and vice versa), sometimes as part of a single commercial arrangement[2] or to source collateral. Moreover, despite the use of different master agreements there is a significant degree of overlap between the ISDA, GMRA and GMSLA agreements, both in terms of the documentation architecture and the substance of the contractual terms. All three framework agreements use close-out netting to mitigate the credit risk associated with entering multiple transactions.

ISDA considers that the above factors (amongst several others) provide fertile ground for greater standardisation and efficiency improvements across the SFT and derivatives markets. This led ISDA to publish a whitepaper "Collaboration and Standardization Opportunities in the Derivatives and SFT Markets" in October 2020 and the publication of the ISDA SFT Documentation in February 2022.

What does the ISDA SFT Documentation aim to achieve?

The purpose of the ISDA SFT Documentation is to enable market participants to document SFTs under the ISDA Master Agreement framework. From a documentation perspective, this is intended to:

- Create efficiencies in the negotiation and management of transaction documentation, principally by avoiding the need for several different master agreements (i.e. GMRAs and GMSLAs) when trading repos or stock loans in addition to derivatives.
- Reduce inconsistencies and duplication in relation to certain key concepts and terms, by introducing common documentation standards.
- Enable updates and digitalisation or automation initiatives in relation to parties' documentation to be implemented consistently and as part of a single roll-out process, including by way of ISDA protocols.

ISDA suggest there are several associated benefits to documenting SFTs under the ISDA Master Agreement framework. Such benefits include:

- Expanding the netting sets for collateral payments and close-outs, which could reduce the parties' credit risk and thus have a positive impact on their regulatory capital position.
- Removing the need for several different netting and collateral opinions, by relying on one set of legal opinions in relation to the ISDA Master Agreement (provided those legal opinions are updated to cover the effect of the ISDA SFT Documentation [3]).

(1) For examples of the similarities in the regulation of derivatives and SFTs, see ISDA's whitepaper entitled "Collaboration and Standardization Opportunities in the Derivatives and SFT Markets", published in October 2020, available at: https://www.isda.org/a/wVrTE/Collaboration-and-Standardization-in-Derivatives-and-SFT-Markets.pdf

(2) Specific examples of how repos, stock loans and derivatives transactions can be used as part of the same commercial arrangement are set out in ISDA's whitepaper.

(3) ISDA are expected to commission updated versions of their existing netting opinions to account for the effect of the ISDA SFT Documentation. The first such opinion is scheduled to be made available later in 2022.

- Enabling market participants to centralise and streamline various pre- and post-trade processes (for example, in relation to collateralisation, execution and confirmation).
- Allowing technology solutions to be deployed on a cross-product basis.

How does the ISDA SFT Documentation fit with the ISDA Master Agreement?

The ISDA SFT Documentation comprises the 2022 ISDA Securities Financing Transactions Definitions (the "SFT Definitions") and the ISDA Securities Financing Transactions Schedule Provisions (the "SFT Schedule Provisions"). These documents are designed to work alongside the ISDA Master Agreement framework commonly used to document derivatives transactions. Specifically:

- The SFT Schedule Provisions are relationship-level provisions that are designed to be inserted into the schedule to parties' ISDA Master Agreements.
- The SFT Definitions are a definitional booklet designed to be incorporated into parties' transaction-level confirmations (in the same way as ISDA's other definitional booklets).

As with the ISDA's other modular documents, the provisions set out in the SFT Schedule Provisions and the SFT Definitions may be applied, disapplied or varied in the parties' trade confirmations. Template confirmations for repos and stock loans are attached as exhibits to the SFT Definitions.

What does the ISDA SFT Documentation contain?

The ISDA SFT Documentation contains contractual terms needed to properly document SFTs. Generally speaking, those terms can be considered an amalgam of the provisions in the GMRA and GMSLA as adapted to fit within the ISDA framework.

The ISDA SFT Documentation contains provisions which:

- Govern the transfer and return of securities, payment of the purchase price and repurchase price, margin and collateralisation. The margin terms include repricing and adjustment provisions for repos, and anticipate SFTs being carved-out from the parties' derivatives credit support documentation.
- Amend the representation provisions contained in the ISDA Master Agreement. This includes provisions allowing the parties to make SFT and derivatives-specific representations (with corresponding changes made to the Misrepresentation event of default).
- Amend the events of default provisions set out in the ISDA Master Agreement. This includes adaptations that (if appropriately applied by the parties) result in certain events of default only affecting either SFTs or derivatives transactions. The Failure to Pay or Deliver event of default and Section 2(a)(iii) have also been adapted as they apply to SFTs.
- Adapt the termination and close-out provisions in the ISDA Master Agreement in relation to SFTs. This includes adding:
    - A separate SFT Close-out Amount definition containing a process for valuing SFTs upon close-out (which is more closely aligned to the processes in the GMRA and GMSLA), to replace the standard Close-out Amount definition.
    - The so-called 'mini close-out' provisions from the GMRA and GMSLA, which provide that a failure to deliver securities or redeliver equivalent securities does not constitute an event of default that could trigger termination of all transactions under the ISDA Master Agreement. Instead, the other party may only close-out the SFTs in respect of which the mini close-out provisions apply.

Should market participants use the ISDA SFT Documentation when entering SFTs?

Market participants entering SFTs may now choose to document SFTs under an ISDA Master Agreement that incorporates the new ISDA SFT Documentation or may continue to trade SFTs and derivative transactions separately under a GMRA or a GMSLA and an ISDA, respectively. The decision as to which approach to take will vary on a case-by-case basis, depending on:

- The products that the relevant parties trade. For example, if the parties trade derivatives, repos and stock loans, or do not yet trade repos and stock loans in sufficient quantity to have already negotiated separate GMRAs and/or GMSLAs, then there may be greater benefits in using a single ISDA Master Agreement for all three products when compared to parties trading only or primarily repos or stock loans (which may be more easily documented under a GMRA or a GMSLA).
- The extent to which the parties are likely to benefit from the synergies and efficiencies associated with using a single ISDA Master Agreement (as described further above). For example, if the parties anticipate significant cost savings when netting collateral payments across different products then the ISDA SFT Documentation may become more attractive.
- The parties' appetite for reviewing the new ISDA SFT Documentation and its effects and/or renegotiating the terms of their existing documentation. Both exercises may have time and costs implications which may not be fully offset by the savings associated with maintaining fewer master agreements.

For these reasons market participants may take different approaches as regards adopting the ISDA SFT Documentation and we expect that significant sections of the market will continue using the GMRA and GMSLA for trading repos and stock loans, at least for the time being.

Note that we expect the market standard legal opinions in respect of the GMRA and GMSLA to continue to be updated for the foreseeable future. Such legal opinions are commissioned by the trade association responsible for the relevant master agreement.

Contacts

Structured Finance & Derivatives

Oliver West
Partner
+44 (0) 20 7825 3380
oliver.west@simmons-simmons.com

Matthew Hebburn
Partner
+44 (0) 20 7825 3916
matthew.hebburn@simmons-simmons.com

Nidhi Sahdev
Associate
+44 (0) 20 7825 3722
nidhi.sahdev@simmons-simmons.com

Marcin Perzanowski
Managing Associate
+44 (0) 20 7825 3616
marcin.perzanowski@simmons-simmons.com

Oliver Ward
Practice Development Lawyer
+44 (0) 20 7825 4703
oliver.ward@simmons-simmons.com

FS Derivatives

Craig Bisson
Partner
+44 (0) 20 7825 4691
craig.bisson@simmons-simmons.com

Allan Yip
Partner
+44 (0) 20 7825 3626
allan.yip@simmons-simmons.com