

ISDA and IIFM publish Islamic Credit Support Deed for Variation Margin

The International Swaps and Derivatives Association, Inc. (ISDA) and the International Islamic Financial Market (IIFM) have published an Islamic Credit Support Deed for Cash Collateral designed to be used with the ISDA/IIFM Tahawwut Master Agreement (TMA)

The publication of the "ISDA/IIFM 2017 Credit Support Deed for Cash Collateral (VM)" (the TMA CSD) is a welcome and much anticipated addition to the suite of template documents for use with the TMA.

Background

Since the launch of the TMA in 2010, there has been market demand for a collateral document for use with it. Recent regulatory changes requiring the collateralisation of uncleared over-the-counter (OTC) derivatives transactions, most notably under regimes such as the European Market Infrastructure Regulations and the Dodd-Frank Wall Street Reform Act, have made this demand more pressing. This led to the establishment by IIFM and ISDA of a working group to consider the most practical way of addressing this demand. The working group determined that both for *Shari'ah* reasons and in light of the lack of robust netting in many of the most relevant jurisdictions, a credit support document providing for security rather than transfer of title was the better approach and that initially focusing on cash collateral was the best way forward. The publication of the TMA CSD is the result of the working group's deliberations.

Copies of the TMA CSD template (together with the TMA and other TMA related documentation) can be obtained at www.isda.org and www.iifm.net.

1. Structure and form of TMA CSD

The TMA CSD will appear familiar to those used to working with the set of credit support documentation published by ISDA relating to the ISDA Master Agreement. It is a standalone security document, providing for the creation of security in respect of cash collateral posted by the collateral provider to secure sums owed by it to the secured party under the TMA. The TMA CSD is a two-way document, meaning that either party may be the party granting security and either party may be the secured party.

The published template comprises a pre printed document accompanied by a pro forma Schedule. The Schedule must be completed by the parties to set out the details of the specific terms agreed between them, including eligible currency, which transactions between them will be covered by the TMA CSD, haircuts, thresholds, timing of valuations, timing of notifications of margin calls and administrative details such as account and process agent particulars.

The TMA CSD is an English law deed.

Key summary

- English law charge
- Cash collateral only
- Calculation of collateral delivery amount is on basis of net Exposure
- No provision for the calculation of a return on Posted Cash Collateral

Parties entering into it will need to take care to ensure that the execution requirements for a deed are followed at the time of signing of the main document and the accompanying Schedule.

Parties should also, of course, satisfy themselves that their counterparty has the requisite capacity to grant security and has obtained all necessary internal authorisations to do so.

2. English law charge

Paragraph 2 of the TMA CSD contains the security interest provision, providing for the creation of an English law charge.

As with any market standard document, particularly a standard security document, parties using the TMA CSD will need to give thought to how it will apply in their particular circumstances, for example in light of the location of the secured asset, how the secured asset is to be held and whether in the circumstances an English law security is the most appropriate approach. This evaluation is similar to the evaluation that parties using other market standard related credit support documentation today need to make.

3. Variation Margin Calculation

Paragraph 3 contains the calculation of the required collateral amount. This calculation is made by reference to a marking to market of each party's exposure. It is thus a variation margin calculation (hence the "(VM)" in the title of the document). Each party's exposure is reduced by the amount of any collateral then held by it so as to determine the collateral amount (the Delivery Amount) which it can call for from the other party. Note that the Delivery Amount is calculated by reference to the Secured Party's net Exposure: a point to bear in mind when determining haircuts, particularly if netting is not robust in the relevant jurisdiction.

Paragraph 5 contains a mechanism for dispute resolution in the event of disagreement as to calculations or valuations.

4. Enforcement

The security under the TMA becomes enforceable upon the occurrence of an Event of Default under the TMA, a failure of a party to pay a called for collateral amount (with a two Local Business Day grace period for

remediating such failure) or a failure to perform any other obligation under the TMA CSD (with a thirty Local Business Day grace period for remediating such failure).

5. Returns on Posted Cash Collateral

The TMA CSD does not provide for the accrual or payment of profit amounts on Posted Cash Collateral. This reflects discussions with the scholars at the time of preparation of the TMA CSD.

Instead, Paragraph 11 (Investment Returns) of the TMA CSD contemplates that the parties may enter into a separate agreement to provide "Investment Returns" on any Posted Cash Collateral. The terms of any such separate agreement should be documented between the parties in consultation with their own *Shari'ah* advisors.

6. Legal Ineligibility

Although the collateral provided for is limited to cash, a provision is included allowing a Secured Party to call for cash in an alternative currency if the first currency ceases to be eligible under applicable regulatory requirements.

7. Governing Law and Jurisdiction

The governing law of the TMA CSD is English law.

The Schedule to the TMA CSD allows the parties to elect for *either* English court jurisdiction *or* arbitration at the International Chamber of Commerce seated in London. In the Schedule, the parties may choose to apply other rules of arbitration if they prefer, but are reminded of the value of being

consistent with their choice under the related TMA.

8. *Shari'ah* approval

IIFM's *Shari'ah* Advisory Panel has approved the TMA CSD after extensive consideration. Naturally, the approval from IIFM's *Shari'ah* Advisory Panel does not extend to any specific transactions between the parties or to any amendments or additions made to the TMA CSD (whether through the Schedule or otherwise).

It would be the responsibility of each of the parties entering into the TMA CSD to ensure that, to the extent that *Shari'ah* compliance is relevant to it in connection with its dealings and corporate governance, its use of the documents satisfies its own *Shari'ah* advisers that the relevant collateral arrangements are *Shari'ah* compliant and that the TMA CSD is suitable for, and is being used appropriately in, the context of that party's needs.

Clifford Chance acted as legal counsel to ISDA and IIFM in the preparation of the TMA CSD.

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