## Ongoing Initiatives

### Legal Infrastructure for Derivatives

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### The Effectiveness of Netting and Collateral as Risk Mitigants

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<tr>
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</thead>
<tbody>
<tr>
<td>Notional Amounts, Total OTC contracts¹</td>
<td>601,046</td>
<td>647,811</td>
<td>632,582</td>
<td>710,182</td>
</tr>
<tr>
<td>Gross Market Values</td>
<td>21,296</td>
<td>27,297</td>
<td>24,733</td>
<td>18,658</td>
</tr>
<tr>
<td>% of Notional Amounts</td>
<td>3.54%</td>
<td>4.21%</td>
<td>3.91%</td>
<td>2.63%</td>
</tr>
<tr>
<td>Gross Credit Exposure (after netting)</td>
<td>3,480</td>
<td>3,938</td>
<td>3,609</td>
<td>3,033</td>
</tr>
<tr>
<td>% of Gross Market Value</td>
<td>16.34%</td>
<td>14.43%</td>
<td>14.59%</td>
<td>16.26%</td>
</tr>
<tr>
<td>% of Notional Amounts</td>
<td>0.58%</td>
<td>0.61%</td>
<td>0.57%</td>
<td>0.43%</td>
</tr>
<tr>
<td>Exposure collateralized, average, all OTC derivatives²</td>
<td>69%</td>
<td>66%</td>
<td>71%</td>
<td>82%</td>
</tr>
<tr>
<td>Gross Credit Exposure (after netting and adjusted for collateral)</td>
<td>1.079</td>
<td>1.339</td>
<td>1.047</td>
<td>0.546</td>
</tr>
<tr>
<td>% of Gross Market Value</td>
<td>5.07%</td>
<td>4.91%</td>
<td>4.23%</td>
<td>2.93%</td>
</tr>
<tr>
<td>% of Notional Amounts</td>
<td>0.18%</td>
<td>0.21%</td>
<td>0.17%</td>
<td>0.08%</td>
</tr>
</tbody>
</table>


Legal Infrastructure as Risk Mitigant in Capital Markets

1. Legal Netting Infrastructure: Close-out netting
   - The most important risk reduction tool in modern financial markets
   - Underpins the risk management of OTC derivatives, which includes such end user hedging products as FX options, cross currency swaps and inflation swaps that cannot currently be centrally cleared; also important for repo markets (and by extension the development of corporate bond markets)

2. Protection of Collateral Interests
   - Collateral: Widely used as a credit risk mitigation tool, important role in working capital funding for SMEs, letters of credit for trade finance and the trading of financial hedging instruments.
   - Margin, likewise plays a critical role in the safe functioning of clearing houses for OTC derivatives
   - Commonly exchanged between counterparties either through title transfer or security interest pledge arrangement
     - Title Transfer Arrangement: Where the legal certainty is not provided, under bankruptcy, collateral taken under a title transfer arrangement could be re-characterized as an asset of the estate of the defaulting party and claimed by other creditors.
     - Pledge Arrangement: In some jurisdictions, i) the local security law does not support mark-to-market of collateral, ii) the secured party’s ability to re-use the collateral is often limited and iii) enforcement of collateral interest is often difficult.

3. Margining of Non-Cleared Derivatives
   - BCBS-IOSCO: Initial and variation margin to be made mandatory for non-centrally cleared derivatives.
   - Requirements for jurisdictions:
     - Implementing rules and regulations to support BCBS’ guidelines
     - Standardization of initial margin calculation model and credit support documentation
     - Robust protection of collateral rights

APFF Action Plan

- Identify legal structural weaknesses in each jurisdiction
- Organize educational seminars targeting
  1) Regulatory/legislative bodies
  2) The judiciary

- APFF resources will be leveraged to coordinate outreach, provide expert speakers and follow up on outstanding issues.