ONGOING INITIATIVES

LEGAL INFRASTRUCTURE FOR DERIVATIVES

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The effectiveness of netting and collateral as risk mitigants.

US$ trillions	**Dec.2010**	**Dec.2011**	**Dec.2012**	**Dec.2013**
Notional Amounts, Total OTC contracts[1]	601,046	647,811	632,582	710,182
Gross Market Values	21,296	27,297	24,733	18,658
% of Notional Amounts	**3.54%**	**4.21%**	**3.91%**	**2.63%**
Gross Credit Exposure (after netting)	3,480	3,938	3,609	3,033
% of Gross Market Value	**16.34%**	**14.43%**	**14.59%**	**16.26%**
% of Notional Amounts	**0.58%**	**0.61%**	**0.57%**	**0.43%**
Exposure collateralized, average, all OTC derivatives[2]	69%	66%	71%	82%
Gross Credit Exposure (after netting and adjusted for collateral)	1.079	1.339	1.047	0.546
% of Gross Market Value	**5.07%**	**4.91%**	**4.23%**	**2.93%**
% of Notional Amounts	**0.18%**	**0.21%**	**0.17%**	**0.08%**

[1] Bank for International Settlements (BIS), May 2014 and prior, Table 19, http://www.bis.org/statistics/dt1920a.pdf
[2] Office of the Comptroller of the Currency (OCC), Quarterly Report on Bank Derivatives Activities, http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/derivatives-quarterly-report.html

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ISDA

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.