



Drafting Guide

# ISDA 1994 Credit Support Annex Paragraph 13

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# ISDA 1994 Credit Support Annex Paragraph 13

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## Introduction

The 1994 ISDA Credit Support Annex (Security Interest – New York Law) (the “1994 NY CSA”) is the most versatile of the New York law governed credit support annexes. It is used by parties who are not subject to the uncleared margin rules (the “UMR”) but also, with a few modifications to make it UMR compliant, by parties subject to the Variation Margin rules of the UMR. In the Comparison Table: 1994 ISDA Credit Support Annex (Security Interest – New York Law) and the 2016 Credit Support Annex for Variation Margin (Security Interest - New York Law) (the “2016 VM CSA”) (Comparison Table) we provide a comparison of the 1994 NY CSA and the 2016 VM CSA. The standard form CSA has twelve paragraphs and while its terms are subject to negotiation between the parties, no modifications are made within the standard form. All amendments and elections are to be made in paragraph 13. Below we provide an annotation of the 1994 NY CSA paragraph 13, explaining the elections and some of the typical changes made by counterparties.

Election in Paragraph 13 of the 1994 NY CSA	Section Reference	Annotation
<b>Obligations</b>	Par 13(a)	The parties specify whether the collateral pledged under the CSA governs obligations other than the obligations under the ISDA Master Agreement. The definition of Obligations is typically not expanded.
<b>Credit Support Obligations</b>	Par 13(b)	
Delivery Amount	Par 13(b)(i)(A)	The Delivery Amount is as defined under <b>paragraph 3</b> of the CSA, unless the parties provide otherwise in paragraph 13. Parties typically do not provide otherwise in paragraph 13.
Return Amount	Par 13(b)(i)(B)	The Return Amount is as defined under <b>paragraph 3</b> of the CSA, unless the parties provide otherwise in paragraph 13. Parties typically do not provide otherwise in paragraph 13.
Credit Support Amount	Par 13(b)(i)(C)	The Credit Support Amount is as defined under <b>paragraph 3</b> of the CSA, unless the parties provide otherwise in paragraph 13. This provision is often amended to make it clear that the Independent Amount is to be held for the life of the trade.
Eligible Collateral	Par 13(b)(ii)	The parties specify the class and maturities of the assets that are “Eligible Collateral” to be delivered by the Pledgor and in which the Secured Party will obtain a security interest. The parties also agree to the discount that will apply to the valuation of the assets in determining how much collateral has been posted (the “Valuation Percentage”). The most common forms of Eligible Collateral are U.S. dollars and U.S. treasuries. The uncleared margin rules (UMR) are prescriptive as to what constitutes Eligible Collateral and the Valuation Percentage to be applied to such collateral. <i>Margin and Capital Requirements for Covered Swap Entities</i> , <a href="#">80 Fed. Reg. 74840</a> (Nov. 30, 2015) (PR Rules) and <i>Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants</i> , <a href="#">81 Fed. Reg. 635</a> (Jan. 6, 2016) (CFTC Rules).

<b>Election in Paragraph 13 of the 1994 NY CSA</b>	<b>Section Reference</b>	<b>Annotation</b>
Other Eligible Support	Par 13(b)(iii)	The parties specify the forms of "Other Eligible Support" that may be delivered as collateral in which the Secured Party will not obtain a security interest. The parties will also agree to the Valuation Percentage to be applied to Other Eligible Support. The most common form of "Other Eligible Support" is a letter of credit which is typically posted between counterparties to commodity transactions.
<b>Thresholds</b>	Par 13(b)(iv)	
Independent Amount	Par 13(b)(iv)(A)	The parties agree as to the Independent Amount, if any, with respect to each party. The Independent Amount may be a fixed amount, a percentage of notional based on the type of product (equity, foreign exchange, commodity etc.) or as agreed between the parties in the document memorializing the trade (the confirmation).
Threshold	Par 13(b)(iv)(B)	<p>The parties agree as to whether either party will have a Threshold. The Threshold is the unsecured credit granted by one party to another. A party's Threshold may be:</p> <ul style="list-style-type: none"> <li>A fixed amount;</li> <li>An amount based on a credit ratings matrix; or</li> <li>the amount of a guarantee provided to the other party.</li> </ul> <p>A party will not be required to post collateral until its Credit Support Amount exceeds its Threshold at which point the party will have to post any Credit Support Amount above the Threshold.</p> <p>The UMRs do not allow unsecured credit and therefore UMR compliant CSAs will have a zero Threshold.</p>
Minimum Transfer Amount ("MTA")	Par 13(b)(iv)(C)	<p>If there is a Threshold, once it has been exceeded, the MTA represents the level of Credit Support Amount that must be reached before collateral must be transferred. Having an MTA prevents the call for nuisance amounts and allows the parties to avoid unnecessary costs involved in small transfers. The practical implications of the MTA are that the Secured Party is unsecured for any Exposure that is less than the MTA until the MTA is reached, at which point the whole amount must be transferred.</p> <p>The UMRs provide for a maximum MTA of USD500,000 (and this amount is applied across both Initial Margin and Variation Margin).</p>
Rounding	Par 13(b)(iv)(D)	The parties may specify the dollar amount by which the Delivery Amount or the Return Amount will be rounded up or down respectively. Rounding the amounts to be transferred ensures that parties are not moving "de minimis" amounts of collateral.

<b>Election in Paragraph 13 of the 1994 NY CSA</b>	<b>Section Reference</b>	<b>Annotation</b>
<b>Valuation Agent</b>	Par 13(c)(i)	The Valuation Agent is defined as the party making a demand under the CSA, however, the parties may amend this definition to appoint one of the parties as the Valuation Agent. The Regulated Entities typically prefer to be the Valuation Agent. If parties agree that only one party will be the Valuation Agent, they can also add language that if that party is subject to an event of default, it shall be replaced as Valuation Agent by the other party or an independent third-party leading dealer.
Valuation Date	Par 13(c)(ii)	The parties agree to the definition of Valuation Date. Typically, it is each day that is a business day for both Party A and Party B
Valuation Time	Par 13(c)(iii)	Valuation Time is the time as of which the Valuation Agent computes its end of day valuations in the ordinary course of its business. There is a choice in paragraph 13 of the Valuation Time between (i) the close of business in the city of the Valuation Agent on the Valuation Date or date of calculation, as applicable or (ii) the close of business on the business day before the Valuation Date or date of calculation. Option (ii) is the most typically elected.
Notification Time	Par 13(c)(iv)	<p>The Notification Time refers to the time at which a party must be notified of a collateral call in order to meet it in accordance with the transfer timing provisions.</p> <p>Same day transfers are required under the UMRs and therefore if the parties are required to have a UMR compliant CSA they will need to ensure that Notification Time is early enough to ensure same day transfer. The default Notification Time is 1pm NY time, however industry standard for parties located on the East Coast of the United States, is closer to 10am NY time.</p>
<b>Conditions Precedent and Secured Party's Rights and Remedies - Specified Conditions</b>	Par 13(d)	The parties agree which of the Termination Events specified in the Master Agreement (Illegality, Force Majeure (if under a 2002 ISDA), Tax Event, Tax Event Upon Merger, Credit Event upon Merger and/or Additional Termination Events) will be "Specified Conditions" for the purposes of the CSA. The choice of Specified Conditions is relevant for the condition precedent provision as well as the remedies. Additional Termination Events ("ATEs") are events negotiated between the parties which, if triggered by a party, will entitle the other party to terminate the transactions under the Master Agreement. ATEs are intended to be leading indicators of the deteriorating credit condition of a party.
<b>Substitution</b>	Par 13(e)	
Substitution Date	Par 13(e)(i)	Subject to "Consent for Substitution" below, a Pledgor can substitute Posted Credit Support with other Substitute Credit Support and the parties can specify whether the "Substitution Date" has the meaning specified in the CSA or whether they wish to amend such definition. This provision is typically not changed; however, some parties may want to provide the Secured Party with more time to return Posted Credit Support.

<b>Election in Paragraph 13 of the 1994 NY CSA</b>	<b>Section Reference</b>	<b>Annotation</b>
Consent	Par 13(e)(ii)	The parties elect whether the Pledgor must obtain consent to transfer substitute Posted Credit Support with Substitute Credit Support. The substitution provision is used by the Pledgor to access liquidity or mitigate counterparty credit risk by substituting a less liquid form of Eligible Credit Support (e.g., Letter of Credit) for previously-posted Cash. Preferably, consent should not be required.
<b>Dispute Resolutions</b>	Par 13 (f)	
Resolution time	Par 13(f)(i)	The Resolution Time is the time by which parties must resolve a dispute, otherwise the dispute resolution mechanism in the CSA will be triggered. The default time is 1:00pm NY time. This time may be changed to accommodate different time zones.
Value	Par 13(f)(ii)	If parties want to amend how Value is calculated for purposes of resolving a dispute with respect to a Delivery Amount and a Return Amount or with respect to the value of Eligible Credit Support or Posted Credit Support, they may amend the CSA to do so. If parties are pledging securities as Eligible Collateral, they will add a method for calculating the Value of posted securities, the buy-side prefers to use the average of the bid and ask price while the sell-side prefers the bid price.
Alternative	Par 13(f)(iii)	Parties can agree to a different dispute resolution process from the one in the CSA.
<b>Holding and Using Posted Collateral (VM)</b>	Par 13(g)	
Eligibility to Hold Posted Collateral; Custodians)	Par 13(g)(i)	The parties specify the conditions pursuant to which each party or its Custodian is entitled to hold Posted Collateral, this may include for example, requirements that: <ul style="list-style-type: none"> <li>(i) the party not be in default under the Master Agreement,</li> <li>(ii) the party have a certain credit rating, or</li> <li>(iii) Posted Collateral be held in a specific jurisdiction.</li> </ul>
Use of Posted Collateral	Par 13(g)(ii)	If a party is entitled to hold Posted Collateral, the parties specify whether such party, as Secured Party, is entitled to use or rehypothecate such Posted Collateral. If collateral is held with a third-party custodian (as is required for mutual funds for instance), the Secured Party will not be allowed to use Posted Collateral.
<b>Distributions and Interest Payment (VM)</b>	Par 13(h)	
Interest Rate	Par 13(h)(i)	The parties agree to the rate of interest that will accrue on cash Posted Collateral. The definition of Cash in the CSA is USD. To the extent the Cash remains solely USD, interest rate is typically Federal Funds (Effective).

<b>Election in Paragraph 13 of the 1994 NY CSA</b>	<b>Section Reference</b>	<b>Annotation</b>
Transfer of Interest Payment	Par 13(h)(ii)	Paragraph 13 provides that the transfer of the Interest Amount will be made on the last business day of each calendar month and on any business day that Posted Credit Support is transferred to the Pledgor as a Return Amount. This can be amended by the parties if they want to transfer interest on a different date -e.g., the fifth business day of the month.
Alternative to Interest Amount	Par 13(h)(iii)	Parties can to amend how interest is transferred, but that is typically not done.
<b>Additional Representations</b>	Par 13(i)	Parties can add additional representations in this section. Given the representations in the Master Agreement, the Schedule to the Master Agreement and the CSA, parties seldom add additional representations.
<b>Other Eligible Support and Other Posted Support</b>	Par 13(j)	
Value	Par 13(j)(i)	If parties have agreed to post Other Eligible Support, such as a Letter of Credit, the parties will agree to the value of such Other Eligible Support. For instance, the Value of a Letter of Credit will be 100% unless the Letter of Credit is subject to an L/C event of default or other specified events.
Transfer	Par 13(j)(ii)	If parties have agreed to post Other Eligible Support, such as a Letter of Credit, the parties must also establish specific terms for transfer. For example in response to a Delivery Amount request, the Pledgor can deliver an executed amendment to a Letter of Credit increasing the amount available to the Secured Party thereunder, and for purposes of a Return Amount, return of the Letter of Credit by the Secured Party to the Pledgor or delivery of an executed amendment to the Letter of Credit, reducing the amount available to the Secured Party thereunder would each constitute a transfer.
<b>Demands and Notices</b>	Par 13(k)	The parties can specify notice information if it is different from what has been specified in the Schedule to the Master Agreement.
<b>Addresses for Transfers</b>	Par 13(l)	The parties can specify in Paragraph 13 the accounts into which transfers of collateral are to be made or they can do so in the confirmations.
<b>Other Provisions</b>	Par 13(m)	Parties can add additional provisions based on their negotiations, their jurisdiction of incorporation and the regulatory regime that governs the CSA. If the CSA is meant to be UMR compliant, parties will add provisions from the 2016 Credit Support Annex for Variation Margin (Security Interest - New York Law) (the 2016 NY VM CSA). Please refer to the Comparison Table for an overview of the differences between the 1994 NY CSA and the 2016 NY VM CSA.