

ISDA Close-out Framework: Explanatory Notes

The Close-out Framework generally assumes that parties will exercise their rights at the earliest possible opportunity, for example following the expiry of any applicable grace period, effective period or cooling off period. However, specifically with respect to collateral enforcement rights, the timeline assumes that such rights will not be exercised before (i) an Early Termination Date has been designated¹, and (ii) the Early Termination Amount has been calculated and communicated to Party A². Users of the ISDA Close-out Framework should consider the potential economic impact on the value of collateral to be liquidated in scenarios where these assumptions are not true, in particular as regards the English law VM CSA³.

To present the Close-out Framework in a form that is easy to consume, whilst also including sufficient detail, certain other assumptions are made as set out below.

- Party A and Party B have entered into a 2002 ISDA Master Agreement.
- Party A is the Defaulting Party.
- ‘Automatic Early Termination’ has not been specified in the relevant ISDA Schedule.
- The occurrence of any event giving rise to a contractual right will occur during business hours on the day attributed to that event and with sufficient time for the relevant party to exercise such rights.
- There are no limitations on the parties’ ability to exercise any such rights, for example difficulties effectively delivering required notices.
- Exercise of any rights relating to termination, and the delivery of any related notices, are in relation to all Transactions.
- ‘Custodian Event’ is not applicable for the IM CSA and the occurrence of any contractual rights do not arise as a result of a custodian failing to follow valid instructions of either party, or any other analogous failure by the custodian.
- The contractual rights and obligations of both parties under the Control Agreement will be analogous with the equivalent contractual rights and obligations under the IM CSA.
- Parties will post only cash and government securities as collateral, in accordance with the applicable eligibility requirements.
- Local law security enforcement issues under the applicable governing law have not been considered. Parties should refer to the relevant ISDA collateral opinion applicable to their documentation.
- For the purposes of the bank resolution analysis, it is assumed that all parties have adhered to the appropriate ISDA Protocols, or otherwise amended contracts that are in scope for a particular resolution regime, to opt-in to the application of the resolution stay on the exercise of termination rights and remedies and the enforcement of security interests.
- It is possible that a resolution action may involve cross-border elements. For simplicity, the Close-out Framework assumes that any applicable resolution action will be undertaken in, and will relate to a bank located in, one jurisdiction.
- The Close-out Framework distinguishes between statutory and contractual stays, however this distinction is intended to address the application of the US Stay Protocol. The application of stays that are contractually recognised in 3rd country law governed agreements are considered to be statutory stays.
- The ‘Return of Collateral’ and ‘Collateral Enforcement’ sections of the Close-out Framework use terminology from the English and New York law IM CSAs (for example, Chargor/Pledgor, Secured Party, Chargor/Pledgor Rights Event and Secured Party Rights Event). These terms should be interchanged with the equivalent terms where the relevant initial margin documentation is the ISDA 2019 Collateral Transfer Agreement for Initial Margin (IM) (for example Security-provider, Security-taker, Security-provider Rights Event and Security-taker Rights Event) or joint ISDA and Euroclear/Clearstream CTAs (for example Enforcement Event).

¹ Pursuant to Paragraph 8(a) (*Secured Party’s Rights and Remedies*) of the NY VM CSA, Party B’s collateral enforcement rights (where Party B is the Non-defaulting Party and in-the-money), including the right to liquidate the Posted Collateral (VM) and set-off the proceeds of such liquidation against (i) the Obligations that are then due by Party A, and/or (ii) collateral posted by Party B to Party A under any Other CSA which is due to be returned to Party B by Party A, are triggered upon the occurrence and continuation of an Event of Default i.e. it is not required that an Early Termination Date has been designated. This is not an issue under the IM CSAs and English VM CSA, where collateral enforcement rights are triggered only upon the designation of an Early Termination Date.

² ISDA is aware that for certain complex derivatives portfolios, the calculations producing the Section 6(e) Early Termination Amount may not be completed on the same day as the delivery of the Section 6(a) notice to designate an Early Termination Date. Users of the ISDA Close-out Framework should refer to the Early Termination Amount Calculation Period and incorporate the appropriate time for the calculation of the Early Termination Amount and preparation of the corresponding Section 6(d) statement.

³ The English and NY law IM CSAs, and the NY law VM CSA, contemplate this issue with the following provision “Each party acknowledges and agrees that Posted Collateral [(VM)][(IM)] in the form of securities may decline speedily in value and is of a type customarily sold on a recognized market, and, accordingly, the Pledgor is not entitled to prior notice of any sale of that Posted Collateral [(VM)][(IM)] by the Secured Party, except any notice that is required under applicable law and cannot be waived.”