

## GMSLA “Pledge” Structure Documentation

Overview & Frequently Asked Questions (FAQs)

## Overview

**ISLA has developed documentation for securities lending activity where the collateral is provided by way of security interest (referred to informally and elsewhere as “pledge”), instead of being provided pursuant to the title transfer mechanism that has been embedded in all previous versions of ISLA’s industry standard securities lending documentation.**

The documentation provides market participants with an additional structure to transact securities lending activity. The pledge structure may not suit all situations and all parties, and it is envisaged that both the pledge structure and the title transfer structure will be used in the market as alternatives. Counterparts wishing to transact using the pledge GMSLA will be required to execute a complete set of new documents.

Prior to green lighting the pledge initiative, ISLA undertook a survey of the ISLA membership to obtain input on pledge activity in the market and the appetite for ISLA to develop market standard documentation. Based on the survey findings, the ISLA board appointed Clifford Chance to produce the documentation. /

## The “Pledge” Structure

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The ISLA pledge documentation has been developed to be used in conjunction with certain tri-party custodians (see the section below entitled “Tri-party custody documentation”).

The following documentation is intended to be used in connection with the ISLA pledge structure:

- Global Master Securities Lending Agreement (Security Interest over Collateral - 2018 Version);
- Security Agreement for GMSLA (Security Interest over Collateral - 2018 Version); and
- Tri-party custody documentation. /





# Global Master Securities Lending Agreement (Security Interest over Collateral – 2018 Version)

**Developed for ISLA members in association with Clifford Chance, the pledge GMSLA (formally referred to as “Security Interest over Collateral – 2018 Version”) is an adapted version of the Global Master Securities Lending Agreement (GMSLA) 2010.**

The modifications that have been made to the GMSLA 2010 during the process have generally focused on the changes required to adapt the collateral provisions in the document so that collateral is provided by way of a security interest, rather than a title transfer, mechanism. As a result, much of the document remains unchanged from the GMSLA 2010 title transfer version.

The document produced has been designed to be used only in conjunction with tri-party custody documentation. The pledge GMSLA is intended, like the title transfer version of the GMSLA, to be used in a wide range of markets, both cross border and domestic.

The pledge GMSLA is an English law document and contains the terms relating to the securities loans and the provision of collateral. Whilst the broad approach has been to try and develop an arrangement that is as similar as possible to that which applies in relation to the title transfer version of the GMSLA, there are inevitably differences between the arrangements.

## Features of the Global Master Securities Lending Agreement (Security Interest over Collateral – 2018 Version)

- The documentation contemplates that a single Borrower will transact with a single Lender or an Agent Lender and that, where an Agent Lender is used, there will be separate secured accounts opened with the tri-party custodian in relation to each principal. Transactions with pooled principals are not documented under the pledge GMSLA.
- Under the pledge version of the GMSLA, the Lender transfers ownership of the borrowed securities to the Borrower outright (as it would have done under the GMSLA 2010 title transfer version). The collateral provided by the Borrower is, however, not transferred to the Lender outright. Instead, collateral securities or collateral cash are transferred to the secured accounts and the Borrower grants security of the posted collateral in favour of the Lender.



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- The collateral is held in an account at the tri-party custodian in the name of the Borrower and security over this account is created in favour of the Lender\*. The collateral is therefore not held in Lender's proprietary account as is the case with the title transfer version of the GMSLA. The tri-party custodian is only permitted to make transfers in and out of the secured account(s) in accordance with the terms of the tri-party custody documentation. (\*The exception to this is where collateral is held with Euroclear, in which case it held by Euroclear Bank acting in its own name but for the account of the Pledge).
  - The pledge GMSLA agreement does not permit the Lender to hypothecate or re-use the collateral.
  - To the extent collateral subject to a record date has not been substituted out of the secured accounts prior to that date, the dividends or other distributions received by the custodian on the collateral are required to be added to the secured accounts as posted collateral and there will be no need for manufactured payments in respect of them. Manufactured payments will continue to be relevant to loaned securities.
  - The procedures involved in realising and liquidating collateral are different. Whilst they are intended to put the Lender in a situation where it can cover its exposure through an ability to liquidate the collateral, there are differences in the way it is implemented, which may have financing consequences.
  - Under the pledge GMSLA structure, the Lender as secured party would need to follow an enforcement process to access the collateral and liquidating the collateral. As noted, the secured accounts are held with the tri-party custodians under control terms agreed between the parties. By contrast, under the title transfer version of the GMSLA, a Lender would own and could immediately realise the collateral upon the occurrence of an Event of Default without taking any further steps to obtain control of the collateral.
  - On the default of the Borrower, the Lender would terminate the outstanding transactions, value the obligations of the Borrower, claim the amount owed, take control from the tri-party custodian of the collateral and enforce its security to the extent required to discharge the Borrower's obligations. Any surplus collateral would be returned.
  - Similarly, the process by which the Borrower might obtain any unused excess collateral back from the Lender differs. /

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# The Security Agreement for GMSLA (Security Interest over Collateral – 2018 Version)

Under the Security Agreement, the party acting as Borrower creates a security interest over the posted collateral.

The parties are expected to use the appropriate Security Agreement based on the location of the secured account(s) in which the posted collateral is maintained and, in the case of Euroclear and Clearstream, these documents also contain specific terms relating to the relevant tri-party collateral documentation.

The Security Agreements produced as part of the ISLA Pledge documentation are as follows:

- English law Security Agreement for GMSLA (Security Interest over Collateral – 2018 Version);
- Euroclear Security Agreement for GMSLA (Security Interest over Collateral – 2018 Version);

- Clearstream Security Agreement for GMSLA (Security Interest over Collateral - 2018 Version); and
- Luxembourg law Security Agreement (JP Morgan) for GMSLA (Security Interest over Collateral - 2018 Version).

The English law version is intended for use with The Bank of New York Mellon accounts opened with its London branch and the Luxembourg law Security Agreement (JP Morgan) is intended for use with accounts opened with JP Morgan Bank Luxembourg S.A. The Euroclear version is governed by Belgian law and the Clearstream version is governed by Luxembourg law. The latter two agreements are intended to be used where the secured accounts are maintained with Euroclear or Clearstream, respectively. /

## Tri-party custody documentation

The tri-party custody documentation is executed between the Borrower, the Lender and the tri-party custodian. It governs how the collateral is to be held and dealt with by the tri-party custodian and acts as a separate “control” agreement between the parties. Early in the process it was evident that it would not be practical to produce a single standard tri-party custody document for use with all tri-party providers. ISLA worked with several tri-party providers to negotiate a standard template document for use with each tri-party custodian.

The tri-party custodians that ISLA have worked with in the development of the ISLA Pledge documentation are as follows:

**The Bank of New York Mellon, London**  
**Clearstream, Luxembourg**  
**Euroclear, Brussels**  
**JP Morgan, Luxembourg**



The Bank of New York Mellon and JP Morgan each has a form of Account Control Agreement which can be entered into between the parties. Euroclear and Clearstream, by contrast, each has a number of documents which perform a similar function.

ISLA has reviewed the tri-party custody documentation from a security perspective only and sought to amend the documentation where, for instance, the relevant provision (or associated operational mechanism) appeared inconsistent with the intended security arrangement (please see the Clifford Chance opinions for the analysis, assumptions and reservations on this topic). In general, ISLA has sought to ensure that the tri-party documentation ties in with the pledge GMSLA and the relevant Security Agreement.

However, please note that where an aspect of the tri-party custody documentation was thought not to counteract the intended security arrangement, ISLA has not sought to amend it. This means there will be elements in tri-party custody documentation which parties may consider commercial issues which they wish to negotiate. Parties should therefore ensure that they have reviewed and identified for themselves any such issues. The tri-party documents are templates only in the sense that they have been aligned with the other documents and their impact on the security has been reviewed.

### Legal Opinions

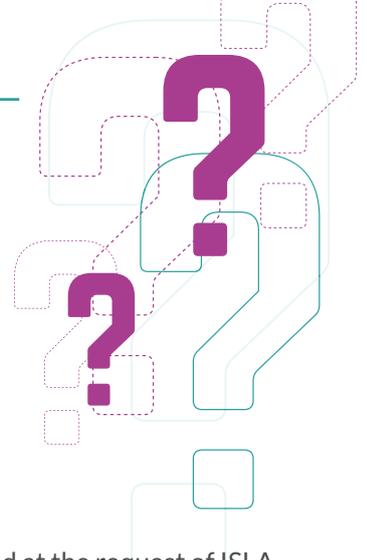
The ISLA pledge documentation is supported by legal opinions from Clifford Chance. There will be an enforceability opinion in respect of each Security Agreement under its governing law. Each opinion will also look at the financial collateral arrangement analysis under that governing law by reference to the Security Agreement and the relevant tri-party custody documentation. The English law opinion will cover the enforceability of the Global Master Securities Lending Agreement (Security Interest over Collateral – 2018 version) under its governing law.

The legal opinions do not address the parties themselves. So if a given type of party would have capacity or regulatory issue in entering into the pledge GMSLA arrangements, or if the pledge GMSLA would not be enforceable against it in its insolvency, this is not considered by the legal opinions. /



In general, ISLA has sought to ensure that the tri-party documentation ties in with the pledge GMSLA and the relevant Security Agreement.





# Frequently Asked Questions

## Q: Why has ISLA developed pledge documentation?

The ISLA pledge documentation (Security Interest over Collateral) was developed at the request of ISLA members. The intention was to provide an industry standard documentation framework for ISLA members who wished to be able to transact using a security interest structure in the securities lending market.

See below for further details on the rationale for implementing a structure which differs from the existing title transfer structure.

## Q: Why is there a need for pledge documentation in the securities lending market to sit alongside the existing title transfer framework?

One issue for Borrowers with the title transfer version of the GMSLA is that the Borrower’s exposure or claim on the Lender is a risk weighted asset for capital purposes. The title transfer version of the GMSLA will usually create an exposure to the Lender, as the Borrower will typically post additional collateral (a margin percentage or “haircut”) to the Lender which exceeds the market value of the loaned securities. The allocation of regulatory capital can be a very significant cost and Borrowers are attracted to the possibility of reducing their regulatory costs.

The pledge structure can also be advantageous to Lenders that accept large blocks of equities as collateral and risk being subject to notification and other obligations in relation to holding significant positions in the underlying shares. A provision of equities under a security interest arrangement may not have the same impact, depending on the applicable rules.

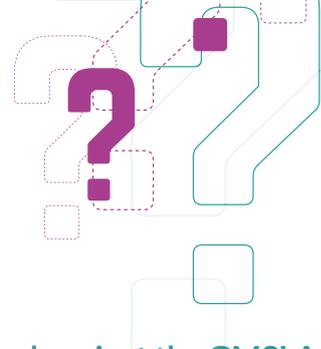
## Q: How can I obtain copies of the ISLA pledge documentation?

The ISLA pledge documentation is available to all ISLA members. The documentation can be accessed via the ISLA website – [www.isla.co.uk](http://www.isla.co.uk). To access the documentation, you are required to be an ISLA member and to have a valid login for the website. For ISLA members without a current login, access can be requested via the “Request login” function on the ISLA website.

## Q: What if I am not an ISLA member?

If your organisation is not currently an ISLA member or your application is pending and you wish to discuss access to the ISLA pledge documentation, please contact [support@isla.co.uk](mailto:support@isla.co.uk).





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**Q: Is there a blacklined version of the GMSLA Security Interest over Collateral against the GMSLA 2010 Title Transfer agreement available?**

Yes, this is available to all ISLA members via the ISLA website ([www.isla.co.uk](http://www.isla.co.uk))

**Q: Are there legal guidance notes available for the pledge GMSLA?**

Not currently. There is a blackline version of the pledge GMSLA (Security Interest over Collateral – 2018 Version) against the last title transfer version of the GMSLA (the GMSLA 2010).

**Q: What governing law is the pledge GMSLA?**

The pledge GMSLA is governed by English Law.

**Q: What if I am not an ISLA member?**

The ISLA pledge documentation is available to all ISLA members. The documentation can be accessed via the ISLA website – [www.isla.co.uk](http://www.isla.co.uk). To access the documentation, you are required to be an ISLA member and to have a valid login for the website. For ISLA members without a current login, access can be requested via the “Request login” function on the ISLA website.

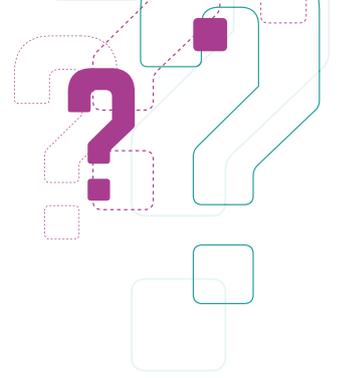
**Q: Will I be required to sign up to an ISDA protocol for Stay Regulations when I enter into the pledge GMSLA?**

As of the date of these FAQs and in relation to an entity governed by the UK (PRA rules), these rules require protocols to be put in place only when entities are transacting under financial contracts governed by third-country laws. Financial contracts governed under EEA laws are already in scope of the UK PRA regulations (this position may be affected by Brexit).

**Q: Can I add the pledge GMSLA Security as an annex to my existing GMSLA 2010?**

No, the ISLA pledge documentation has been developed as a separate set of documentation as it was felt it would be easier to create a standalone set of documents. The parties can therefore choose which collateral structure will apply between them – either title transfer or security interest.





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**Q: Are netting legal opinions available for the pledge GMSLA?**

No, as the structure does not envision the exposures of the Borrower and the Lender being netted under the pledge GMSLA.

**Q: Does pledge activity fall under the guidance of the Bank of England Money Markets code?**

Yes, pledge activity will be subject to the Bank of England Money Markets code.

**Q: What is the purpose of the supporting legal opinions?**

The supporting opinions conclude that, subject to the relevant assumptions and reservations, the relevant Security Agreement constitutes legal, valid, binding and enforceable obligations under the law of that agreement. The English law opinion will also cover the enforceability of the GMSLA Security Interest agreement under its governing law.

**Q: Does the ISLA pledge structure constitute a Financial Collateral Arrangement?**

The opinions provided by Clifford Chance will provide analysis on this matter.

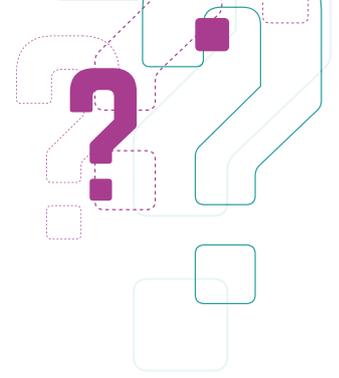
**Q: Can ISLA provide guidance on regulatory reporting or capital treatment pledge activity?**

During the development of the ISLA pledge structure documentation, members have requested information from ISLA regarding regulatory reporting and capital treatment for pledge transactions. It is not an area that ISLA has reviewed or is intending to review. ISLA members should seek their own advice in these matters as regulators may have differing interpretations of pledge structures.

**Q: Is there a difference in risk profile if I access the market via the title transfer or security interest collateral structure?**

Accessing the securities lending market via a pledge structure could entail a change in risk profile, as there are differences in the default timelines. For instance, there are differences in the enforcement process and this may have an impact on timing. It is important that counterparts appreciate the differences between the structures and the potential risk implications. Counterparts should therefore seek their own independent advice and guidance as appropriate.





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**Q: How does pledge differ operationally from title transfer business?**

We intend to issue some guidance notes identifying the key operational differences between pledge and title transfer business.

**Q: Does the pledgor need to substitute collateral over an income date?**

No. If the relevant items of posted collateral are not substituted out prior to the relevant income date, dividends or distributions received by the Lender on collateral will be added to the posted collateral in the secured accounts and there will be no manufactured payments in respect of them.

The pledge arrangements do contemplate withdrawal of excess collateral and to the extent that the dividends or distributions are or become excess collateral when or after they have been added to the collateral, there is scope for their withdrawal.

**Q: Are there plans to develop similar documentation for repo activity?**

We understand that ICMA are reviewing pledge structures for Repo activity. Please contact ICMA directly for further information.

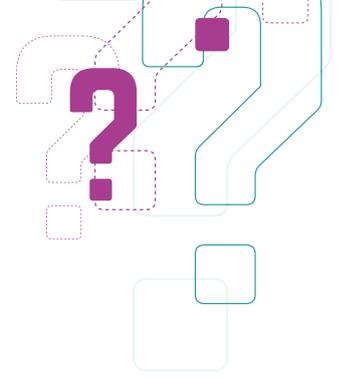
**Q: Is it possible to rehypothecate or have right of re-use of collateral using the ISLA pledge structure?**

No, the ISLA pledge documentation does not allow for the Lender to have rehypothecation rights, or rights of use over posted collateral.

**Q: Who controls the pledge collateral account?**

The tri-party provider holds and carries out transfers of the posted collateral in accordance with the terms of the relevant tri-party custody documentation.





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**Q: Can the pledgor vote on collateral in the pledge account?**

No. Under the ISLA security interest structure, it is not possible to vote on securities in the secured account(s).

**Q: Can ISLA provide any information on potential tax implications when using the GMSLA Security Interest agreement?**

During the development of the documentation, a question was raised as to whether the movement of collateral would be considered a disposal by tax authorities in certain jurisdictions. The tax implications were considered by the ISLA tax group and it was determined that each firm using the documentation would have to gain comfort with the risks of pledge and complete their own due diligence.

**Q: Can the ISLA pledge documentation facilitate agency transactions for a pooled principal arrangement?**

The current ISLA pledge documentation structure does not support activity for agency transactions for pooled principals. If you require further information regarding activity for pooled principals, please contact ISLA directly.

**Q: Is there a glossary of terms?**

Not at present, however we are in the process of developing a glossary of general market terms that will be available on the ISLA website in due course.

**Q: What types of collateral are covered by the GMSLA Security Interest agreement?**

Eligible collateral under the GMSLA Security Interest agreement is cash and securities. These are set out in the appendix of the GMSLA Security Interest agreement.

**Q: What happens in a Borrower default situation?**

On a default of a Borrower, the Lender would call an event of default resulting in the termination of the outstanding transactions, value the return and any other obligations of the Borrower and enforce its security to the extent required to discharge the Borrower's obligations. Any surplus collateral would be returned to the Borrower. The legal documentation outlines the notices that need to be distributed.





## Disclaimer

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