Derivatives-related FAQs *(subject to change)*

1. Are U.S. derivatives moving to T+1?

Yes, no, and maybe. If a derivative is DTC-eligible and there is otherwise no exemption, then it will move to T+1. Section 3(a)(10) of the *Exchange Act* includes security-based swaps and options, and excludes an exempted security (indeed, security-based swaps are exempted). Even if a derivative were exempt, it still may move to T+1 by agreement or market practice. For example, over-the-counter (OTC) options are not mandated to follow T+1, but are expected to align with listed options, which must move to T+1.

2. What derivatives will move to T+1?

At a SIFMA-hosted T+1 presentation by ISDA representatives, participants heard that, as a rule of thumb, firms could expect depository-eligible securities that moved from T+3 to T+2 to likely move from T+2 to T+1 to keep cash flows aligned (avoiding increased capital, pre-funding, or credit costs) and to reduce business risk between the derivative and corresponding hedge transaction as much as possible. The OTC market will follow suit to keep cash flows aligned as much as possible, and to avoid basis risk between securities and the related derivative instruments. Even for formal exceptions to the T+1 rule (for example, security-based swaps, which have been exempted), many parties may still choose to adopt T+1 to avoid mismatched settlement cycles.

- ***Equity*** derivatives are expected to be most impacted by T+1 while classes like ***credit*** derivatives are not expected to be impacted by T+1. Other asset classes may be affected to a greater or lesser extent and there may be further discussions among market participants. For example, ISDA equity working groups could discuss exotic/highly structured derivatives, including non-standard non-linear transaction types (e.g., barrier and compound options).

- ***Other*** asset classes that may be affected to some extent are those where a market participant may want to align payment dates of an interest rate swap with the settlement of the security. In the case of U.S. dollar for SOFR trading (Secured Overnight Financing Rate, a benchmark rate chosen to replace USD LIBOR), the derivatives convention is 'compounded in arrears.' SOFR is published on T+1, with the last observation made on the termination date when payment is due, providing little to no notice of the amount of interest due. Fortunately, there are new ISDA lookback, observation shift, and lockout conventions that have now been in place for several years. They are reflected in industry documentation, which has been deployed and is in use by the market. These allow observation of a rate so that the interest amount can be determined *ahead* of the payment date, allowing for certainty as to the amount and time to make that payment on T+1. Firms also may elect *not* to alter the observation of the rate, but to apply instead a payment delay to the floating amount, agreed on a trade-by-trade basis.

3. Will there be changes to derivatives documentation, processes, and systems for the move to T+1?

The T+1 impact on derivatives **documentation** is expected to be minimal. ISDA updated and futureproofed' equity derivative agreements in 2017 at members' request (replaced hard-coded settlement cycle references with more generic wording). There was limited uptake by market participants of the new protocol at the time as, instead, most chose to amend existing OTC equity documentation on a blockchain basis or otherwise. No change is seen as needed to the master documentation for T+1 at this time. Industry participants should, however, check if payment dates they specify in their confirmations or product descriptions require an update. Also, participants may have to look at updating any specific calendar dates in their Master Confirmation Agreements (MCAs) for products such as equity options (as well as credit default and variance swaps) in several jurisdictions.

Regarding **processing**:

- There may be risk-booking systems and settlement system updates to make to ensure correct payment timelines are captured and payments can/will be made in the reduced timeframe.
- Market participants also should consider what business day convention applies in the time zones of counterparties.
- Physical- and cash-settled derivatives should be aligned.

While technology solutions are clearly desirable, efforts to identify and implement new systems should not be underestimated. In the meantime, ISDA is working on an operational practice document that should help with some unnecessary problems, for example, those caused by (poor management, communication, and reconfirmation of standing settlement instructions (SSIs) to improve the ability to make payments on a timely basis.

4. Will ISDA facilitate remediation of legacy trades – transactions outstanding as of May 26, 2024 in Canada/May 27, 2024 in the U.S.?

Yes, ISDA, as it did in the case of the 2017 move to T+2, can facilitate co-ordination (likely two-three months before transition) of what firms expect to do with respect to outstanding (live) transactions executed before May 26/27 2024 and continuing afterward. Firms have not yet begin stating their preferences, and there are various issues to consider, including whether a market participant wants to spend time remediating a transaction that will expire soon versus transactions that will remain on the books for two or three years after. ISDA expects to circulate a table (see attached example) listing equity options, accumulators, and equity/variance swaps/dividend swaps, that members could use to record their own – and better understand other – firms' intentions regarding the settlement cycle of particular products and business events.

Example of ISDA Table to Capture Approaches to T+1 Transition

US & CANADA - TRANSITION TO T+1 SETTLEMENT			
Dealer vs Dealer	**Settlement cycle for existing trades entered into Prior to [DATE TBC, 2024]**		
Event	**Scheduled Eq and Funding & Expiry Cash flows (if applicable)**	**Unwinds / Upzise / (if applicable)**	**Physical delivery at expiry (if applicable)**
Equity Swaps			
Single Share			
Indices			
Equity Options			
Single Share			
Indices			
Variance Swaps			
Single Share			
Indices			
Dividend Swaps			
Single Share			
Indices			
Accumulators / Deccumulators			
Single Share			
Indices			
Other			
Single Share			
Indices			
Dealer vs Client	**Settlement cycle for existing trades entered into Prior to [DATE TBC, 2024]**		
Event	**Scheduled Eq and Funding & Expiry Cash flows (if applicable)**	**Unwinds / Upzise (if applicable)**	**Physical delivery at expiry (if applicable)**
Equity Swaps			
Single Share			
Indices			
Equity Options			
Single Share			
Indices			
Variance Swaps			
Single Share			
Indices			
Dividend Swaps			
Single Share			
Indices			
Other			
Single Share			
Indices			

Additional information: