IC Brief

PARA BELLUM ADVISORS

ISDA Negotiation and Margin Optimisation

Scenario Type: Asset Manager – UCITS Global Macro
Asset Class: OTC Derivatives (Rates, FX, Equity Index, Commodities)
Situation Type: Scaled derivatives programme operating under legacy ISDA/CSA terms
Primary Issue: Structural capital drag from asymmetrical CSA economics, excess margin posting, and ungoverned collateral behaviour

1. Decision Context

The fund is a scaled UCITS macro platform with a liquid, multi-asset derivatives book and strong underlying performance.

Trading activity has expanded across counterparties, products, and gross notional in line with AUM growth. What has *not* scaled is the collateral and documentation framework governing that activity.

The IC decision is not whether derivatives are appropriate.

It is whether the existing ISDA/CSA stack remains economically coherent and defensible for a fund that has outgrown its start-up documentation.

This is not an operational tidy-up. It is a **balance-sheet and performance intergrity** decision.

2. What Changed

At launch:

- ISDAs and CSAs were executed quickly to enable trading
- “Market standard” terms were accepted without leverage
- Margin behaviour was immaterial at small scale
- Documentation was treated as static infrastructure

As the fund scaled:

- Gross notional and turnover increased materially
- Counterparty count expanded
- Margin posted grew faster than risk
- Cash buffers became persistent rather than tactical
- Documentation remained unchanged

The strategy scaled. The collateral economics did not.

3. How the Risk Actually Manifests

The risk is not volatility or counterparty failure. It is structural capital drag.

- Excess cash trapped as variation and initial margin
- Asymmetric thresholds forcing one-way collateral posting
- Daily calls and zero MTAs creating nuisance liquidity buffers
- Cash collateral earning sub-economic or negative carry
- Operational effort consumed by avoidable margin activity

On paper, the fund performs. In practice, collateral quietly taxes the returns.

4. What Surfaces on Review

When assessed as an economic system rather than a legal document, consistent issues emerge:

- CSA terms reflect start-up bargaining power, not current scale
- Threshold asymmetry favours dealers despite diversified risk
- IM mechanics act as permanent capital locks
- Call frequency and settlement windows force idle cash
- Eligible collateral rules prevent optimisation
- No benchmark exists for "what good looks like" at the funds current wallet size
- Governance focuses on trading performance, not collateral behaviour

This is not error or negligence. It is structural drift.

5. Structural Assessment

This is not:

- A pricing problem
- A PM issue
- An operational failure

It is:

- A funding model embedded in documentation
- A capital efficiency problem hidden in plain sight
- A governance blind spot created by scale

Any response must preserve:

1. Trading flexibility and counterparty access
2. Regulatory and audit defensibility
3. Liquidity resilience under stress
4. Ongoing control to prevent re-drift

One-off renegotiation without governance simply resets the clock on drift.

6. Structuring Logic

Effective remediation focuses on economics and control, not legal theory.

Key principles:

- Treat the CSA as a live funding instrument
- Map collateral drivers, not just posted balances
- Benchmark achievable terms for this wallet and risk profile
- Use credible counterparty leverage, not goodwill
- Align thresholds, IM, MTAs, and call cadence with actual risk
- Embed reporting and review so drift cannot re-emerge

The objective is not "better paperwork". It is governed collateral behaviour at scale.

7. Intended Outcomes

When addressed correctly:

- Posted collateral falls without increasing risk
- Cash yield leakage is reduced or eliminated
- Margin calls become predictable and manageable
- Idle liquidity buffers shrink materially
- Governance gains line-of-sight over a previously invisible drag
- Performance reflects strategy, not documentation artefacts

The outcome is not optimisation. It is control.

8. IC Takeaway

This was not a trading problem.

It was the predictable result of running an institutional-scale derivatives programme on start-up collateral terms.

Collateral does not fail loudly. It fails quietly – by compounding drag as scale increases.

Treating CSA economics as a managed balance-sheet line restores performance integrity.

9. Applicability

Most relevant where:

- OTC derivatives are core to the strategy
- AUM and notional have scaled materially since launch
- Margin posted is significant relative to NAV
- CSAs have not been re-underwritten
- Cash collateral earns poor or negative carry

Counterparty leverage exists but is unused

Less relevant where:

- The book is small or listed-only
- Collateral strategy is actively governed
- A single counterparty relationship is intentional and priced accordingly
- CSA terms are regularly benchmarked and renegotiated

10. Engagement Path

Primary Offer: Capital Efficiency Rebuild ™- CSA economics review, collateral drag mapping, benchmark framework, renegotiation strategy, and governance controls.

Secondary / Bespoke: Counterparty consolidation planning, CSA amendment support (alongside client counsel), collateral eligibility redesign, reporting and governance build-out.

A full structural narrative is available for readers who wish to review the underlying mechanics, trade-offs, and remediation sequencing in greater detail.

Disclaimer

Illustrative scenario for discussion purposes only. Not a transaction summary or client-specific case study.