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**DRS**<sup>TM</sup>  
Alternative. Legal. Solutions.

 **margin**  
R E F O R M  
Educate | Mitigate | Transform

# IMpact<sup>3</sup>

A WEALTH OF EXPERIENCE,  
DELIVERED WITH PRECISION

# WHAT IS THE ISSUE?

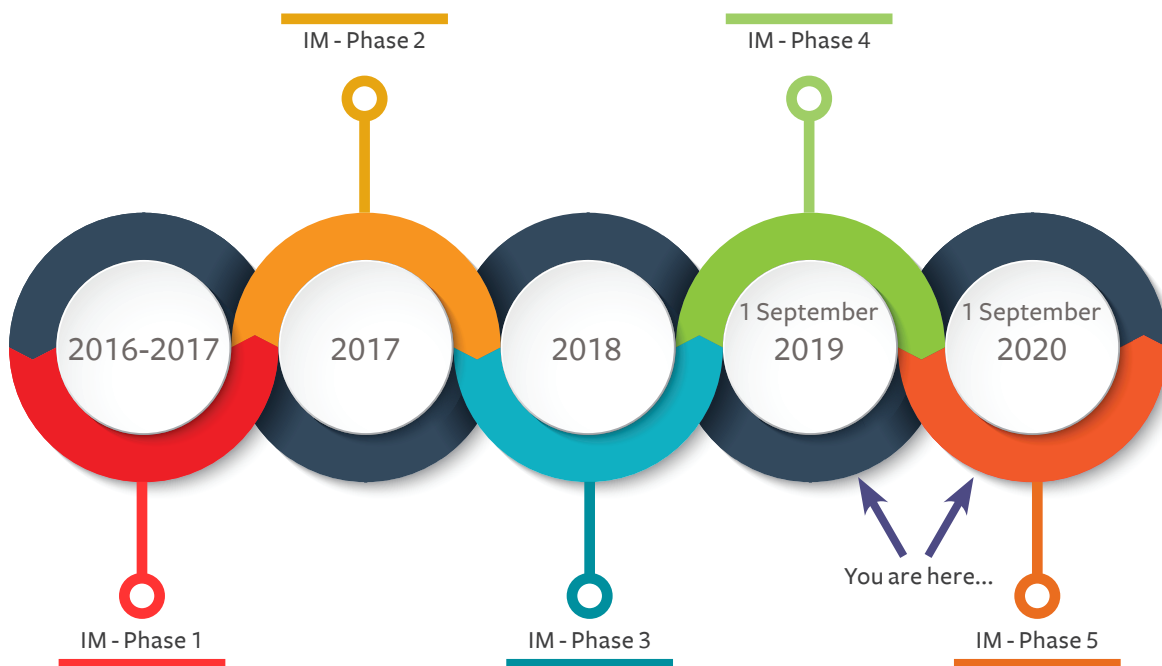
## (a) 2016/2017-2020 – Phased-in IM Seg Requirements.

Between 2016/2017 to 2020, the Dodd-Frank rules and the EU’s EMIR Margin RTS’ phases-in a requirement for counterparties, with more than EUR 8 billion gross notional amount of uncleared OTC derivatives, to collect Initial Margin or “IM”, from other similarly affected counterparties. As the margin must be segregated, these arrangements are called “IM Seg” requirements.

This is being introduced in five phases. Phase 1, which took effect in September 2016/February 2017, obliged counterparties to post and receive IM with similar affected Counterparties, where both had a gross notional amount of derivatives over €3 trillion. Phase 2 and Phase 3 captured Counterparties having a gross notional amount of derivatives over €2.25 trillion and €1.5 trillion respectively.

### THE TIMELINE

The key milestones in the Initial Margin implementation timeline are:



PHASE	1	2	3	4	5
AANA*	> 3 trillion	> 2.25 trillion	> 1.5 trillion	> 0.75 trillion	> 8 billion
No. of in-scope groups (IM)	26	6	8	50+ (est.)	Max 1,100 <sup>2</sup>

\*“AANA” means aggregate average notional amount of non-centrally cleared derivatives, across a 3 month observation period

In-Scope Counterparties must exchange IM with all other In-Scope Counterparties, not only from their Phase, but also (a) previous Phases; and (b) subsequent Phases.

So, for example, a Phase 4 entity, with 20 separate ISDA Master Agreements in place with other entities in the Phase 1,2, 3 and 4 groups, will, by 1 September 2019, be required to put IM documentation in place for each of the paired entities in all four of those groups. This may lead to multiple documentation sets being put in place between affected Counterparty Groups.

Any entity caught within the scope of Phase 5, will, by 1 September 2020, need to agree IM arrangements with its trading counterparties, covered by Phase 5 and any of the prior phases.

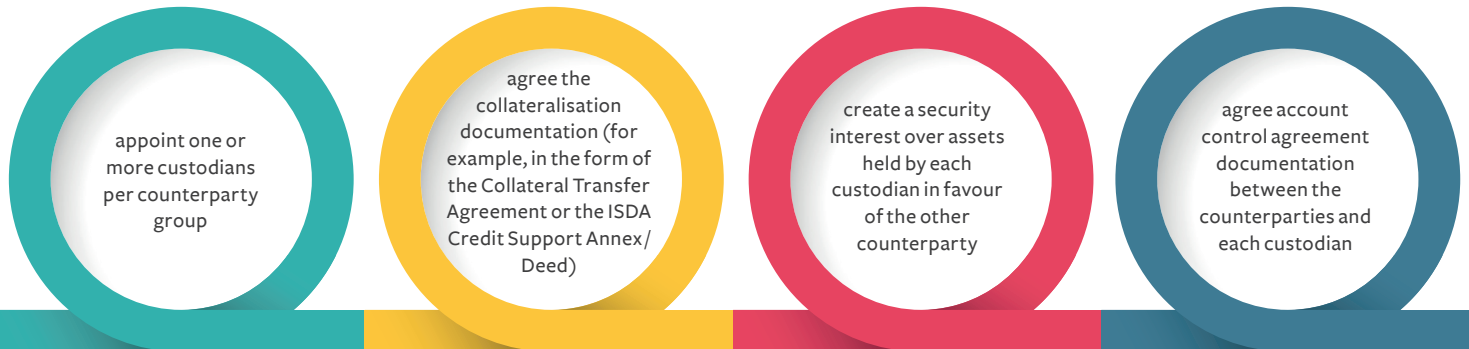
1. Regulation (EU) 2016/2251 of 4 October 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty.  
 2. ISDA guidance estimates that the actual number will fall significantly lower than this maximum number.

## (b) The Scale of the Task

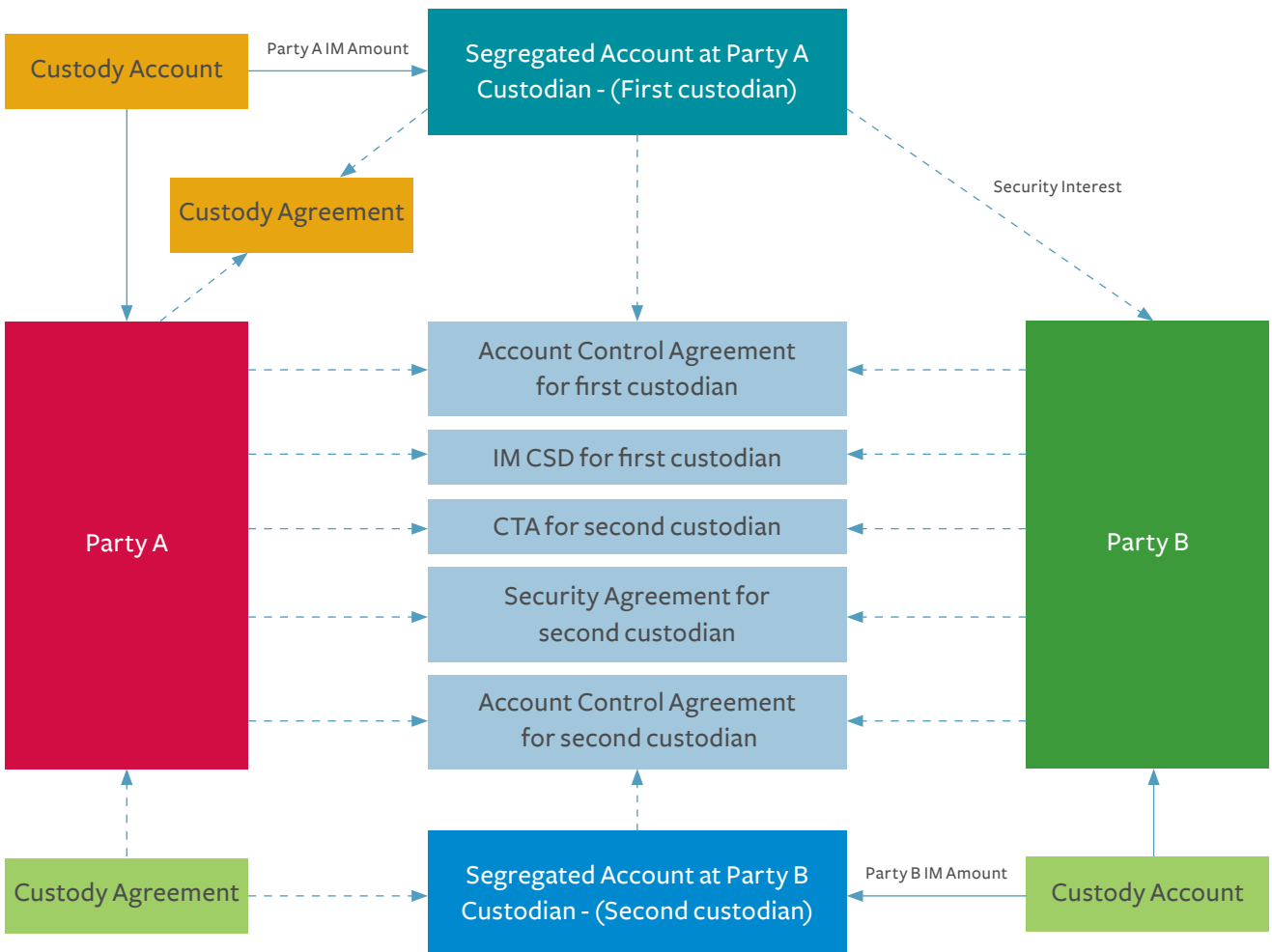
Each affected entity must post and receive IM. So each counterparty in a relationship will act both as a collateral receiver and collateral taker at the same time. Collateral transferred by the collateral provider must be held by a third party custodian and be secured in favour of the collateral taker.

The rules require pledged collateral to be either: (a) freely available to the collateral taker in case of a default by the collateral provider, or (b) returned to the collateral provider in case of the collateral taker's default.

This means that, for each pairing, the counterparties will need to:



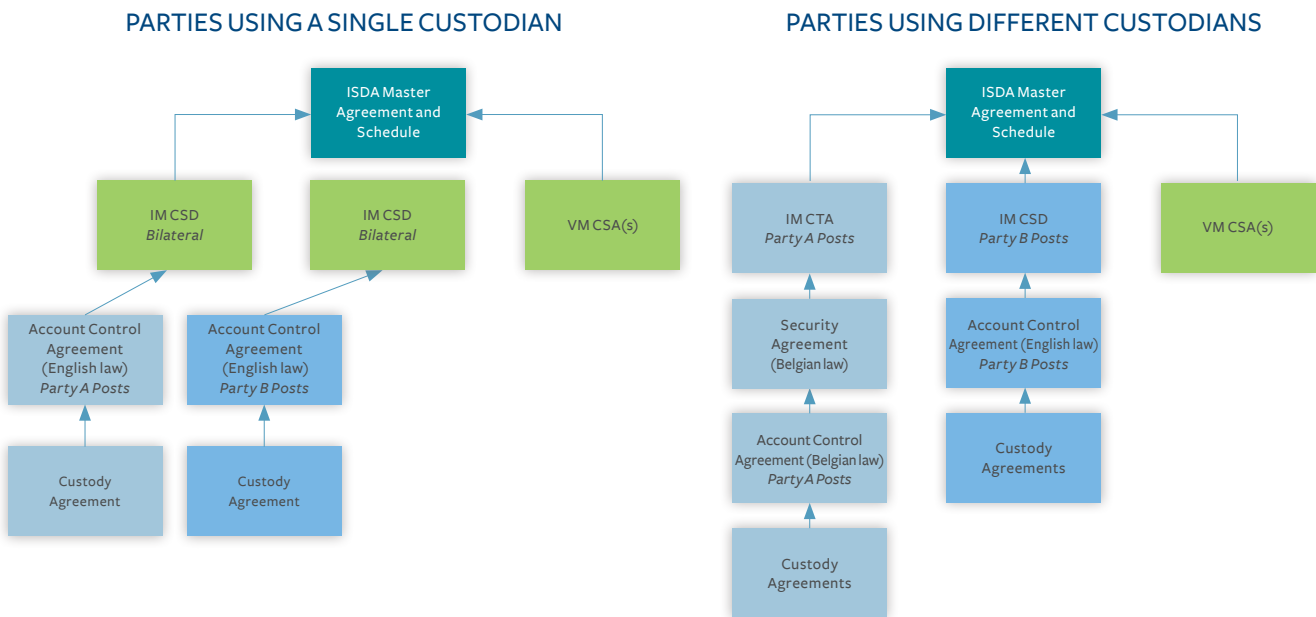
This can be illustrated as follows:



This is a simplification. Party A's group may use two custodians, and Party B's, two others. A counterparty group may face multiple combinations of custodians. You may choose your own custodian but not your counterparty's.



The amount and type of documentation will primarily depend on the choice of custodian and its location. An example of the documentation framework can be illustrated as follows where a single custodian is located in the UK and the other in Belgium.



Considering the number of entities caught within the scope of Phase 4 and 5, the implementation of the new IM requirements is transformative for the industry and, at the same time, it represents a considerable operational challenge. The principal difficulties for both Phase 4 and Phase 5 include:

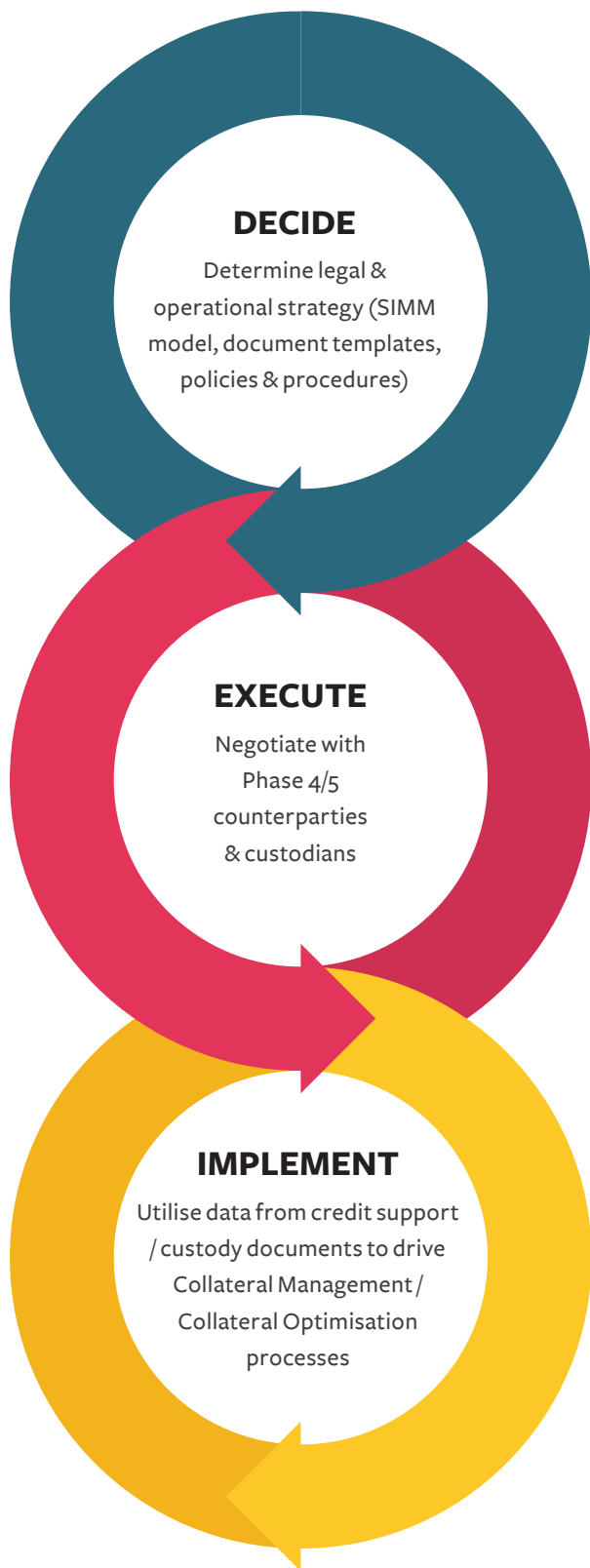
- Numerical Scale**
  - Phase 4 could bring over 50 newly in-scope counterparties (NISCs). Phase 5 ISDA estimated over a maximum of 1,100 NISCs, with over 9,600+ new relationships subject to UMR. After recent BCBS/IOSCO statement (05 March 2019), ISDA now estimate the actual number will fall significantly lower than the maximum number of 1,100.
- Limited Resources for new entrants**
  - There are limited internal resources available for Phase 4 and 5 Counterparty Groups, and many external service providers will have had limited experience of earlier Phases.
- Existing Demands**
  - There are extensive resource demands on Phase 1, 2 and 3 Dealer/Counterparty Groups due to requirements to put documentation in place before regulatory deadlines for a large number of pairings. This may lead to Dealer/Counterparty Groups prioritising relationships.
- Operational Challenges**
  - Operational challenges will be varied and will affect all areas of the organisation from pricing through credit risk and collateral into back office support areas such as settlements and reconciliations. Understanding the impact on your business and the future operating model as volume and complexity increases is critical to ensure risk and controls are understood.

# WHAT IS IMPACT<sup>3</sup> AND HOW DOES IT WORK?

Mayer Brown, DRS and Margin Reform have created Impact<sup>3</sup>: a compelling cost effective service providing high quality regulatory advice and legal analysis by Mayer Brown implementing the right IM infrastructure; together with cutting edge execution and implementation from DRS and Margin Reform.



# WHY?



A successful IM project will combine several core activities

IMpact<sup>3</sup> delivers at each stage of this cycle

The volume and complexity of legal agreements that require negotiation in advance of September 2020 presents an almost unprecedented challenge to participants in the derivatives market.

In order to meet that challenge, affected organisations will need to have access to:

- Global legal and regulatory advisory capability
- Large scale outreach and IM negotiation capability; and
- Collateral management expertise

IMpact<sup>3</sup> brings those three disciplines together in one co-ordinated and comprehensive solution, combining Mayer Brown’s global derivatives practice with DRS’s outsourced contract management service and Margin Reform’s unique IM implementation experience.

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# OUR TRACK RECORD

## Mayer Brown Experience

### A STRONG TRACK RECORD IN ADVISORY AND IMPLEMENTATION OF IM AND VM

We have a strong record in advisory and implementation of similar schemes. We list 6 examples of our work representing buy side, custodians, industry bodies and sell side.

#### CASE STUDIES

##### 1 A PHASE 1 GLOBAL DEALER

#### OUTSOURCED IM IMPLEMENTATION PROJECT FOR A PHASE 1 GLOBAL DEALER

Mayer Brown advised A Phase 1 Global Dealer on its compliance with the US and European regulations on margining of uncleared derivatives. Our client, as one of the largest global 'Phase 1' dealer was required by US, Canadian and EU rules to have compliant documentation for posting/receiving initial margin with all other 'Phase 1' dealers and variation margin with all other financial entities by the 1 Sept 2016 and 1 March 2017 regulatory deadlines respectively. We assisted them in putting in place this documentation with all these counterparties, including handling their most important negotiations, as well as providing them with legal support for the entire project. The regulations affected our client's entire derivatives portfolio with a notional value of over \$3 trillion and this matter involved close co-ordination between our US, UK and German practices, as well as with Canadian counsel.

##### 2 A PHASE 1 GLOBAL DEALER

#### ADVISING A PHASE 1 GLOBAL DEALER

We have assisted A Phase 1 Global Dealer in a number of discreet cross-border projects relating to the implementation of the EU and US margin regulations. These have included: (a) updating a template 2016 VM CSAs to address gross/gross posting with net settlement for non-netting counterparties under both the US and EU regimes; (b) preparing US and EU VM-compliant versions of the 1995 ISDA Credit Support Annex for both cash and securities; and (c) advising on the determination of 'investment grade' without reference to credit ratings in respect of collateral posted as IM under the CFTC rules.

##### 3 BNY MELLON

#### OUTSOURCED IM SEG ACA NEGOTIATION AND MANAGEMENT PROJECT FOR BANK OF NEW YORK MELLON ("BNY MELLON")

Mayer Brown is currently advising BNY Mellon on its compliance with the European and US regulations on margining of uncleared derivatives. This involves all aspects of advisory and project management throughout Phase 1 to 3 and also Phase 4 and 5. This includes a preparation of master templates, drafting the playbook and advising on the outreach and ACA negotiation process. Mayer Brown is also responsible for commissioning any opinions that may be required by BNY Mellon and its clients.

Mayer Brown is providing advisory and consultancy input and working in partnership with a third party service provider in the operational and implementation aspects of the project.

## Mayer Brown Experience (cont'd)

### 4 ISDA

#### ADVISING ISDA ON THE MARGIN DOCUMENTATION AND COMPLIANCE

Mayer Brown advised ISDA in connection with the implementation of the ISDA 2016 Variation Margin Protocol (the “**VM Protocol**”) and the ISDA Regulatory Margin Self-Disclosure Letter (the “**ISDA SDL**”). We liaised with Markit to ensure that both the VM Protocol and the ISDA SDL are integrated correctly into the ISDA Amend platform, allowing market participants to access and use both documents in an electronic and interactive format. We also produced additional educational materials (as available on the ISDA website) and participated in a number of industry calls relating to that project. Mayer Brown advised ISDA on the enforceability of the VM Protocol under English law and New York, including issuing opinions to ISDA and its members.

### 5 ZURICH

#### OUTSOURCED VM CSA REPAPERING PROJECT FOR THE GLOBAL ZURICH GROUP

Mayer Brown advised the global Zurich group in respect of its compliance with the new obligations under the European Market Infrastructure Regulation (EMIR). At its first stage, this included advice on the clearing documentation, the risk mitigation obligations, and any inter-group exemptions. We also assisted the client with the new margin requirements and finalised negotiations of their collateral agreements with their market counterparties. This was a cross-border matter and we advised the London, New York, Dublin, Zurich and Madrid offices, branches or affiliates of the global Zurich group.



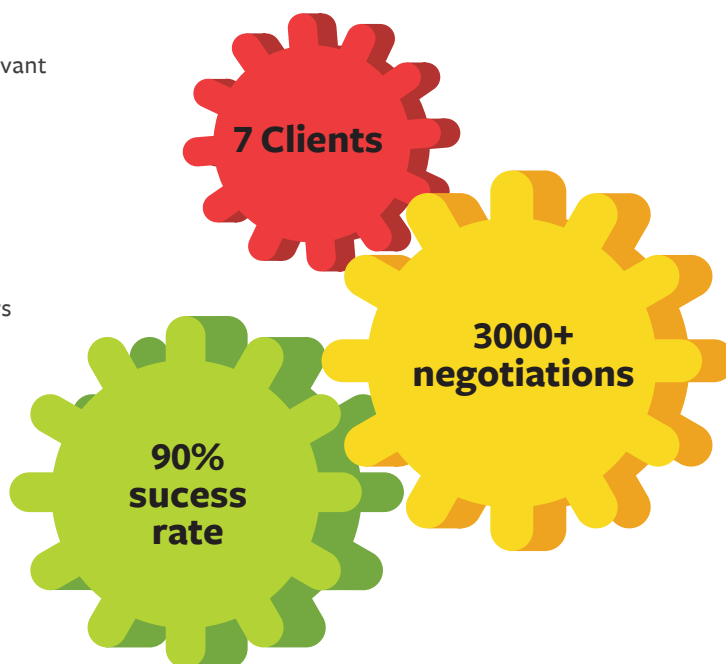
## DRS Experience

Since Q3 2016, DRS has been instructed by 7 of our clients (both buy-side and sell-side institutions) to assist them in the negotiation of credit support and custody documentation to comply with both the variation margin and initial margin requirements of the WGMR non-cleared margin rules.

### HOW HAVE WE HELPED?

We provided an outsourced end-to-end outreach and repapering service encompassing the following:

- Assistance in the creation and maintenance of relevant negotiation policies and playbooks;
- Creation of first draft documentation;
- Management of all communication with in-scope counterparties;
- Liaising directly with relevant internal stakeholders to seek approval for non-standard amendments and to resolve barriers to negotiation;
- Management of re-drafting of documentation to incorporate agreed amendments
- Production and processing of execution copies;
- Checking signing authorities;
- Post-completion update of core commercial data within legal and collateral management systems;
- Production and distribution of regular MI and participation in project steering group meetings; and
- Delivery of detailed VM and IM CSA training to internal legal and risk teams to assist them in the negotiation of relevant documentation once it has been brought back in-house as BAU.



### HOW HAVE OUR CLIENTS BENEFITTED?

We have achieved a significant and, we believe, unmatched, level of success for our clients. To date we have managed the negotiation of in excess of 3,000 VM and IM CSAs and, in doing so, we have consistently outperformed the market by reference to reported completion rates.

For Variation Margin we achieved for our clients an average completion rate of 76% by the 1 March 2017 deadline (with a best result of 99%) against a reported industry average of 42%.

For Initial Margin we have so far achieved an average completion rate of 90% by the Phase 1.5, Phase 2 and Phase 3 deadlines (with a best result of 92%) against a reported industry average of 56%.

Our clients have benefitted from far higher than average levels of timely compliance resulting in a reduction in regulatory risk coupled with the financial benefit of lower incidences of disruption to trading relationships. We have achieved all this whilst, at the same time, delivering savings of up to 80% when measured against the costs of other consultancies or external law firms.

# WHY MARGIN REFORM?

Margin Reform provides a practitioner led consultancy who bring a deep and deliberate expertise to the Collateral, Margin and Legal domain. Our extensive implementation experience coupled with industry knowledge and partnerships means we are positioned to bring your requirements to fruition in a scalable and structured way.

## THE JOURNEY SO FAR?

Margin Reform have worked with Phase 1 dealers, industry associations and multiple vendors since 2014 to successfully deliver the Uncleared Margin Rules in a Phase 1 organisation. Over those 4 years they worked and supported the Accountable Executive on:



A new collateral system, specifically overseeing the regulatory requirements that were required.



A new legal documentation system that enabled new regulatory documents to feed pricing, credit, collateral and capital interfaces.



Multiple regulatory attestations including a regulatory rules tracker



Completion of Custody RFI/RFPs



Interfaces with >60 upstream and downstream technologies.



Management of all internal stakeholders on the requirements, development and implementation of UMR



Leading multiple internal audits post go-live on general Margin Reform compliance and SIMM



Managing the creation and implementation of a new process to support custodial onboarding, documentation and legal negotiation playbooks



Benchmarking internal practices for legal negotiations and best practice versus the industry



Managing the pre-go live operational readiness review through every Phase from 2016.



Leading the development, implementation and regulatory approval of the ISDA SIMM model.



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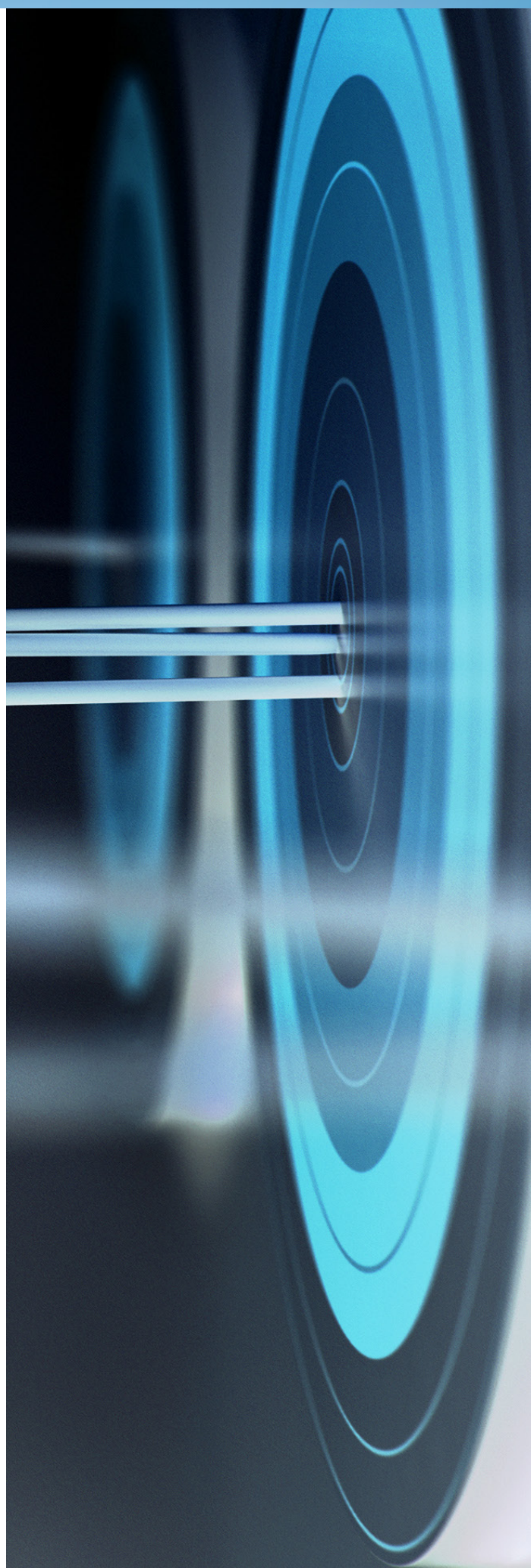
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