TOP TIPS

for navigating uncleared margin rules

1

Do you have a complete list of counterparties with whom you need new agreements?

First, gather a list of counterparties where there are open active trades. Next, consider portfolios without open trades as these may also become active. Make sure to review and agree upon this list with the front office and risk teams to ensure that the correct initial target list of counterparties and agreements will be updated. The source of this data may come from the main back office "books and records" system, risk management system, or legal system (or all of them) to clarify the scope.

TIPS

1. Make a complete list of collateralised relationships.
2. Combine it with current exposure values and activity level.
3. Reconcile this list with the front office and risk management.
4. Keep the list up to date as new counterparties become active.

2

Have you prioritised the order in which the counterparties are handled?

Once a final target list of counterparties and agreements is complete, prioritising the re-papering is next. Criteria could include a) active trading activity b) non-zero credit exposure c) counterparties who are about to begin trading d) the size of their credit exposure to you e) the revenue the counterparty represents to the firm. Develop the inputs to this prioritisation in conjunction with colleagues in the front office, as well as risk and legal teams.

TIPS

1. Agree the criteria and method of prioritising with the front office and risk management.
2. Apply the criteria to your list.
3. Review the outcome, especially the highest priority relationships.
4. Match the size of your list with staff capacity and consider the overall time to re-paper the entire list.
5. Compare time versus staff capacity and find accelerators such as an electronic platform like SmartDX or a third party service (also using SmartDX).

3 Have you agreed an approach to re-papering with those counterparties?

Once there is a priority list, establish a process or preferred approach for re-papering each agreement. Choices include the ISDA Amend Protocol, a bespoke update to the existing agreements or new agreements. Consider the number of CSAs put in place, which could be up to four per relationship for VM and IM with pre- and post-regulation portfolios. Communicate with all counterparties to confirm the preferred approach.

According to the Peer Benchmark Survey on Uncleared Margin Rules, the adoption of ISDA Amend has been low, with most firms using in-house teams. Firms still should consider the ISDA Protocol, but it may not cover a sufficient population to become compliant in time for the deadline.

TIPS

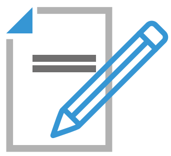
1. Initiate communication with your counterparties to establish their preferred approach to negotiation, whether fully bespoke, via a protocol or some other way.
2. Estimate the time to complete each agreement and keep your plan updated to predict completion.
3. Use of the protocol as a technology enabler for adherence to the new regulations for Variation Margin saw far lower uptake than originally envisaged. In order to be prepared, organisations should plan for this to remain the case whilst being aware that there will be no protocol for Initial Margin. As such, it is prudent to plan for a large proportion of bilateral negotiations during repapering efforts.

4 Have you defined your preferred policies and terms to achieve UMR compliant agreements?

Prior to re-papering, it is necessary to agree across the firm upon preferred terms for the CSAs going forward. These need to achieve compliance with the regulations while also meeting commercial needs. Input to these policies should come from multiple teams, including the front office and the risk, credit and legal departments. Areas for discussion will include eligible assets, product scope (as long as the firm remains compliant), the method for calculating IM if any, and minimum transfer amount (capped at 500,000 in some cases). The new CSAs described in the regulations leave less room for variation than a typical pre-regulation CSA.

TIPS

1. Discover the structure of agreements required with counterparty, either one entire agreement or four individual agreements for VM, IM, pre- and post- UMR.
2. Compare your preferred approach with your counterparty, you both need to agree.
3. Consider whether splitting into pre- and post- agreements will speed up becoming compliant or cause more work. Re-using existing agreements may be more efficient.



Our survey asked: "Which (if any) of these actions has your firm taken?"

- **51%** have prioritised negotiations using various criteria (mentioned above)
- **22%** have stopped trading with some counterparties
- **18%** have reallocated staff to speed up re-papering

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5 Have you allocated responsibilities to manage the flow of work within your organisation?

When re-papering begins, be clear on how each agreement gets processed across internal teams. 1) How the initial agreement mandate is kicked off 2) how the re-papering work is allocated to the legal team(s) 3) how progress is tracked 4) how exceptions are escalated and resolved and 5) how execution of the final agreement is handled. Some of these steps may be part of day-today work, but anticipate the potential for bottlenecks with the volume required for the new regulations.

TIPS

1. This exercise for many firms means considerable increase in work for the legal and collateral teams, along with colleagues in the front office.
2. Spend enough time to plan and verify the team workflow to initiate, negotiate, execute and implement agreements with realistic estimates for the effort required from everyone.
3. Build a plan which reflects the effort required and predict your compliance date accordingly.
4. Consider using a platform like SmartDX which transforms efficiency amongst teams.

"Which areas would you say cause the greatest delays or inefficiencies in the documentation process?"

- **22%** said communicating with counterparties
- **17%** said managing team work and the flow of negotiations
- **12%** said handling interactions with the front office

6 Have you agreed a procedure for loading, checking and beginning operational implementation of agreements?

Once each agreement is executed, make sure there is a workflow to implement these. In some cases this means hand keying the terms of each agreement into a collateral management system, or upload these electronically. Whatever the method, it is vital that the representation of the agreement in electronic form matches the intention of the legal document behind it. In this case, it is critical for the legal team to undertake a final review step before live operation, as well as a postimplementation review that the agreements are operating as expected.

TIPS

1. Hand keying the terms of an agreement into a collateral management system is time consuming and error prone.
2. Try to find an electronic way to receive the terms of each agreement, and load it directly without manual keying. Platforms like SmartDX and CloudMargin already integrate this way and speed up this crucial step of the implementation process.
3. SmartDX is based upon the concept of data driven agreements, with an underlying machine readable version. The service facilitates the seamless extraction of data points into CloudMargin.

"If you had a magic wand, where would you invest in your legal (and collateral) environment?"

- **19%** said managing the execution of agreements (getting signatures)
- **17%** said ensuring compliance with policies
- **48%** said a combination of managing agreements, expanding team capacity and communicating with counterparties

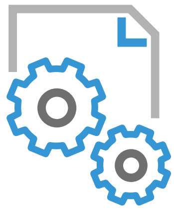
7

Have you considered the impact of the new agreements on your operational process for exchanging collateral?

The new rules require daily exchange of collateral with a maximum limit on the threshold before a margin call is required. Since market participants must now collateralise FX derivatives too, the volume of margin calls is expected to increase by 500% on average. Margin calls must be agreed and settled on the same day.

TIPS

1. Confirm with your operations team that they can handle the expected increased margin call activity.
2. Adding more operations staff is an expensive solution and might not be sufficient (in other words consider automation rather than adding people).
3. Consider using a collateral management system that can automate the calculation of any margin calls, allow margin calls to be sent directly to your counterparties, track any dispute margin calls and also send payments directly or automatically feed your payments systems.



8

Have you allocated responsibility and procedures for the funding of margin agreements?

Some firms fund the outgoing payments for margin from within the collateral management team as payment instructions into the treasury team. Many firms build a close relationship between the collateral management team and their treasury or funding desk to both optimise the outgoing flow of assets but also anticipate funding over future time periods. For large numbers of agreements, an electronic interface between the collateral team and the funding desk is essential to ensure the accurate recording and management of both outgoing and incoming movements.

TIPS

1. The way in which you calculate interest on collateral (either paid or received) is in effect a trade under the ISDA master.
2. Establish within your firm the way your treasury funds the business.
3. Align your margin agreements with this approach.
4. Give responsibility for defining the terms of each margin agreement for interest to a group of front office, risk management and collateral teams to ensure the most favourable outcome.
5. There is an opportunity to maximise the return on your collateral if the front office are involved.
6. A misalignment between your sources of funding and placement of assets with counterparties will be a cost to your firm.

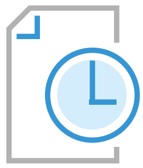
9

Have you agreed procedures for calculating marks each day?

For firms new to running collateral management agreements, it is important to receive daily trade valuations. In an ideal world these are generated automatically and delivered as a file with corresponding unique trade identifiers. For the exposure on an agreement to be calculated accurately, firms need the latest valuations and the ability to accurately map the trades to the right agreement. Make sure there are procedures in place to handle missing or stale valuations, as these can cause an incorrect exposure amount, which will cause a potential dispute with your counterparty.

TIPS

1. Most firms need to re-value their trades every day for all sorts of reasons.
2. The collateral team need an electronic feed of this data.
3. Every individual valuation must have a time stamp showing when the valuation was produced.
4. Stale or missing valuations must be identified, escalated and resolved.
5. Poor procedures in this area will lead to disputes, wasted effort and cost.



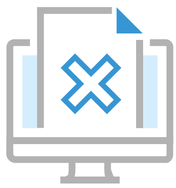
10

Have you agreed procedures for dispute reporting and resolution?

With substantial portfolios it is common that on any margin call, the counterparty may dispute the call. If this happens, capture the dispute precisely and prioritise resolution based on the economic value of the event. A dispute for a small amount will resolve itself the following day as the new call may well supersede the dispute. For larger amounts, there are procedures from ISDA which guide firms into exchanging trade portfolios for reconciliation purposes to compare data. Some collateral management platforms provide tools to resolve disputes, which are recommended. Manually using Excel to reconcile portfolios can quickly become a big time waster for teams.

TIPS

1. Despite many years of investment by third party vendors and ISDA disputes are still common.
2. Recording and resolving disputes using Excel is the least effective way of handling these.
3. Find a platform such as CloudMargin which incorporates full support for dispute resolution.
4. You need tools which will identify gaps in the population, or significant differences in valuations immediately.



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11 What platform are you using to run your collateral programme?

Larger firms have had no choice but to invest in systems to run their collateral agreements, given the scale of activity. Smaller firms had the luxury of taking a lower investment approach, perhaps using Excel. With UMR being a regulated activity, this is no longer adequate. Firms must stay on top of these agreements and prove to regulators not only satisfaction of the compliance deadline but also the ability to run the agreements efficiently and handle disputes and internal errors quickly.

TIPS

1. Consider the audit and control aspects of however you run your collateral agreements.
2. Look at the time taken to run each days calls.
3. Take time to compare the latest platforms such as CloudMargin which not only run your agreements but integrate other functions such as dispute handling.

"Which approaches do you use to run your margin agreements now?"

- **23%** said Excel
- **20%** use in-house software
- **15%** said they were intending to change their approach

About CloudMargin: Headquartered in London, CloudMargin created the world's first cloud-based collateral management workflow tool, which has earned eight different industry awards since 2015 for innovation and best-in-class technology. The firm's Software-as-a-Service (SaaS) model is helping many of the leading financial institutions globally – including exchanges, brokerage firms, banks, asset management firms and insurance companies – meet time-critical regulatory deadlines and reduce costs associated with collateral requirements that are growing dramatically. CloudMargin bypasses many of the shortfalls of legacy, on-premise software, enabling clients to experience rapid implementation and access to robust and secure collateral management workflow software. For more information, visit www.cloudmargin.com.

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