



The Road Forward for Initial Margin

Challenges that lie ahead as IM documentation transitions from a regulatory-phased project to a BAU workflow

A new phase for initial margin

The Initial Margin (IM) workstream has been a huge drain on General Counsel (GC) and their in-house teams for the past seven years.



Throughout this daunting journey, in-house teams have been bogged down by challenges like an avalanche of work, the need to learn and negotiate diverse legal agreements, complex third-party custodial documents and processes, increased legal opinion work, negotiator attrition, regulatory deadlines, and new systems and processes to implement.



As IM nears the end of its initial regulatory phase and becomes 'endemic' as a business-as-usual (BAU) workstream for all market participants, in-house counsel and legal departments will continue to face challenges. On September 1, 2022, IM did not go away – it simply became part of your existing BAU infrastructure. The demands from the past seven years will still be there. Are you prepared to rise to the challenge?



In this paper, we explore the hurdles in-house legal teams will face as they transition IM to BAU and the ways those challenges can be managed.



Why will IM become part of the BAU process?

Since 2016, the regulatory landscape has been dominated by the looming deadlines of IM Phases 1 to 6. With the completion of the final deadline, one question hangs heavy:

What happens next?

01

For a significant number of market participants, a substantial number of Phase 5 and 6 counterparties remain un-papered following the September 1, 2022 implementation date. This will inevitably mean that Phase 6 will continue into 2023, and possibly beyond.

04

In addition, existing in-house systems and processes, which have largely been project-driven up to now, will need to be integrated, adapted, and streamlined with wider in-house documentation work streams (e.g., ISDAs, VM CSAs, GMRAs, etc.) and the associated policies and procedures.

02

This is no surprise given the long-standing tradition that ISDA documentation can take years to put into place, due to its complexity, scale, and volume. Given that many Phase 5 and 6 participants were also largely unprepared and lacked the requisite expertise to deal with IM negotiations, it's a proverbial perfect storm for regulatory documentation.

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In short, IM will need to be integrated and become part of the BAU process.

03

With the passing of the Phase 6 deadline, IM documentation will effectively become part of BAU workstream for most, if not all, market participants. Even if all in-scope counterparties were successfully papered by September 1, 2022 (which did not occur), the thousands of contracts that have been executed between 2016 and 2022 will still need to be maintained and curated.

06

All of those IM agreements that have already been put into place will likely require subsequent amendments or supplements, and new IM agreements will need to be put in place for in-scope market participants in due course as they sign up to new ISDA Master Agreements. BAU will need to account for this, but are your BAU teams and systems truly prepared?

What are the challenges of transitioning to BAU?

There are several challenges that all organizations will face as they transition to BAU. Areas likely to pose difficulties (and accompanying questions to consider) include:

Resourcing

- How much of your staff will be required to service IM documentation on an ongoing basis?
- Will you upskill existing negotiators and queue it with your existing pipeline of ISDA documentation workstreams, or hire/retain additional resources to ensure that you are regulatory compliant and able to continue trading?

Incomplete IM Phase Workstreams

- How much of the non-regulatory compliant IM Phase 5 and 6 workstreams are left unfinished or incomplete after September 1, 2022?
- How long is it going to take to complete and become reg compliant?

Legal Opinions

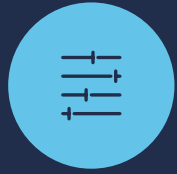
- Have legal opinions been sought and kept up to date for IM collateral documentation, including new types of posting documents, and security agreements (e.g., new Belgian or Luxembourg law security agreements)?

Templates

- Who is going to be responsible for maintaining existing templates, incorporating updates, and preparing new templates?
- ISDA will be preparing new templates, such as the recently published Euroclear 2022 Security Agreements. Who will review these templates and ensure they tie in with existing templates?

Threshold Monitoring

- How many of those counterparties and pairings that have been deferred to Threshold Monitoring are likely to breach internally determined monitoring thresholds?
- What happens when those monitoring thresholds are breached?
- Which team is going to deal with and paper those relationships in a truncated period to ensure that there are no disruptions to trading?



Existing IM Thresholds

- Who, if anyone, is monitoring existing Thresholds from Phases 1 to 6, including their FX movements and regime inter links (e.g., FX threshold differences between UK regime and EMIR regime or USPR and UK)?



Documentation Remediations and Mismatches

- Who is going to take care of remediations and any mismatches on IM documentation including posting documents, eligible collateral schedules or account control agreements/ security documents?



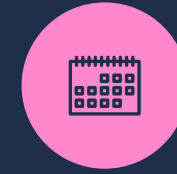
Amendments

- How are amendments going to be handled, whether that be Regime, counterparty type, IM thresholds, or eligible collateral amendments?



New BAU requests for IM

- As new counterparties are onboarded, how are IM agreements going to be papered?
- Will you send out IM agreements as part of your ISDA suite of documents or will you wait for the ISDA Master and VM CSA to be sufficiently advanced first?
- Will you Threshold Monitor all clients that are below the Threshold, or are you going to make a concerted effort to put each new client into a documentation queue and ensure they are papered for IM in a truncated fashion?



Custodian Deadlines

- As all custodian deadlines have now passed, fully-executed IM control agreements and/or eligible collateral schedules delivered to custodians will be processed (and related accounts opened) on a 'best efforts' basis, meaning that a documentation backlog is inevitable for all market participants. Who is going to manage and execute this backlog for you?



Turning talk into practice

Since 2016, Factor has helped clients negotiate IM documents. In that time, we've encountered a number of contentious terms. Learn a few of their stories below, the hurdles that may accompany them and how those problems were resolved – though these lessons were gained during regulatory-phased projects, they're still relevant as IM becomes part of BAU workflows.

Case Study 1:

A financial services client was having a continual problem with the “**Collateral Access Breach**” provision (i.e., an Additional **Termination Event** that effectively covers the circumstances where a party breaches the provisions that specify how and when it can unilaterally access or control the posted collateral).

In this instance, the client had concerns regarding how long the grace period should be for remedying the relevant access breach (known as the “CAB End Date” definition in the IM documents). Our client strongly preferred a zero Local Business Days grace period for CAB End Date. This had been its default position until Phase 5, when the in-scope demographic of market participants for regulatory IM changed from banks to buy-side clients.

The market typically agrees on anywhere from 1-3 Local Business Days, and it is uncommon that a party chooses a zero-day grace period. Our client's IM negotiations quickly came to a standstill given its own internal stance on the CAB End Date grace period.

Our team quickly determined that this issue would put the regulatory deadlines at risk, so we escalated the issue to the in-house legal team. Our subject matter experts helped review legal advice prepared by external counsel, we leveraged our negotiating expertise to provide analysis and participated in conference calls with in-house/external counsel to determine a path forward.

Factor helped develop an escalation procedure to assist in dealing with such issues going forward and developed a consistent, robust approach to such clauses. This resulted in quicker and less contentious negotiations, a streamlined process, no further impasses and regulatory deadlines being met.



Case Study 2:



A Factor financial services client encountered a recurring problem with the “**Secured Party Rights Event**” definition in the IM CSA/CSD. This provision specifies the events and conditions that must occur before the Security-taker or Secured Party can unilaterally control and access the posted collateral. Our team determined very early on that our client’s existing templates would need to be modified as we were aware of a different market practice with respect to this provision.

The Factor team quickly escalated to the client’s in-house counsel and advised that a new approach would be required. Due to our knowledge and expertise in the market, we suggested an alternative approach that we had seen used in the market and as a result, we were able to introduce new fallbacks, thereby creating adaptable templates and negotiation guidelines which were quickly rolled out to all front-line negotiators, helping to clear the client’s backlog.

Case Study 3:



Whilst most of the market is taking an alternative approach to **Threshold Monitoring**, our client wanted us to help implement a very detailed and data driven approach to the issues they faced with Threshold Monitoring (i.e., how do they track that population, how do they approach documenting that population, how do they defer those regulatory requirements while still ensuring legal documentation efficiency, safety, and integrity).

Factor helped create and establish a bespoke solution to the Threshold Monitoring population, using the experience and expertise we have cultivated in this space. This approach is far more holistic and comprehensive than we have seen anywhere else in the market, we believe that a similar approach to Threshold Monitoring populations would benefit many of our financial services clients.

Market data: Factor client vs industry average

We've learned a lot in the last seven years – and it shows. Factor's approach to IM consistently delivers better results than the industry average. We know that's an easy claim to make, but we have the results to back it up. Looking at the last two IM phases (5 & 6), you can see a clear trend in the numbers:

Phase 5 Statistics:

		Factor Client(s)	Industry average
Agreement Completion	IM Agreements	75.5%	56%
	ACA	80%	69%
	ECS (Pledging and Receiving)	82.5%	68%

Phase 6 Statistics:

		Factor Client(s)	Industry average
Agreement Completion	IM Agreements	50%	15%
	ACA	61.5%	22%
	ECS Pledging Receiving	72.5% 54.5%	30% 28%

After seven long years of challenging work related to Initial Margin, a new set of challenges looms on the horizon with the transition to BAU.

Factor is uniquely positioned to help in-house legal teams tackle this next phase of challenges. We have the required expertise from helping numerous in-house teams across our global portfolio of clients successfully repaper their ISDA Agreements, and an impressive bench of senior lawyers and negotiators with valuable derivatives experience. Now, as the industry transitions to BAU, we'll draw on our years of IM experience to provide a streamlined, cost-effective solutions to meet evolving IM needs.

How can Factor help?

We have built on our expertise in delivering legal projects at scale and have assembled and trained a team with the required skillset to manage IM as an integrated end-to-end workstream.

Here's what Factor brings to the table:

01

The expertise and pedigree to solve the proficiency and scale problems our clients will face in ongoing regulatory obligations with IM and can help build out your BAU program for IM work.

02

Ability to integrate with your team, negotiating and delivering consistent results to clear your existing IM pipeline (including any 'tail' or back logs remaining from Phases 5 & 6).

03

Existing teams (which are ready to be deployed) to help you avoid the headache of extensive hiring, upskilling, or repositioning existing in-house headcount.

04

Threshold Monitoring population management.

05

Familiarity with the suite of IM documentation, templates, and the most frequently negotiated terms.

06

Legal opinion requirement support, including reviews, summaries, collation, interpretation and compliance.

07

Experience establishing robust streamlined procedures, ensuring internal documentation targets are met and eliminating large scale documentation errors.

08

A global team comprised of negotiators and subject matter experts in various centers of excellence, providing coverage and support in both the European and American time zones.

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Factor understands the challenges of IM and we understand our clients: we can help you navigate the Initial Margin documentation requirements and satisfy all of your regulatory IM documentation requirements.

Contact

For further information regarding Initial Margin documentation and Financial Services solutions, and how we can help you and your in-house teams, please reach out to:



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