

**Roadmap for the Implementation of UMR Phase 6 for Uncleared OTC Derivatives
December 13, 2021**

BACKGROUND	
Overview	Phase 6 of the UMR (“Phase 6”), which will be implemented on September 1, 2022, applies to uncleared derivatives, lowering the AANA threshold for firms to be in scope to \$8bn; Phase 6 also includes a \$50m exposure threshold, at which point both parties are required to post Initial Margin (“IM”). Furthermore, Phase 6 requires firms to calculate IM, differing from Variation Margin (“VM”) in that IM is gross, two-way margining based upon risk factors and not net present value. In sum, Phase 6 lowers the AANA threshold to \$8bn, incorporates a \$50m exposure threshold, requires IM versus VM and creates additional requirements and concerns related to custodial relationships.
Uncleared OTC Derivatives	For purposes of the U.S. rule, uncleared OTC derivatives include CFTC-regulated swaps, SEC-regulated security-based swaps and foreign exchange derivatives and forwards, with some exceptions, in each case, that are not cleared through a central clearing counterparty. Phase 6 applies to uncleared OTC derivatives.
Impact	<p>Phase 6’s \$8bn threshold is expected to bring more firms into scope. Notably, Phase 6 requires IM to be held in a segregated account at a third-party custodian, triggering additional requirements related to custodial relationships.</p> <p>Funds should focus on the relationships that will hit the IM threshold soonest, ensuring the continuation of trading with no disruptions; this includes promptly beginning calculations and communicating with global custodians and counterparty custodians.</p>
Working with Quadrangle	Given Quadrangle’s expertise with counterparty agreements and derivatives regulations, Quadrangle can assist with the transition to UMR Phase 6 by providing guidance related to whether a counterparty is in-scope of Phase 6, negotiating margin provisions, threshold amounts and advising on eligible collateral; Quadrangle can also advise on the intricacies of specific custodial relationships, third party vs. triparty agreements and ensuring that funds are adequately protected in counterparty agreements.

Identify In-Scope Counterparties
<p>When identifying in-scope counterparties, funds should be aware of the following:</p> <ul style="list-style-type: none"> • The proposed approach from each counterparty, including but not limited to: <ul style="list-style-type: none"> ○ The structure of the arrangement; ○ Dealer-preferred custodians; and ○ Economic terms, including but not limited to: <ul style="list-style-type: none"> ▪ Fees; ▪ Types of collateral to be posted and received; and ▪ Pricing • Trading relationships that will quickly reach the \$50m threshold, will eventually reach the threshold and those which will likely never reach the threshold

Select and Inform your Counterparties

Once a counterparty has been selected, funds should discuss and settle a number of key points, including but not limited to:

- Calculating IM;
- Minimum Transfer Amounts;
- Threshold Amounts;
- Information governing the collateral to be segregated;
- Eligible Collateral does not include cash, but, it can include:
 - Money Market Funds;
 - G7 sovereign bonds

Determine Custody Arrangement

When Funds are determining their custody arrangements, funds should:

- Determine whether the arrangement is with a third-party or triparty;
- Ensure that each counterparty relationship includes an IM CSA (CSD if counterparty is governed by UK law); and
- Include Two Account Control Agreements (“ACA”) (One for the fund to post collateral and one for the counterparty to post collateral)

Negotiate Custody Documents

Phase 6 requires the segregation of IM. Consequently, funds must pay attention to the Termination of the Agreement because of the segregation requirement. Funds should consider including additional protections in their custodial agreements to ensure that the fund can establish a new ACA should the applicable ACA be terminated.

Also, it is important to consider that fund and dealer will be both “Secured Party” and “Pledgor,” making it difficult to push in favor of one over the other. Consequently, it is important to discuss Additional Duties of Securities Intermediary, Limited Liability, Recourse, etc.

COMPLIANCE DATES

September 1, 2022

AANA threshold lowers to \$8bn along with the implementation of a \$50m exposure threshold.

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