

USE A SIDE LETTER TO ADVISE CUSTODIANS YOU WILL BE USING DTCC'S MARGIN TRANSIT UTILITY (MTU)

BACKGROUND

Under the terms of the Uncleared Margin Regulations (UMR), many financial institutions engaged in OTC derivative trading are faced with a new requirement to post initial margin to each other using 'segregated account' structures. *Segregated accounts* are also used in respect of existing collateral agreements between '40-Act funds and their counterparties.

These *segregated accounts* are hosted and operated by custodian banks, and the *terms of use*, which are vital to protect the interests and actions of all parties, are set out in a document known as an *account control agreement (ACA)*. The ACA may be referred to as a *triparty agreement* since it is signed by three parties: the custodian bank, the client, and the secured party.

In many cases, ACAs contain language which prescribes how the parties will instruct the movement of collateral to the custodian bank. Unfortunately, ACAs did not foresee the adoption of platforms such as SWIFT and MTU, so while these platforms deliver clear process and control improvements for all parties, there is now a need to record the agreement to use SWIFT and MTU for the instruction of the movement of collateral.

The purpose of this paper is to propose the practical and efficient use of *side letters* to record this agreement in order to circumvent a significant amount of ACA re-negotiation and execution. This is critical given the impending Phase 5 UMR deadlines and the work from home conditions imposed on many by the pandemic.

It is of course imperative that any actions taken in this area are fully reviewed and approved by your own legal department.

HOW IT WORKS:

There are two distinct use-cases in respect of segregated accounts and the related ACAs:

1 CLIENT AND SECURED PARTY ARE BOTH MTU CLIENTS

Without side letter, all ACAs are individually amended by all 3 parties

With side letter, all ACAs among the three parties are covered by one document

BENEFITS

- No more faxes, call backs etc.
- Faster return of collateral to client account
- Increased automation
- Risk reduction

2 SECURED PARTY IS AN MTU CLIENT ("SINGLE-SIDED SERVICE")

Without side letter, all ACAs are individually amended by all 3 parties

With side letter, all ACAs are covered by one document signed by custodian and secured party

BENEFITS

- No more faxes, call backs etc.
- Faster return of collateral to client account
- Increased automation
- Risk reduction

LEARN MORE:

DTCC has worked with major custodian banks to develop side letter templates for the situations described above. Please contact your DTCC representative if you wish to obtain copies of these for your own review and use.