
End-user Adherence with the ISDA August 2012 Dodd-Frank Protocol

November 2012

Over-the-counter derivatives trades between dealers and end-users are generally governed by master agreement forms and other documentation published by the International Swaps and Derivatives Association, Inc. (“ISDA”), the derivatives industry association. Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) the trading of derivatives, including over-the-counter derivatives, is subject to regulation by the U.S. Commodity Futures Trading Commission (the “CFTC”) and the U.S. Securities and Exchange Commission (the “SEC”). The CFTC has recently finalized a number of rules governing derivatives, which for the most part, will take effect on January 1, 2013.

On August 13, 2012, ISDA announced the ISDA August 2012 Dodd-Frank (DF) Protocol (the “Protocol”). The Protocol was developed to provide a mechanism for market participants to amend existing swap documentation to facilitate compliance with certain CFTC rules promulgated under the Dodd-Frank Act without the need for time consuming negotiations and amendments of individual swap agreements between each dealer and end-user.

The CFTC has promulgated rules under the Dodd-Frank Act that require “Swap Dealers” and “Major Swap Participants” to comply with certain regulatory requirements such as “know your counterparty” rules, verification of legal status of a counterparty, verification of status as an Eligible Contract Participant and business conduct rules¹. Although end-users (e.g., hedge funds) are not required by the CFTC to comply with these rules, Swap Dealers will be required to obtain such information from their counterparties at the time new swap transactions are offered or executed. The Protocol includes notices, representations and covenants that will supplement the adhering parties’ existing swaps documentation to ensure that Swap Dealers are in compliance

¹ The Protocol addresses requirements set forth in the following final rules promulgated by the U.S. Commodity Futures Trading Commission (the “CFTC”): CFTC, Final Rule, Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 Fed. Reg. 9734 (Feb. 17, 2012); CFTC, Final Rule, Large Trader Reporting for Physical Commodity Swaps, 76 Fed. Reg. 43851 (July 22, 2011); CFTC, Final Rule, Position Limits for Futures and Swaps, 76 Fed. Reg. 71626 (Nov. 18, 2011); CFTC, Final Rule, Real-Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (Jan. 9, 2012); CFTC, Final Rule, Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136 (Jan. 13, 2012); CFTC, Final Rule, Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 Fed. Reg. 20128 (Apr. 3, 2012); and CFTC, Final Rule, Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, 77 Fed. Reg. 35200 (June 12, 2012) (all such rules, the “Covered Rules”).



with the CFTC's rules and that end-users do not experience a disruption in their trading practices.

When designing the Protocol, ISDA recognized that the information that each participant must supply to its counterparties may differ from one counterparty to the next. As such, the Protocol permits participants to send different information to different counterparties.

The Protocol includes the following four documents: (1) the "Adherence Letter," (2) the "Questionnaire," (3) the "Protocol Agreement," and (4) the "DF Supplement." The Protocol also includes the "DF Terms Agreement," which can be used by parties that wish to transact in swaps without entering into a pre-executed master agreement.

The basic procedure under the Protocol is that all participants submit an Adherence Letter to ISDA, and then exchange Questionnaires with counterparties to their swap agreements. Once Questionnaires are exchanged between two parties, all covered swap agreements between them are deemed amended by the Protocol.

Adherence Letter and Protocol Agreement

Participation in the Protocol requires each adhering party to submit an Adherence Letter to ISDA online stating that such party agrees to the terms of the Protocol Agreement. The Adherence Letter includes basic non-sensitive information and will be made publically available. The Adherence Letter also gives an adhering party the opportunity to specify how it will accept Questionnaires from its counterparties. Options for delivery include fax, email and ISDA Amend, an online system developed in tandem with the research firm Markit that allows a participant to send Questionnaires to multiple counterparties.

The Protocol Agreement establishes an agreed upon process for amending existing swap agreements (each, a "Protocol Covered Agreement") and allows each adhering party to supplement its Protocol Covered Agreements through the delivery of a Questionnaire.

The Protocol Agreement clarifies that the Protocol is available only to the entity that entered into the Protocol Covered Agreement that is being amended. Therefore, if a Protocol Covered Agreement was entered into by an agent on behalf of a principal, only the agent may execute the Protocol Agreement not the principal and vice versa.

Questionnaire

The Questionnaire will be used by adhering parties to supplement their Protocol Covered Agreements and will be the mechanism through which adhering parties will provide the information required under the Covered Rules to their relevant counterparties. The Questionnaire is structured so that an adhering party can select the amendments that it wishes to agree to and the counterparties that will receive the Questionnaire. A participant may complete more than one Questionnaire if it wants to provide different information to certain counterparties.



DF Supplement

The DF Supplement sets forth certain standardized representations, acknowledgments, notifications and agreements relating to the Covered Rules. The DF Supplement is comprised of six schedules. Schedules 1 and 2 are automatically incorporated into Protocol Covered Agreements by parties that exchange Questionnaires and include representations and covenants necessary for compliance with the Covered Rules. Schedules 3-6 include certain safe harbors for swap dealers, including safe harbors regarding the swap dealer's duty to determine the suitability of a swap for its counterparty, a safe harbor for special entities that have qualified independent representatives and a safe harbor based on certain representations for ERISA special entities and plans. Schedules 3-6 are optional and will be incorporated only if both parties elect in their Questionnaires to do so.

DF Terms Agreement

In addition to the Protocol Agreement, ISDA has developed the DF Terms Agreement which can be used by parties to apply selected provisions of the DF Supplement to their swaps trading with certain counterparties in the absence of an existing agreement between them. A party can use the DF Terms Agreement if its counterparty is a Swap Dealer and (a) the parties execute swaps that are not governed by a written agreement (including cleared swaps or swaps that will be executed to be "given up" to a third-party) or (b) the parties have not entered into a written agreement, but would like to begin offering or entering into swaps.

Timeframe for Adherence to the Protocol

Although the original compliance date for most of the Covered Rules was October 15, 2012, on August 27, 2012, the CFTC published a final rule extending the compliance date for many of the rules that the Protocol is intended to address until January 1, 2013. While this extension provides market participants additional time to comply with the Covered Rules, ISDA is urging such participants to adhere to the Protocol as soon as possible to ensure that Swap Dealers have sufficient time to integrate the information provided by counterparties into their processes and systems prior to trading.

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