

## Dodd-Frank Insight Webinar Series

### Swap Compliance Issues for US and Non-US End Users

December 12, 2012



#### **Katherine Tew Darras**

General Counsel, Americas, ISDA

T +1 212 901 6000

[KDarras@isda.org](mailto:KDarras@isda.org)

#### **Jeffrey H. Koppele**

Partner, SNR Denton

T +1 212 768 6844

[jeffrey.koppele@snrdenton.com](mailto:jeffrey.koppele@snrdenton.com)

#### **Rosali Pretorius**

Partner, SNR Denton

T +44 (0)20 7246 7181

[rosali.pretorius@snrdenton.com](mailto:rosali.pretorius@snrdenton.com)

# Outline

- Business Conduct Standards and ISDA August Dodd-Frank Protocol.
  - What are the Title VII business conduct standards and why are they important for end users?
  - How does the August DF Protocol address the business conduct standards?
  - Significant provisions of the August DF Protocol.
  - What are the basic steps required to adhere?
- Non-US End-Users:
  - Selected issues in extraterritoriality rules.
  - SEC Joint Press Statement, December 4, 2012.

# Business Conduct Standards and August DF Protocol

- The business conduct standards are a set of rules that impose various duties on Swap Dealers and Major Swap Participants in their dealings with counterparties.
- The rules are essentially a customer protection regime for the counterparties of Swap Dealers and MSPs.
- Certain of the business conduct rules impact swap documentation, and these are addressed by the ISDA August Dodd-Frank protocol.

# Business Conduct Standards and August DF Protocol

- Swap Dealers and MSPs may satisfy many of their obligations under the business conduct rules by obtaining specified representations and agreements in swap documents.
- The ISDA August Dodd-Frank Protocol is a mechanism to modify ISDA agreements to permit Swap Dealer compliance with the business conduct rules (and several other rules).
- A Swap Dealer that does not modify its ISDA agreements to comply with the business conduct rules by the time compliance is required would face potentially significant regulatory risk.

# August DF Protocol Addresses Business Conduct Rules

- Business conduct rules require Swap Dealers to obtain and transmit various information from and to counterparties.
  - August DF Protocol: provides for information exchange.
- Business conduct suitability rules require potentially intrusive diligence, unless the counterparty makes certain representations permitting the Swap Dealer to avail itself of a safe harbor.
  - August DF Protocol: allows for safe harbor elections.
- Business conduct notification and disclosure rules may affect efficiency of trade execution and timing.
  - August DF Protocol: permits elections to facilitate efficient trading.

# Timing

- A Swap Dealer must satisfy the business conduct rules from the date it registers as a Swap Dealer.
- Most large Swap Dealers are expected to register by December 31, 2012.
- It will take end users some time to adhere to the ISDA August Dodd-Frank protocol. Any end user that has not begun the process should start immediately.
- On November 27, 2012, ISDA requested that the CFTC delay the effective date of certain of the external business conduct rules until May 1, 2013.

## Who is affected by the business conduct rules?

- All end-users that are US persons.
- All end-users that are not US persons, but that trade swaps with Swap Dealers that are US persons (as defined in CFTC's proposed cross-border guidance).

## Definition of US Person

- CFTC's proposed cross-border guidance defines a US person to include:
  - A corporation, partnership or other legal entity either:  
(1) organized or incorporated under US laws or (2) whose direct or indirect owners are responsible for the liabilities of such entity and one or more of such owners is a US person;
  - An individual account where the beneficial owner is a US person;
  - Any commodity pool or collective investment vehicle of which a majority ownership is held, directly or indirectly, by US persons; and
  - Any commodity pool or collective investment vehicle *the operator of which is required to register under the CEA.*



# Key Protocol Provisions: August DF Supplement

- Representations and Information.
  - Under the business conduct rules, a Swap Dealer may reasonably rely on CP representations, absent “red flags,” if the CP agrees to timely update any material changes.
  - Sections 2.1, 2.3: CP represents that information provided and representations made are accurate, agrees to timely update information and representations, and agrees to provide certain additional information.
  - Section 2.2: A breach or misrepresentation in the DF Supplement will not constitute an event of default, termination event or other similar event under the relevant ISDA agreements.

# August DF Supplement: Confidentiality

- Confidentiality.
  - Business conduct rules impose confidentiality requirements on Swap Dealers and MSPs. This may benefit CPs that have not entered into non-disclosure or confidentiality agreements.
  - A Swap Dealer or MSPs is prohibited from:
    - disclosing confidential information to “any other person”;  
and
    - using confidential information in a way that would tend to be materially adverse to the counterparty.
  - A SD or MSP may, however, disclose or use confidential counterparty information if authorized in writing by the counterparty or to comply with requests from regulators.

# August DF Supplement: Confidentiality

- Protocol Provisions on Material Confidential Information.
  - Parties agree to disclosures required to comply with the Covered Rules, such as to swap data repositories.
  - If parties have an existing non-disclosure agreement, that agreement will continue to govern the disclosure of material confidential information.
  - If parties do not have a non-disclosure agreement:
    - Material confidential information may be disclosed in accordance with the Covered Rules, and
    - The parties agree that such information may be used or disclosed to certain parties to comply with risk management policies and to structuring, sales or trading personnel for pricing and hedging purposes.

# August DF Supplement: Daily Marks and Scenario Analysis

- Daily Marks:
  - A Swap Dealer is obligated to provide a "mid-market" mark both prior to the trade and on a daily basis during the trade.
    - The CP may elect to receive the pre-trade mark orally (confirmed in writing).
    - Daily mark may be based on the previous day's close of business.
- Scenario Analysis:
  - A Swap Dealer is obligated to provide a scenario analysis upon request.
  - Protocol requires that, unless the parties agree otherwise, the end-user must request any scenario analysis before the trade.

## August DF Supplement – Institutional Suitability

- Under the business conduct rules, a Swap Dealer that recommends a swap or trading strategy involving a swap to a counterparty is subject to suitability requirements, including “reasonable diligence.”
- Institutional Suitability Safe Harbor:
  - CP or its agent represents that it is independently evaluating any recommendations.
  - SD must determine that the CP or its agent is capable of independently evaluating the investment risks of a swap.
    - This can be satisfied by representation of CP or its agent. However:
    - CP must represent that it has complied with written policies and procedures designed to ensure that the persons evaluating swap recommendations and trading decisions are capable of doing so.

# August DF Protocol – Component Documents

- Adherence Letter: Evidences a party's agreement to be bound by the Protocol.
- Protocol Agreement: The protocol's main structural document.
- Questionnaire: Allows a party to provide certain information about itself, make certain elections, and identify counterparties with whom it is willing to utilize the protocol.
- DF Supplement: Contains representations, acknowledgements, notifications, and agreements related to the Covered Rules that a participant may apply through the protocol.
- DF Terms Agreement: Allows parties to apply selected provisions of the DF Supplement to a swap trading relationship, particularly where the parties do not have a master agreement in place.

# The Questionnaire

- Form by which an August DF Protocol participant provides basic information relating to the participant.
  - Each participant selects the counterparties to which it will deliver Questionnaires.
  - May deliver different Questionnaires to different counterparties.
- Allows a participant to make certain elections.
  - Institutional suitability safe harbor election.
  - Agreement to receive pre-trade mid-market marks orally.
  - Agreement to incorporate the DF Terms Agreement.
- Participant must identify any applicable legal status (e.g., Commodity Pool, SD, MSP, Special Entity, Financial Entity) and specify the manner in which it is an eligible contract participant.

# August Dodd-Frank Protocol: How to Participate

- Obtain a CICI from [ciciutility.org](http://ciciutility.org). Cost: \$200 per entity.
- To participate in the August Dodd-Frank Protocol, an end user must:
  - Adhere to protocol (submit Adherence Letter to ISDA).
  - Deliver Questionnaire to each Swap Dealer counterparty.
    - Swap Dealers specify delivery means on ISDA website.
- Party that adheres to the protocol is the one that has executed the underlying ISDA Master Agreement (eg an agent can adhere where they have executed the underlying master agreement), cost: \$500 per entity. ISDA recently instituted operational and fee improvements for large corporate/fund families.
- Note: if an end user does not deliver a Questionnaire to one or more of its Swap Dealer counterparties, then the Protocol will not apply to its swap documents with those counterparties.



# DF Terms Agreement

- The DF Terms Agreement allows a party to apply selected provisions of the DF Supplement to its swap trading relationship with a counterparty:
  - Governs the parties' *relationship*, not the terms of the swaps.
  - Should be considered if at least one party is a SD, and parties either:
    - execute undocumented swaps not governed by an existing written agreement (e.g., swaps for prime brokerage), or
    - wish to begin offering or entering into swaps prior to entering a written agreement.
- “Bare-bones” agreement that includes basic representations, governing law, address information and basic contract provisions.

# Recent Developments and Upcoming Items

- Clearing
- Margin
- ISDA Protocol 2.0, relating to Swap Trading Relationship Documentation, Portfolio Reconciliation, Dispute Resolution
- Tax:
  - FATCA
  - HIRE Act (withholding tax re: equity derivatives)

## Non-US End Users

- Key question for non-US end users: Will trading with the following entities make me a Swap Dealer?
  - US-based Swap Dealer
  - Non-US branch of US Swap Dealer
  - Non-US affiliate of US Swap Dealer
  - Non-US Swap Dealer, not affiliated with US Swap Dealer
- Source Documents:
  - Proposed cross-border guidance and exemptive order
  - Oct. 12 no-action relief: **time limited**
- Further guidance on this and other issues?
  - In the immediate term, expect delay rather than answers
  - Final answers: will require coordination among regulators

# Global Regulators' Understandings

SEC Joint Press Statement Dec. 4, 2012

- Consult before mandating clearing
- Supervisory and enforcement cooperation arrangements
  - Work to ensure access to data held in trade repositories
- Aim for consistent timing and scope

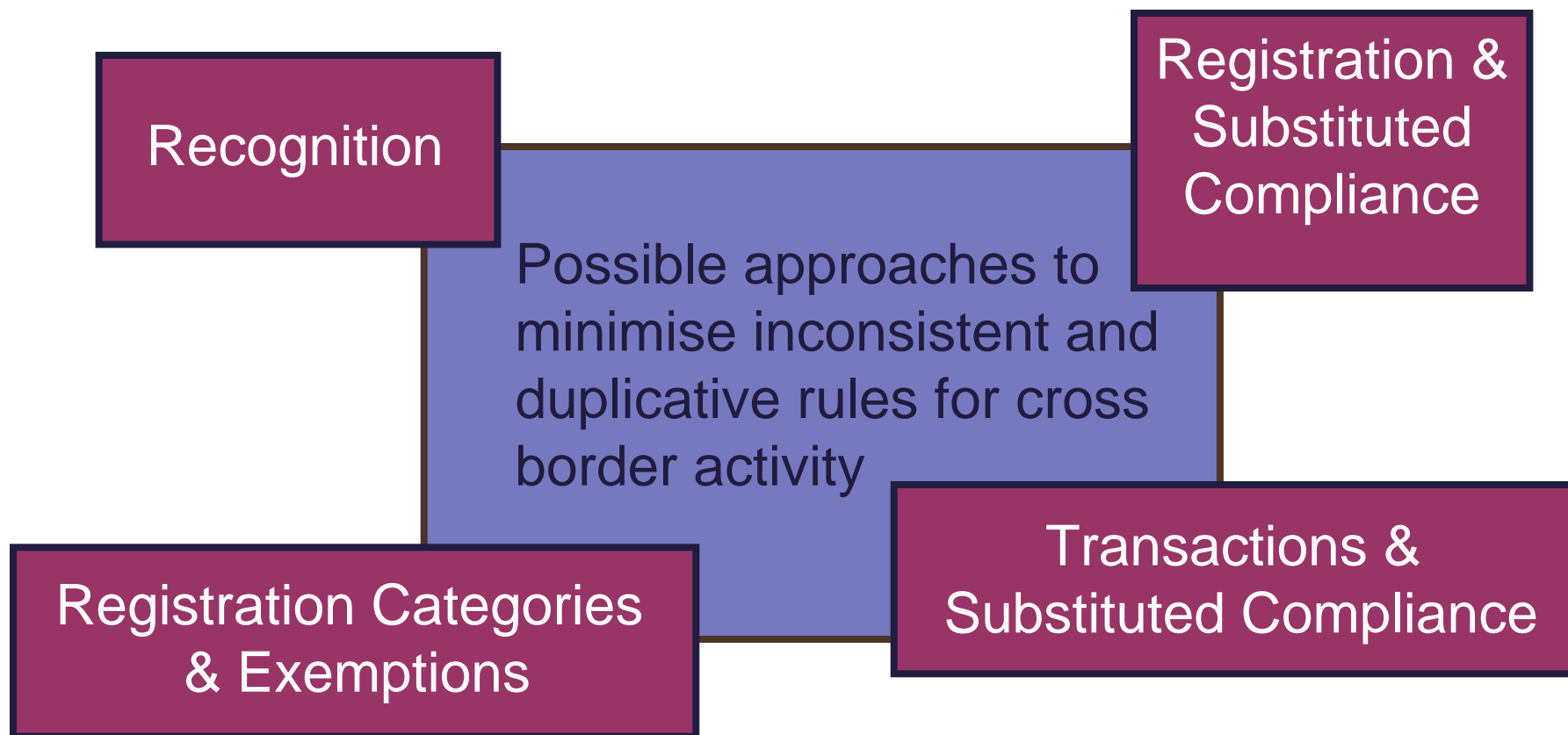
## GOAL:

**TO ADOPT AND ENFORCE ROBUST & CONSISTENT STANDARDS ON THE REFORM OF THE OTC DERIVATIVES MARKET**

- Australia
- Brazil
- EU
- Hong Kong
- Japan
- Ontario
- Quebec
- Singapore
- Switzerland
- US

# Global Regulators' Areas of Exploration

SEC Joint Press Statement Dec. 4, 2012



# About SNR Denton - Dentons

Following an affirmative vote on November 28, Salans, based principally in Europe, FMC, based principally in Canada, and SNR Denton will create a new law firm - Dentons - driven to provide clients a competitive edge in an increasingly complex, interconnected and competitive marketplace. Dentons will have offices in 79 locations in 52 countries across Europe, Canada, the UK, the US, the Middle East, Asia Pacific, Central and East Asia, and Africa, including a network of 22 associated offices in Africa.

The new firm will connect clients to talented lawyers across Europe, Canada, the UK, the US, the Middle East, Asia Pacific, Central and East Asia, and Africa who will provide the same high quality advice and prompt service wherever clients do business. We will bring together more than 2,500 lawyers and professionals, making the firm the 7th largest firm in the world measured by number of lawyers and professionals, including 346 *Chambers*-recognized practices and 345 *Chambers*-recognized lawyers and 75 lawyers rated by *Lexpert* (Canadian equivalent of *American Lawyer*).

# Questions



© 2012 SNR Denton. SNR Denton is the collective trade name for an international legal practice. Any reference to a "partner" means a partner, member, consultant or employee with equivalent standing and qualifications in one of SNR Denton's affiliates. This publication is not designed to provide legal or other advice and you should not take, or refrain from taking, action based on its content. Attorney Advertising. Please see [snrdenton.com](http://snrdenton.com) for Legal Notices.