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Protocol 2.0 – ISDA’s March 2013 Dodd-Frank Protocol

Since the effectiveness of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “**Dodd-Frank Act**”), the Commodity Futures Trading Commission (the “**CFTC**”) has finalized many of the rules that implement the detailed regulatory regime outlined by the Dodd-Frank Act. A number of these rules require market participants to update their swap trading documentation to comply with this new regulatory regime. This client alert outlines coverage and adherence mechanisms of the ISDA March 2013 Dodd-Frank Protocol (the “**March Protocol**”), the newest installment of ISDA’s well-tested mechanism aimed at facilitating the multilateral and standardized amendment of swap trading documentation.

I. Regulatory Framework

Overview

The March Protocol focuses on regulations governing mandatory documentation of swap trading relationships (including trade confirmations), portfolio reconciliation, and representations related to the End-User Exception (as defined below)¹. In general, these regulations become effective on July 1, 2013.

Swap Trading Relationship Documentation

Pursuant to Regulation 23.501, swap dealers and major swap participants (“**SDs and MSPs**”) must establish, maintain and follow written policies and procedures reasonably designed to ensure that they execute a confirmation for each swap transaction that they enter into. Regulation 23.501 sets forth specific time limits during which SDs and MSPs must acknowledge and document swap transactions, which limits vary depending on the legal classification of the SD’s or MSP’s counterparty and the nature of the product traded.

Pursuant to Regulation 23.504, SDs and MSPs also must establish, maintain and follow written policies and procedures reasonably designed to ensure that swap trading relationship documentation meets certain specified criteria with all counterparties. Generally speaking, such documentation must:

¹ See 17 C.F.R. § 23.502 – Portfolio Reconciliation; 17 C.F.R. § 23.504 – Swap Trading Relationship Documentation; 17 C.F.R. § 23.501 – Swap Confirmation; 17 C.F.R. § 50.50 – Exceptions to the Clearing Requirement. For a detailed review of the end-user exception, see Client Memorandum entitled “*CFTC Finalizes End-user Exception to the Clearing and Trade Execution Requirement for Swaps*”, available at <http://www.paulweiss.com/media/1125175/30-jul-12alert.pdf>.

- Be in writing and include all terms governing the trading relationship (e.g., terms such as events of default and dispute resolution)
- Provide confirmations for all swap transactions
- Include details of credit support arrangements
- Include procedures whereby swaps can be valued for purposes of risk management and future regulations concerning required margin²
- Contain certain acknowledgments regarding the status of the documented swap vis-à-vis the parties thereto in the event the swap is “given up” for clearing

Portfolio Reconciliation

Regulation 23.502 requires that SDs and MSPs establish, maintain and follow written policies and procedures regarding portfolio reconciliation and the resolution of portfolio value discrepancies. The terms and frequency of any reconciliation are determined by the size of the swap portfolio in question and the legal classification of the SD's or MSP's counterparty.

End-User Exception Documentation

Section 2(h)(7)(A) of the Commodity Exchange Act provides an exception (the “**End-User Exception**”) from the CFTC's clearing mandates for swaps where one of the parties is not a financial entity³, enters into swaps to hedge or mitigate commercial risk, and notifies the CFTC how it generally intends to meet its financial obligations under such non-cleared swaps. To take advantage of the End-User Exception, a qualifying market participant must report, or cause to be reported, certain information proving its eligibility for the exception to a registered swap data repository or, if no such swap data repository is available, the CFTC.⁴

² Note that if the SD's or MSP's counterparty is neither an SD/MSP nor a financial entity, such information must only be accounted for in the swap documentation if requested by such counterparty.

³ See 7 U.S.C. 1 § 2(h)(7)(C), which defines “financial entity” as a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, commodity pool, private fund (as defined in the Investment Advisers Act of 1940), employee benefit plan (as defined in ERISA), or a person predominantly engaged in activities that are financial in nature (as defined in the Bank Holding Company Act of 1956).

⁴ See 7 U.S.C. 1 § 2(h)(7)(A).

Regulation 23.505 requires that SDs and MSPs obtain documentation sufficient to provide a reasonable basis on which to believe that counterparties availing themselves of the End-User Exception meet the statutory conditions described above. SDs and MSPs can satisfy this regulation either by receiving certain representations from an end user regarding such end user's eligibility for the End-User Exception or by receiving a representation that the end user has otherwise satisfied its reporting obligations.

II. Adhering to the Protocol

How Does the Protocol Work?

The March Protocol adopts the same approach as the ISDA August 2012 Dodd-Frank Protocol (the "**August Protocol**")⁵ and consists of four documents – an adherence letter, a protocol agreement, a protocol supplement, and a questionnaire.

Adherents must submit an adherence letter to ISDA and exchange protocol-related information by submitting a questionnaire reflecting relevant agreements and representations to their SD and MSP swap counterparties.

What Am I Agreeing to by Adhering?

The effect of adhering depends on the provisions that adherents agree to apply when they complete a questionnaire. These provisions are set forth in the protocol supplement in four schedules. The first (mandatory) schedule contains definitions. The second (mandatory) schedule contains basic representations and also sets forth certain agreements and acknowledgments regarding swap confirmations and the effect of central clearing on swap transactions and representations regarding the End-User Exception. The third (optional) schedule contains agreements and representations regarding calculations of risk-related trade valuations and dispute mechanisms with respect to such valuations. The fourth (optional) schedule contains agreements and representations with respect to portfolio reconciliation.

What Is the Timeline for Adherence?

There is no specific cut-off date for adhering to the March Protocol (though ISDA retains the right to set such a date in the future). As was the case with the August Protocol, the timing for adherence will be effectively set by the date on which the key regulations come into effect – namely, July 1, 2013. Adherents

⁵ For a more detailed description of the ISDA August 2012 Dodd-Frank Protocol, see Client Memorandum entitled "*Key Dodd-Frank Compliance Considerations for End-Users*", available at http://www.paulweiss.com/media/1162351/31aug12_df.pdf.

should consider adhering in advance of this date to avoid trading disruptions in the event SD and MSP counterparties insist on adherence.

How Do I Adhere?

As described above, adherence is a two-step process. Parties must first provide ISDA (via ISDA's website) with an adherence letter indicating their desire to adhere to the protocol; then, parties must complete a questionnaire (either in paper form or online via ISDA Amend⁶) providing information about themselves, making certain elections and identifying the counterparties to whom they would like protocol-related information to be sent.

Where Do I Obtain an Adherence Letter? Is There a Fee for Adhering?

Adherence letters may be obtained on ISDA's website at the following URL: <https://www2.isda.org/functional-areas/protocol-management/submit-adherence-letter/>. As with the August Protocol, ISDA charges a \$500 fee for the submission of each letter.

Is Adherence Necessary?

SDs and MSPs must comply with the CFTC's regulations applicable to them. These include the regulations at the heart of the March Protocol. That said, SDs and MSPs may comply with these regulations by means other than the March Protocol. However, for many market participants, adherence may well be the simplest means of providing SDs and MSPs with the information they need to comply with the new regulations.

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⁶ ISDA Amend is a third-party service offered by Markit, which has partnered with ISDA to provide a digital platform via which questionnaires can be completed and shared. As of the date of this publication, it is free to use and can be accessed at: <http://www.markit.com/en/products/distribution/counterparty-manager/isda-amend.page>. The platform has been updated to reflect the March Protocol mechanics.

This memorandum represents a general discussion of the issues presented and is not intended to provide legal advice. No legal or business decision should be based on its content. We would be pleased to answer any questions concerning the issues addressed in this memorandum. If you wish to receive more information on the topics covered in this memorandum, you may contact:

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