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Protocol Déjà Vu: ISDA's 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol

On July 4, 2012, the European Parliament and the Council of the European Union finalized Regulation 648/2012[1]. Commonly referred to as the European Market Infrastructure Regulation ("**EMIR**"), Regulation 648/2012 implements new rules regarding OTC derivatives trading in the European Union (the "**EU**"). On September 15, 2013, several provisions of EMIR are expected to come into effect, including rules requiring the establishment of procedures for portfolio reconciliation and dispute resolution.

In order to help market participants establish these procedures, the International Swaps and Derivatives Association ("**ISDA**") has released the ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol (the "**EMIR PR Protocol**"). This client alert outlines coverage and adherence mechanisms of the EMIR PR 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

ISDA has promulgated two protocols regarding EMIR. The first protocol, the ISDA 2013 EMIR NFC Representation Protocol (the "**EMIR NFC Protocol**"), allows adherents to represent to their regulatory status under EMIR[2]. The second protocol, the EMIR PR Protocol, permits adherents to satisfy EMIR's requirements regarding the establishment of procedures for portfolio reconciliation and dispute resolution. Pursuant to EMIR, certain market participants must ensure that appropriate procedures and arrangements are in place to measure, monitor and mitigate operational risk and counterparty credit risk. These procedures must include processes to reconcile portfolios, to manage the associated risk and to identify disputes between parties early and resolve them[3]. The EMIR PR Protocol permits market participants to establish such procedures in a standardized fashion by easily amending their current swap

[1] See Regulation (EU) No. 648/2012, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF.

[2] The EMIR NFC Protocol is available on ISDA's website at http://www2.isda.org/functional-areas/protocol-management/protocol/11. Note that adherence to this protocol is not a precondition to trading.

[3] See Regulation (EU) No. 648/2012; see also Commission Delegated Regulation (EU) No. 149/2013 supplementing Regulation (EU) No. 648/2012, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:052:0011:0024:EN:PDF.

trading documentation. Additionally, in light of EMIR's extensive reporting obligations, the EMIR PR Protocol also permits parties to except EMIR-mandated disclosures from existing confidentiality agreements to facilitate compliance with EMIR.

II. Adhering to the Protocol

Haven't I Done this Already?

Market participants will notice the similarity between the EMIR PR Protocol and the ISDA 2013 March Dodd-Frank Protocol (the "**March Protocol**")[4]. While both protocols deal with a similar subject matter (e.g., portfolio reconciliation and dispute resolution), absent explicit guidance to the contrary from the European Commission, adherence to the March Protocol <u>does not</u> constitute compliance with EMIR at this time.

Do I need to Adhere?

EMIR's portfolio reconciliation and dispute resolution requirements are binding on a wide range of market participants. Generally speaking, market participants formed under the laws of the EU will be expected to adhere to the EMIR PR Protocol, regardless of their counterparty's jurisdiction of formation. Additionally, market participants formed under the laws of the United States and other jurisdictions will likely be asked to adhere by their European trading counterparties in order to enable those counterparties to meet EMIR compliance requirements[5].

How Does the Protocol Work?

The EMIR PR Protocol adopts a simpler approach than that of the March Protocol, and consists of a protocol agreement, an adherence letter and a revocation letter. In order to adhere, parties need only make basic, check-the-box elections in the adherence letter and submit the same to ISDA. Upon ISDA's receipt of adherence letters from an adherent and its counterparty, the parties' swap documentation is deemed amended to reflect the substance of the protocol. If an adherent determines that it no longer

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4 For a more detailed description of the March 2013 Dodd-Frank Protocol, see Client Memorandum entitled "*Protocol 2.0 – ISDA's March 2013 Dodd-Frank Protocol*", available at http://www.paulweiss.com/media/1659079/31may13_alert.pdf.

5 See Article 11(12) of Regulation (EU) No. 648/2012, which clarifies that the portfolio reconciliation and dispute resolution requirements apply to "third country entities" that would be subject to these requirements but for their jurisdiction of formation so long as the relevant OTC derivative contracts have a "direct, substantial and foreseeable effect" within the European Union.

wishes to accept amendments to swap documentation going forward, it may submit a revocation letter to ISDA (note that this will have only prospective effect).

Can Investment Managers Adhere on Behalf of Funds They Manage?

An investment manager can adhere on behalf of a fund that has authorized it to amend its swap documentation. An investment manager with authority to adhere on behalf of all funds it manages can submit one letter on behalf of all such funds; an investment manager with authority to adhere on behalf of only some funds it manages can submit a letter listing the funds on behalf of which it is adhering. Funds whose investment managers do not have authority to adhere on their behalf must submit their own adherence letter.

What Am I Agreeing to by Adhering?

The effect of adhering depends on the selections adherents make in their adherence letters. When completing an adherence letter, adherents must determine how they intend to reconcile portfolio data with their counterparties (either by sending or by receiving portfolio data) and may provide information regarding back-office location, appropriate contacts and service providers (if any) to be used by counterparties in the reconciliation process. Generally speaking, by adhering, parties are agreeing to a market-standard process for portfolio reconciliation and dispute resolution. They are also agreeing to except EMIR-mandated disclosures from existing confidentiality agreements. Of course, the agreements made via the protocol are operative only between adherents and those counterparties that have also adhered.

What Is the Timeline for Adherence?

There is no specific cut-off date for adhering to the EMIR PR Protocol (though ISDA retains the right to set such a date in the future). As was the case with the March Protocol, the timing for adherence will be effectively set by the date on which the key regulations come into effect – namely, September 15, 2013. Banks located in the EU have recently begun requesting that their counterparties adhere; these requests will likely increase in frequency as we near the effective date of the regulations.

How Do I Adhere? Is there a Fee for Adhering?

To adhere, parties must provide ISDA (via ISDA's website) with a completed adherence letter indicating their desire to adhere to the protocol. 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 March Protocol, ISDA charges a $500 fee for the submission of each letter.

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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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