

ClientAlert

Capital Markets/Derivatives

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ISDA August 2012 Dodd-Frank Protocol

Since the publication of the ISDA August 2012 Dodd-Frank Protocol (the "DF Protocol") in early August, many market participants are asking how the DF Protocol works, what it is intended to achieve and whether they should adhere to it. To assist market participants in understanding the DF Protocol, we are publishing the below summary. This summary does not address all the minutiae of the protocol or cover in detail the provisions that may affect certain types of entities (such as "special entities") and is intended only as an introduction to the DF Protocol.

What Is the DF Protocol?

The DF Protocol was published by the International Swaps and Derivatives Association ("ISDA") to facilitate compliance by the industry with documentation requirements for various Commodity Futures Trading Commission ("CFTC") rules including the external business conduct rules (the "Covered Rules"), compliance with which was originally set for October 15, 2012.¹ Pursuant to the Covered Rules, swap dealers ("SDs") and major swap participants ("MSPs") must obtain certain information and verifications from their counterparties. For example, SDs must obtain certain "know your counterparty" information and also verify that counterparties qualify as "eligible contract participants." In addition, SDs/MSPs must provide certain information, give notices and make certain disclosures to their counterparties, which differ depending on the legal status of the counterparty (e.g., eligible contract participant, swap dealer, major swap participant, special entity, etc.).

The DF Protocol is the first protocol published by ISDA to address industry compliance with the requirements of the Dodd-Frank Act and relevant CFTC rules. It is likely that further protocols will follow. The DF Protocol is intended to provide a simple solution to facilitate the (i) amendment of bilateral trading relationship documentation between SDs and their counterparties and (ii) exchange of relevant information between SDs and their counterparties.

What and Who Does the DF Protocol Apply To?

The DF Protocol is relevant only to SDs/MSPs and their counterparties. To be effective, one of the adhering parties in each pair must be a SD/MSP.

Although the DF Protocol is not limited to ISDA Master Agreements (and may be used to amend all agreements between a SD/MSP and a counterparty pursuant to which they enter into swaps), it is limited to existing written agreements between the parties. The DF Protocol does not apply to undocumented swaps unless the parties have elected to enter into a DF Terms Agreement.



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¹ Compliance with respect to some of the business conduct rules has been delayed until January 1, 2013.

Participants may elect to enter into a DF Terms Agreement by making the relevant election in Question 10 of Part III of the Questionnaire.

See below for more information on the DF Terms Agreement.

How Does the DF Protocol Work?

An entity adheres to the DF Protocol in much the same way as with prior ISDA protocols—by submitting a completed letter of adherence to ISDA together with an adherence fee (US\$500). A list of adhering parties is available on the ISDA website. Unlike prior protocols, however, where amendments or supplements were effected solely through delivery of an adherence letter to ISDA, with respect to the DF Protocol, submission of the adherence letter is only the first step. Trading relationship documentation between a SD/MSP and its counterparty will not be amended by the terms of the DF Protocol until the SD/MSP and its counterparty have each submitted and exchanged a completed DF Protocol Questionnaire (“DF Questionnaire”). The DF Protocol is not self-effecting, in other words. As part of the adherence letter, an adhering party must specify how it will accept DF Questionnaires from its counterparties. DF Questionnaires can be submitted and received manually or through ISDA Amend. ISDA Amend is discussed in more detail below.

What Is a DF Questionnaire?

The DF Questionnaire is the document that allows a pair of adhering parties (i.e., a SD/MSP and its counterparty) to amend the written swap trading relationship documentation (“Covered Agreements”) between them. In order for the DF Protocol to be effective with respect to a Covered Agreement, both parties to such Covered Agreement must complete and submit a DF Questionnaire and specify that the other is entitled to receipt of its completed DF Questionnaire—this is a process known as “matching.” Only when matched DF Questionnaires are received by the parties will the Covered Agreement between a SD/MSP and its counterparty (“Matched Adherents”) be deemed to have been amended by the terms of the DF Protocol.

A DF Questionnaire may only be executed and submitted by a party who has previously, or simultaneously, executed and submitted an adherence letter.

An adhering party completing the DF Questionnaire online through ISDA Amend will have the ability to deliver the DF Questionnaire through ISDA Amend to those adhering parties that it has specifically approved.

What Information Does the DF Questionnaire Contain?

The DF Questionnaire includes representations by the relevant adhering party as to its legal status (e.g., eligible contract participant, swap dealer, major swap participant, special entity, commodity pool, etc.) and certain “know your counterparty” information. The DF Questionnaire also enables the relevant adhering party to elect which of the six Schedules contained in the ISDA August DF Supplement (the “DF Supplement”) will be incorporated into the relevant Covered Agreement. A party may elect to incorporate different Schedules for different counterparties by submitting multiple DF Questionnaires, however only one DF Questionnaire may be delivered to a single counterparty.

The Schedules to the DF Supplement are briefly summarized below:

Every pair of Matched Adherents will be deemed to have supplemented the Covered Agreement(s) between them by incorporating Schedules 1 and 2 of the DF Supplement.

- Schedule 1 incorporates the definitions used throughout the DF Protocol.
- Schedule 2 contains representations and other basic agreements between a SD and its counterparty covering (i) disclosure of information, (ii) reporting, (iii) receipt of daily marks and scenario analysis, and (iv) clearing.
- Schedule 3 is a safe harbor for SDs from the suitability requirements of Part 23 of the CFTC Rules.
 - Schedule 3 applies if both of the Matched Adherents have agreed in their respective DF Questionnaires to incorporate Schedule 3 into the Covered Agreement between them. In addition, to incorporate Schedule 3, any Matched Adherent who has represented in its DF Questionnaire that it has a Designated Evaluation Agent (“DEA”) must have obtained the countersignature of each such DEA in order that the DEA makes the representations and covenants applicable to it. Any Matched Adherent that is not a SD may, but is not required to, have a DEA.
 - Schedule 3 contains representations that are made by the adhering party or its DEA, if any, as to compliance with written policies and procedures that are reasonably designed to ensure that either the adhering party or its DEA, as applicable, is capable of evaluating swap recommendations (if any) of the SD and making trading decisions.

- Schedule 4 provides a safe harbor for SDs facing a non-ERISA special entity from certain requirements of Part 23 of the CFTC Rules, which otherwise place fiduciary-type obligations on the SD when transacting with a “Special Entity.” Schedule 4 applies if the Matched Adherents have so specified in their respective DF Questionnaires and, with respect to the Special Entity, its advisor (known as a “Designated QIR”) has countersigned such DF Questionnaire and agreed to make the representations and agreements applicable to it. Schedule 4 requires that the ERISA Special Entity have a Designated QIR.
 - Schedule 4 contains representations made by the Special Entity and the Designated QIR which include:
 - (i) representations by the Special Entity as to its compliance with written policies and procedures that are reasonably designed to ensure that it has selected a satisfactory representative; and (ii) representations by the Designated QIR that it has policies and procedures reasonably designed to ensure it complies with applicable CFTC rules, that it satisfies the independence test set forth in Part 23 of the CFTC rules and that it is exercising independent judgment in evaluating swap recommendations.
- Schedules 5 and 6 provide safe harbors for SDs facing an “ERISA Special Entity” from certain requirements of Part 23 of the CFTC Rules. Schedules 5 and/or 6 will apply if both Matched Adherents have agreed in their respective DF Questionnaires to the incorporation of such Schedule. The ERISA Special Entity is required to have a “Designated Fiduciary” that must countersign the DF Questionnaire, thereby agreeing to make certain representations.

What Is the Purpose of the Safe Harbors in Schedules 3 through 6?

As noted above, Part 23 of the CFTC Rules imposes certain requirements on SDs with respect to swaps. For example, a SD has a duty to reasonably determine the suitability of any swap “recommended” to its counterparty. With respect to swaps with a “Special Entity,” the CFTC Rules impose fiduciary-type duties when a SD recommends a tailored swap to a “Special Entity.” Safe harbors from these requirements are available to a SD where the counterparty is adequately advised and will exercise independent judgment in assessing swap recommendations. These safe harbors can be satisfied in whole or in part through representations of the counterparty and relevant advisers.

Schedules 3 through 6 provide a standardized approach to the safe harbors designed to allow counterparties that are able to make a full set of representations required to establish the applicability of a safe harbor to do so. As noted above, application of the safe harbors is optional and the relevant Schedule will apply to a Covered Agreement only if both Matched Adherents have specified as such in their DF Questionnaires.

We note that the available safe harbors contain representations (other than with respect to Schedule 5) that an entity is complying with certain written policies and procedures. As the requirement for these policies and procedures is new, many adhering parties wishing to use the safe harbors may need to create new written policies and procedures before entering into the DF Protocol.

Is There a Cut-Off Date for Adherence to the DF Protocol?

Currently there is no cut-off date for adherence, although ISDA may elect to close the DF Protocol on 30 days’ prior notice.

What is ISDA-Amend?

ISDA and Markit have jointly developed an electronic platform (“ISDA Amend”) to automate the information-gathering process and provide sharing of submitted data and documents relevant to the DF Protocol. Parties that opt to use ISDA Amend can electronically complete and submit DF Questionnaires. To access ISDA Amend, an entity must register with Markit.

ISDA Amend is free to use and is available [here](#).

What Happens if I Do Not Adhere to the DF Protocol?

To ensure that trading is not interrupted, if an entity chooses not to adhere to the DF Protocol or is unable to make the representations or provide the information required so that relevant safe harbors apply, it should contact its swap dealer counterparties as soon as possible so that a bilateral solution can be found. We are aware that a number of swap dealers are offering bilateral amendments to existing swap trading relationship documentation.

Does the Recent CFTC Extension Affect the DF Protocol?

On August 27, 2012, the CFTC published the “Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants”² final rule. Section III.C of the CFTC’s release accompanying the rule extends the compliance date for certain provisions of the external business conduct rules until January 1, 2013. This means that the compliance date for many requirements of the external business conduct rules addressed by the DF Protocol has been deferred until January 1, 2013. The extension notwithstanding, swap dealers are encouraging their counterparties to adhere to the DF Protocol and submit DF Questionnaires on a timely basis so that trading will not be interrupted.

2 77 FR 55904, September 11, 2012. The Final Rules add §§23.500 through 23.505.

What Is the ISDA August 2012 DF Terms Agreement?

The ISDA August 2012 DF Terms Agreement allows adhering parties to apply selected provisions of the DF Supplement to their trading relationship in respect of swaps, irrespective of whether or not such relationship is governed by an existing written agreement. As noted above, the DF Protocol only affects written agreements between the parties with respect to swaps. The DF Terms Agreement is designed to be used by any pair of parties, provided that at least one of the parties is a swap dealer.

According to ISDA, parties should consider entering into a DF Terms Agreement if at least one of them is a swap dealer and either of the following circumstances applies:

- (a) the parties may execute swaps that are not governed by an existing ISDA Master Agreement, an execution agreement or other written agreement, including swaps that are executed by a party to be cleared or swaps that are executed to be "given up" to a third-party derivatives dealer or "prime broker"
- (b) the parties may not have yet entered into an ISDA Master Agreement or other written agreement, but would like to begin transacting swaps

What Is Addendum I?

Addendum I to the DF Protocol (the "Addendum") is currently available in draft form on ISDA's website and publication of the final version of the Addendum is expected later this month. The Addendum supplements the DF Questionnaire and addresses the requirements of certain CFTC Rules that are expected to come into force on December 31, 2012. Such CFTC Rules make changes to the statutory definition of "eligible contract participant" with respect to entities that are commodity pools. The Addendum allows an adhering party that is a commodity pool to update information that it has provided with respect to its "eligible contract participant" status. We will provide further detail with respect to the Addendum once it is published.

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