

A Dodd-Frank Derivatives Update

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Program Summary

- Overview of Dodd-Frank Title VII
- Status of Title VII rulemaking to date
- Significant issues still to be addressed
- Registration as a swap dealer (SD) or major swap participant (MSP)
 - Entity and Product Definitions
 - Compliance issues for Swap Dealers/MSPs
- End-users
- Clearing
- Margin
- Recordkeeping and reporting
- Swap execution facilities
- Extraterritoriality

Title VII Overview

- **Objectives of Title VII**

- Reduce systemic risk posed by the swaps market to the U.S. financial system
- Increase transparency of the swaps market, particularly as to both pre and post execution pricing
- Enhance the integrity of the swaps market and improve the conduct of major market participants

- These objectives are furthered by:

- Subjecting market participants to registration and oversight
- Requiring most swaps to be centrally cleared, and imposing recordkeeping and reporting obligations
- Imposing margin requirements

Title VII Overview (cont'd)

- Regulates products
 - Swaps
 - Security-based swaps (SBSs)
- Regulates entities
 - Swap dealers
 - Security-based swap dealers
 - Major swap participants (MSPs)
 - Major security-based swap participants
 - Derivatives Clearing Organizations (DCOs)
 - Swap Execution Facilities (SEFs)
 - Swap Data Repositories (SDRs)
- Splits regulation between CFTC and SEC
 - CFTC regulates swaps, swap dealers and major swap participants
 - SEC regulates security-based swaps, security-based swap dealers and major security-based swap participants

Status of Rulemaking

- Most of the critical building blocks of the Title VII regulatory regime have been finalized
 - Entity definitions covering definitions of swap dealer, security-based swap dealer, major swap participant, major security-based swap participant and eligible contract participant
 - Product definitions covering definitions of swap and security-based swap
 - First wave of swap dealer registrations occurred at the end of 2012
 - Recordkeeping requirements are effective
 - Clearing and reporting is commencing
- Although many of these matters are the subject of final rules, the CFTC has had to issue many no-action letters and other forms of interpretative relief, and to defer deadlines

Status of Rulemaking (cont'd)

- SEC is taking a different approach to Title VII rulemaking
 - It appears that no registration requirements will be imposed until all substantive Title VII rulemaking by SEC is complete
 - SEC's substantive rulemaking has lagged significantly behind the CFTC's
 - In some cases, the SEC is yet to publish a proposed rule on matters that the CFTC has long since published proposed rules on or even proceeded to adopt final rules
 - For example, as yet no SEC proposed rule on:
 - cross border application of SEC's Title VII regulation
 - Even where SEC has published proposed rules, the timeline for finalizing these rules is unclear

Significant issues still to be addressed

- However, there are still important open issues to be addressed:
 - Margin requirements
 - SEF rules
 - Extraterritoriality
 - Harmonization of Title VII and EMIR/MiFID
 - Lincoln “push out” provisions
 - Volcker Rule

Requirements under Title VII

- Under Title VII, new requirements are imposed on swap dealers and MSPs (the entity definitions identify these), and on other regulated entities
- Title VII also imposes general requirements related to transacting in swaps, including clearing and margin requirements, and recordkeeping and reporting requirements

Registration requirement

- Swap dealers and MSPs are subject to a registration requirement
- In conjunction with registration, each newly registered swap dealer or MSP faces a host of other regulatory compliance dates
- The registration process is delegated to the NFA:
 - Registration is made on a provisional basis, by filing forms 7-R, 8-R, finger print cards and compliance documentation, and paying required filing fees
 - A registrant must include with its application to NFA materials demonstrating its **ability to comply** with any “4(s) Implementing Regulations”, which consist of:
 - Capital and Margin (Section 4s(e)); Reporting and Recordkeeping (Section 4s(f)); Daily Trade Reporting (Section 4s(g)); Business Conduct Standards (Section 4s(h)); Documentation Standards (Section 4s(i)); Duties (Section 4s(j)); CCO Designation (Section 4s(k)); and Segregation Requirements for Uncleared Swaps (Section 4s(l))
 - Compliance will be demonstrated on a rolling basis, so that as compliance dates occur a registrant will need to supplement its application to show its ability to comply with those additional 4(s) Implementing Regulations for which compliance is then required

Registration deadlines

- Swap dealer rule provides that registration is not required until two months after the month in which swap dealer's activity exceeds de minimis threshold with counting starting on the effective date (without a lookback). (See Rules 1.3(ggg)(4)(i) and (iii)). The first wave of registrants filed just prior to or on December 31, 2012.
 - The NFA maintains a list on its website of those entities that have registered.
- MSP rule provides that a filing requirement arises two months after the end of the first fiscal quarter in which the registration criteria are met (subject to certain re-evaluation rights). Registration generally was required by the end of February 2013.

Entity Definitions

- Swap dealers and MSPs are two of the most heavily regulated new entities established by Title VII. The statutory definitions for these entities provide:
 - Swap Dealer: Any person who—
 - Holds itself out as a swap dealer;
 - Makes a market in swaps;
 - Regularly enters into swaps with counterparties as an ordinary course of business for its own account; or
 - Is commonly known in the trade as a dealer or market maker in swaps
 - Major Swap Participant: Any person who is not a dealer and—
 - Maintains a substantial position in swaps, excluding positions held for hedging or mitigating commercial risk;
 - Outstanding positions create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or
 - Is a highly leveraged financial entity that maintains a substantial position in swaps and is not subject to a Federal banking agency's capital requirements

Entity Definitions (cont'd)

- CFTC and SEC jointly adopted rules and provided guidance in an effort to clarify these statutory definitions:
- For swap dealers, the regulations and guidance include:
 - A three-step process to be followed in determining swap dealer status
 - Importance of the “dealer-trader” distinction in this analysis-this is a concept long used by the SEC in regulating securities broker-dealers
 - Exclusion of some hedging activities from the “dealer” determination
 - Further description of what types of activities will be considered “market making”
 - Clarification of the exclusion for swaps executed in connection with loan originations, though this exclusion is only available to insured depository institutions
 - Expansion and phasing in of the “de minimis” exemption

Entity Definitions (cont'd)

- For MSPs, the regulations and guidance include:
 - Definitions of “major swap participant” and “major security-based swap participant” focus on the market impacts and risks associated with that person’s swap and security-based swap positions. (Note that “swap dealer” and “security-based swap dealer” definitions focus on activities)
 - Major participants generally must follow the same statutory requirements that apply to swap dealers and security-based swap dealers since their activities could pose a high degree of risk to the U.S. financial system generally.
 - MSP: Any person who is not a dealer and–
 - Maintains a substantial position in swaps,
 - Outstanding positions create substantial counterparty exposure that could have serious adverse effects on the financial stability of the US banking system or financial markets; or
 - Is a highly leveraged financial entity that maintains a substantial position in swaps and is not subject to federal bank capital requirements

Product Definitions

- In July 2012, the SEC and CFTC approved the Product Definitions.
- Title VII generally bifurcates regulation of the OTC derivatives markets, with the CFTC having jurisdiction over “swaps” and the SEC having jurisdiction over security-based swaps (“SBS,” and with “swaps,” “Title VII Instruments”).
- The SEC and CFTC share jurisdiction over “mixed swaps.”
- The CFTC also has regulatory and enforcement authority over “security-based swap agreements” (“SBSAs”), but the SEC has antifraud and certain other authority over SBSAs.

Product Definitions (cont'd)

- Title VII defines a “swap” broadly to include transactions involving a purchase, sale, payment or delivery that is dependent on the occurrence, nonoccurrence, or extent of occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence
- This broad scope raised concerns regarding the status of a number of different types of products and instruments, and the final definitions include guidance regarding quite a number of products that are excluded from the definitions provided certain conditions are met. In the next series of slides, we will outline the treatment of a number of these products.
- The final rules also establish a process by which parties may request a joint interpretation from the CFTC/SEC regarding whether a particular OTC derivative or type of derivative that is subject to Title VII of Dodd-Frank should be treated as a swap, SBS or mixed swap.

Product Definitions (cont'd)

- Key exclusions from the swap/SBS definition:
 - **Consumer Transactions:** certain consumer transactions primarily for personal, family or household purposes were excluded, including real estate transactions, mortgages, personal service transactions and interest lock and caps related to such transactions
 - **Commercial Transactions:** those involving customary business or commercial arrangements, such as employment, sales, servicing, or distribution, business combinations, and equipment, inventory and IP transfers or leases, and many commercial finance arrangements
 - **Forward Contracts on Physical Commodities:** consistent with longstanding distinction between forward contracts and futures contracts, with helpful clarification regarding bookouts, embedded optionality and other common commercial terms, such as requirement, output and evergreens
 - **Forward Contracts on Securities:** confirmed MBS TBA transactions are covered
 - **Participation Agreements:** excluded both LSTA true sale participations and LMA risk participations
 - **Insurance Products:** provided a safe harbor based on either being an “Enumerated Product” or satisfying a “Product Test”

Product Definitions (cont'd)

- Rules also provide guidance for allocation between swaps and SBSs
- One major basis for allocation is narrow-based versus broad-based index
- Treatment of FX Swap and FX Forwards remains one of the more puzzling aspects of the Product Definitions
- Title VII permits the U.S. Treasury to exempt FX Swaps and FX Forwards (but not other types of FX transactions) from the swap definition for some, but not all, aspects of Title VII
 - FX Swaps and FX Forwards are narrowly defined by the statute
 - As a result, many other types of FX transactions (such as non-deliverable forwards, cross-currency swaps and FX options) are within the swap definition
- U.S. Treasury issued an exemption for FX swaps and forwards; however, several important compliance requirements still apply to FX swaps and forwards

Product Definitions Summary

PRODUCT	CHARACTERIZATION	PRODUCT	CHARACTERIZATION
Cash/spot trades	NOT TITLE VII	Option on a single stock	NOT TITLE VII
CDS on a broad security index	SWAP	Option subject to securities laws	NOT TITLE VII
CDS on a narrow security index	SBS	Option on a swap	SWAP
CDS on a single name	SBS	OTC option on a single non-security loan	SBS
Commercial agreement	NOT TITLE VII	Retail OTC FX	NOT TITLE VII, but CEA regulated
Commodity swap	SWAP	SBS also based on certain CFTC-regulated rates,	MIXED SWAP
Consumer agreement	NOT TITLE VII	indices, currencies, commodities, etc.	
Correlation swap on a broad security index	SWAP	Security forward	NOT TITLE VII
Correlation swap on a commodity-based	SWAP	Spot FX transactions	NOT TITLE VII
Dividend swap on a broad security index	SWAP	Swap on an exempt security (other than muni)	SWAP
Dividend swap on a narrow security index	SBS	Swap on municipal security	SBS
Dividend swap on a single security	SBS	TBA MBS	NOT TITLE VII
Foreign exchange forward	SWAP, but subj to UST exemp	TRS on a broad security index	SWAP
Foreign exchange swap	SWAP, but subj to UST exemp	TRS on a narrow security index	SBS
Forward delivery contract	NOT TITLE VII	TRS on a single security	SBS
Guarantee of a swap	SWAP	Variance swap on a broad security index	SWAP
Guarantee of a SBS	NOT TITLE VII	Variance swap on a narrow security index	SBS
Insurance products	NOT TITLE VII	Variance swap on a single security	SBS
Interest rate swap	SWAP	Weather, energy, or emissions swap	SWAP
LCDS on multiple loans	SWAP		
LCDS on a single loan	SBS		
Listed futures contract	NOT TITLE VII	Abbreviations: CDS – credit default swap; FX – foreign exchange; LCDS – credit default swap on loan(s); LTRS – total return swap on loan(s); MBS – mortgage backed security; SBS – securities based swap; BA – to be announced; TRS – total return swap Notes: Not Title VII means instruments are outside the scope of Title VII of Dodd-Frank, but might still be subject to CFTC/CEA regulation	
Listed FX option contract	NOT TITLE VII		
LTRS on multiple loans	SWAP		
LTRS on a single loan	SBS		
Non-deliverable forward (NDF)	SWAP		
Option on a SBS	SBS		

Compliance requirements

- Swap dealers and MSPs face a significant array of regulatory and compliance burdens, including
 - External Business Conduct Standards
 - Internal Business Conduct Standards
 - Real time Reporting and General Recordkeeping and Reporting
 - Trading Documentation Requirements
 - Clearing Documentation and Processing Requirements
 - Margining and Collateral Segregation Requirements
 - Capital Requirements

Compliance Issues

- External Business Conduct Standards
 - General standards include:
 - Verification of counterparty status
 - KYC and institutional suitability requirements
 - Disclosure obligations relating to material risks, characteristics and conflicts of interest
 - Daily mark-to-market values
 - Clearing Documentation
 - Trading Documentation
 - Additional standards apply to interactions with Special Entities

Compliance requirements

- What does the ISDA August 2012 DF Protocol consist of?
 - ISDA August 2012 DF Protocol Agreement (including form of Adherence Letter)
 - ISDA August 2012 DF Supplement (including Schedules with representations)
 - ISDA August 2012 DF Protocol Questionnaire (and Questionnaire Answer Sheet)
 - ISDA August 2012 DF Terms Agreement (to be used where parties do not have a master agreement in place but wish in any event to comply for swaps they execute)
- What does the ISDA August 2012 DF Protocol address?
 - Entity status
 - Verify identity
 - Confirm ECP status
 - Determine Special Entity status
 - Identify and verify advisory relationships
 - Confirm essential details
 - Presence of advisor/agent
 - Hedging status
 - Suitability issues
 - Disclosure requirements
 - Confirm application of regulatory safe harbors

Compliance Issues

- How does the ISDA August 2012 DF Protocol function?
 - The protocol, in effect, establishes a set of standard amendments to ISDA Master Agreements or other agreements governing swap transactions
 - An entity joins the protocol by submitting, online, its adherence letter together with a required \$500 fee.
 - This is done on the ISDA website.
 - An agent may adhere on behalf of multiple entities
 - In addition, an adhering entity must complete the Questionnaire and effect delivery of the Questionnaire to those trading parties for which it wishes the Protocol to be effective
 - ISDA and Markit have established ISDA Amend, an online system, to facilitate the delivery of Questionnaires being pairs of entities
 - By adhering to the Protocol and delivering a completed Questionnaire a party will have amended its covered agreements to include various representations that address many external business conduct requirements and, in particular, are geared to satisfying certain compliance “safe harbors” that are available to swap dealers and MSPs under the applicable regulations

Compliance Issues (cont'd)

- What is the substantive effect of the Protocol?
 - Each adhering party will make the representations in Schedule 1 and 2 to the DF Supplement, which cover certain generally applicable matters (e.g., ECP status)
 - Certain adhering parties will make the representations in Schedules 3 through 6 to the DF Supplement, which cover cases where a party has a “Designated Evaluation Agent” or is an ERISA or non-ERISA Special Entity
 - The Protocol is not intended and does not purport to address all external business standard compliance requirements
 - In addition, ISDA notes that further protocols may be needed to address regulatory requirements that have not yet been adopted
- Verification of “Commercial End-User Status” is not directly addressed by the ISDA Protocol, but ISDA Protocol 2.0 intends to cover this and other matters
 - Also note that end-users that are public companies need to implement certain board or committee approvals to take advantage of this status
 - CFTC’s new OTC Trading Documentation rules also address this issue

Compliance Issues (cont'd)

- Internal Business Conduct Standards
 - CFTC final rules:
 - Requires registrants to adopt risk management programs
 - Requires that swap documentation with counterparties address certain matters, including payments netting, events of default and termination, transfers, governing law
 - Complying with the new Internal Business Conduct Standards will present many new challenges, including addressing:
 - Changes In Communications Between Swap Dealers and Third Parties
 - Communications Involving Research Analysts
 - Communications Involving Research Reports
 - Relationship Between Clearing and Business Trading Units
 - Role of the Chief Compliance Officer
 - Required Annual Compliance Report
 - Reporting and Recordkeeping for Swap Dealers-Trade and Marketing Data
 - Reporting and Recordkeeping for Swap Dealers-Governance Data
 - Duties of Swap Dealers
 - Required Risk Management Program for Swap Dealers (including a new products policy)
 - Diligent Supervision Requirement

Clearing

- Mandatory clearing
 - Section 2(h)(1)(A) of the CEA makes it unlawful to engage in any swap that the CFTC requires to be cleared, unless it is submitted to a registered clearing organization for clearing.
 - The CFTC subjects classes or types of swaps to mandatory clearing by describing them in a clearing determination. To date, there has been only one final clearing determination.
 - Once a final clearing determination has been issued, the related swap types are subject to mandatory clearing on a phased-in timeline based on type of entity
 - (T+90, T+180, T+270)
 - Section 2(h)(7)(A) of the CEA provides an exception to the clearing requirement (the “end-user exception”).
 - Possible additional exception for inter-affiliate swaps.

Clearing (cont'd)

- Mandatory clearing of standard IRS and CDS products started yesterday for Category I entities. End-users will be required to clear (**subject to applicable exceptions**) these swaps starting September 9, 2013.
 - End-user clearing deadline for CDS of iTraxx CDS Indices has been extended to October 23, 2013.
- To Clear, or Not to Clear?
 - Some end-users may prefer to clear
 - Some factors end-users may consider when deciding whether to clear:
 - Depending on how the final margin rules come out, it may not be much more expensive to clear than not (this is speculative until we get some finality on margin for uncleared swaps).
 - Clearing will require new infrastructure and relationships (SEFs, FCMs).
 - Some products are clearly not amenable to clearing (e.g., loan-related IRS with unique loan-related termination and amortization provisions).

Clearing mechanics

- Establishing a clearing relationship
 - As swap clearing becomes a reality, additional or modified documentation will be required by some non-registered entity types (although true corporate end-users may never need to use them)
 - The ISDA Master Agreement may serve a lesser or different role for cleared swaps
 - CFTC regulations place certain constraints on clearing-related documentation
 - Clearing firms currently are proposing the following three types of documents:
 - Futures Account Agreement (“**FAA**”)
 - Customer agreement for setting up a futures account between an FCM and a customer
 - Cleared OTC Derivatives Addendum to FAA
 - Necessary because FAAs do not address swaps or close-out rights in relation to cleared swaps
 - Execution Agreement
 - New documentation must address consequences if a transaction that is expected to clear is not accepted for clearing

Clearing mechanics (cont'd)

- Cleared OTC Derivatives Addendum to FAA
 - Addendum makes FAA applicable to cleared swaps
 - After an initial draft was released by ISDA and the Futures Industry Association (“*FIA*”) in 2011, some dealers determined that they would need legal opinions in relation to netting for regulatory cap purposes
 - The final standardized document was published in August 2012
 - As discussed below, the final document resolved the dealers’ netting opinion concerns by elaborating on close-out of swaps upon termination:
 - Some market participants had wanted to follow futures model (menu of broad rights upon termination, not especially transparent)
 - Others wanted to follow an ISDA-like model (market quotation or similar, more transparent approach)

Clearing mechanics (cont'd)

- Cleared OTC Derivatives Addendum to FAA
 - In addition to addressing close out rights, Addendum forms used in the market typically also:
 - Contain representations as to authority, non-reliance language and tax provisions.
 - Require a clearing member to transfer (“port”) the customer’s trades to another clearing member upon client’s request in accordance with National Futures Association rules.
 - Many market participants will need to negotiate the Cleared OTC Swaps Addendum
 - Some have already negotiated and agreed to the prior version and will likely need to renegotiate based on the final version

Clearing mechanics (cont'd)

- Cleared OTC Derivatives Addendum to FAA (cont.)
 - As compared to its earlier version, the newly published Cleared OTC Swaps Addendum has the following significant features:
 - Covers all derivatives transactions amenable to clearing (including forwards and options), not just swaps
 - Liquidation provision (Section 7):
 - Provides detailed liquidation and close out methodology for clearing members
 - Following a “Close-out Event” a clearing member may execute “Close-out Transactions”, but also may execute “Risk-reducing Transactions” and “Mitigation Transactions”
 - All such close out activity is to occur in accordance with a defined Liquidation Standard that is based on good faith and commercially reasonable procedures, though it is also recognized that a clearing member may have to effect a close out in circumstances where no prevailing market prices or bona fide quotations are available
 - However, if despite its commercially reasonable efforts, a clearing member determines it cannot satisfy the Liquidation Standard based on quotations, prices and other market data, then it may base its valuation on internal sources

Clearing mechanics (cont'd)

- Cleared Swaps Execution Agreement
 - This agreement sets out the procedure for trade affirmation or rejection and states what happens if a transaction that is expected to clear is not accepted for clearing
 - Each of the parties to the original transaction (dealer and client) represents that it has a clearing agreement with a clearing member
 - Once a transaction is accepted for clearing, neither dealer nor client has any obligation to the other (DCO becomes a party to both sides of transaction)

Clearing mechanics (cont'd)

- Cleared Swaps Execution Agreement
 - If a trade does not clear, then unless otherwise agreed, at the option of the dealer:
 - The dealer (if it is a clearing member) may elect to accept the transaction in its capacity as clearing member, or have a clearing member affiliate do so
 - If the transaction is not legally required to be cleared, the dealer may enter into the transaction on a bilateral (uncleared) basis or
 - The transaction may be terminated
 - at the dealer's side of the market if the transaction's failure to clear is caused by the customer or its clearing member (including the customer's clearing member breaching a position limit imposed by the relevant DCO)
 - at the customer's side of the market if the transaction's failure to clear is caused by the dealer or its clearing member (including the dealer's clearing member breaching a position limit imposed by the relevant DCO)

Clearing mechanics (cont'd)

- Cleared Swaps Execution Agreement
 - In accordance with recent CFTC rules, each Execution Agreement can only be bilateral, between dealer and customer
 - As previously proposed by FIA and ISDA, the Execution Agreement would have been trilateral, with optional annexes under which either party's clearing member could become a party to the agreement
 - Trilateral arrangement was a major point of contention with the buy-side, which was concerned that clearing members would steer trades to their own affiliates and restrict the dealers with which the buy-side could transact
 - Market consensus that CFTC final rules effectively prohibit a trilateral agreement
 - Apparently, ISDA/FIA are working on a further updated version of this agreement

Clearing mechanics (cont'd)

- Cleared Swaps Execution Agreement
 - Under those rules, among many other restrictions, clearing members may not enter into any arrangement that:
 - discloses to the clearing member the identity of the member's customer's original executing counterparty or
 - restricts the size of the position a member's customer may take with any individual counterparty, apart from an overall limit for all positions held by the customer at the clearing member
 - Manner in which Execution Agreement will be used in evolving cleared swaps market remains unclear

End-User Exception

- An end-user may be eligible for an exception from the clearing and trade execution requirements
- To qualify for the end-user exception, an end user:
 - Cannot be a “financial entity” (with limited exceptions)
 - Must use swap to “hedge or mitigate commercial risk”; and
 - Must notify the CFTC of how the entity “meets its financial obligations associated with entering into non-cleared swaps”

End-User Exception (cont'd)

- A financial entity includes:
 - SDs, MSPs;
 - Commodity pool operators;
 - Private funds;
 - ERISA plans; or
 - Persons “predominantly engaged” in activities that are in the business of banking, or in activities that are “financial in nature” (defined under Section 4(k) of the Bank Holding Company Act), including securities underwriting and dealing, investment advisory activities, insurance agency or brokerage, and extending credit.

End-User Exception (cont'd)

- To qualify for the end user exception, a swap must be used to hedge or mitigate commercial risk, which requires that a swap:
 - qualifies as a bona fide hedging under the CEA position limit rules, or
 - qualifies for hedging treatment under FASB, or
 - be “economically appropriate” to reduce, in the ordinary course of business, risks arising from a change in: the value of assets that the entity owns, produces, manufactures, processes or merchandises; the value of liabilities due to fluctuations in interest, currency or foreign exchange rates, or the interest, currency or foreign exchange rate exposures arising from a person’s assets, services or liabilities; and
 - not be used for a purpose that is in the nature of speculation, investing or trading and not be used to hedge or mitigate the risk of another swap, unless that other swap itself is used to hedge or mitigate commercial risk.

End-User Exception (cont'd)

- Actions to be taken by end-users in connection with the end-user exception:
 - Board/Committee approval (public companies only)
 - Reporting
 - Enter into the ISDA DF Protocol (or similar arrangement)
 - Obtain an LEI/CICI
 - Evaluate margining arrangements

End-User Exception (cont'd)

- Reporting
 - Reporting counterparty reports the following data points to an SDR (or the CFTC):
 - whether the swap is subject to the end-user exception;
 - the identity of the exempt end-user; and
 - whether the end-user has filed an annual filing with the SDR (or the CFTC).
 - End-user is required to report annually (or, if it chooses, on a trade-by-trade basis) to an SDR (or the CFTC) containing the following information:
 - whether it is a financial entity or a finance affiliate;
 - whether the swap hedges or mitigates commercial risk;
 - whether it is an SEC reporting company, and, if so, whether the appropriate committee of its board of directors has reviewed and approved the decision to enter into swaps that are exempt from clearing; and
 - how it generally expects to meet its financial obligations

Proposed Affiliate Exception

- The proposed rule would allow the counterparties to an inter-affiliate swap to elect not to clear a swap that would otherwise be subject to mandatory clearing, subject to the following limitations:
 - Only majority-owned affiliates eligible for exemption
 - Both counterparties would have to elect not to clear the swap
 - Swap trading relationship documentation required between the parties
 - Swap must be subject to a centralized risk management program within the group of affiliated entities that is reasonably designed to monitor and manage the risks associated with inter-affiliate swaps

Proposed Affiliate Exception (cont'd)

- If both counterparties are financial entities, daily marking-to-market and posting of variation margin required (except in the case of 100% commonly owned and commonly guaranteed affiliates where the common guarantor is also 100% commonly owned)
- Each affiliated counterparty required to satisfy one of the following conditions:
 - located in the United States
 - located in a country with a comparable and comprehensive clearing regime
 - required to clear swaps with unaffiliated counterparties in compliance with U.S. law or
 - does not enter into swaps with unaffiliated counterparties; and
 - Additional reporting requirements would apply.

Margin Requirements

- There will be margining requirements for uncleared (OTC) swaps.
- The margin requirements have not been finalized, although it is widely anticipated that levels will be higher than for cleared swaps (keeping in mind, however, that clearing houses and FCMs can increase the level of margin on a cleared swap).
- Once margin requirements are finalized, end-users will need to evaluate their credit support arrangements with their swap dealer counterparties and determine whether any modifications are necessary.
- Title VII gives end-users the right to require that any initial margin they post be segregated and, if it chooses, held by a third-party custodian.
- If the end-user opts to have collateral held by a custodian, it will need to negotiate and enter into custodial arrangements.

Margin Requirements (cont'd)

- Cleared Swaps
 - Margin posted in respect of cleared swaps is required to be “legally separate but operationally commingled” (“**LSOC**”) to limit fellow customer risk.
 - For cleared swaps, clearing houses will drive how much margin will be required for swaps.

Recordkeeping

- The swap recordkeeping requirements are contained in CFTC Rule Parts 45 and 46. They are already in effect.
- They effect each counterparty to a swap subject to the CFTC's jurisdiction.
- Part 45—recordkeeping for new swaps
 - full, complete and systematic records of each swap (together with all applicable data and memoranda), including LEI, USI and UPI
 - for end-users electing the end-user exception, includes records related to the election not to clear
 - end-users required to retain records throughout the life of the swap, plus five years after the termination of the swap
 - during the retention period, end-user records must be capable of retrieval within five business days
 - records may be retained in electronic or paper format

Recordkeeping (cont'd)

- Part 45—recordkeeping for new swaps (cont'd)
 - Unique Swap Identifier (“**USI**”)
 - Each swap will assigned its own USI
 - If executed on a SEF or DCM, the SEF or DCM will create the USI
 - If off-facility, SDR will create the USI and provide to the reporting counterparty (where the reporting counterparty is an end-user, SDR to notify both counterparties of USI)
 - Unique Product Identifier (“**UPI**”)
 - Each swap type/class will be assigned its own UPI
 - System not yet established
- Part 46—recordkeeping for legacy swaps
 - Legacy swaps in existence on or after April 25, 2011:
 - minimum primary economic terms;
 - swap confirmation terms;
 - any related master agreement, incl. any modifications; and
 - any related credit support agreement, incl. any modifications.

Recordkeeping (cont'd)

- Part 46—recordkeeping for legacy swaps (cont'd)
 - Expired or terminated prior to April 25, 2011:
 - for “Pre-Enactment Swaps,” the information and documents in party’s possession on or after October 14, 2010
 - for “Transition Swaps,” the information and documents in party’s possession on or after December 17, 2010.
- Legacy swaps do not have USIs or UPIs

Swap Reporting; LEI/CICI

- Introduction

- Under Dodd-Frank, all swaps, whether cleared or uncleared, are required to be reported to registered swap data repositories (“**SDRs**”), or to the CFTC if no SDR for swaps in the relevant asset class is available.
- Subject to certain exceptions, the reporting obligation under cleared swaps rests with the clearing house.
- For swaps executed on a SEF or DCM, the parties satisfy their initial reporting obligations (*i.e.*, Part 43 (if applicable) and Part 45 creation data reporting requirements) by executing the transaction on such facility, unless there was a delay in the initial reporting of the swap
- In most OTC swaps, end-users will face SDs, MSPs or financial entities, who will generally bear the swap reporting obligations.
- However, if an end-user faces another non-financial entity end-user (including an affiliate), the parties will need to agree which counterparty will bear the reporting obligations.
- Being the reporting counterparty imposes significant operational burdens
- End-users facing non-U.S. non-registered entities may face additional considerations.

Swap Reporting; LEI/CICI (cont'd)

- Part 43—real-time public reporting
 - Pricing and volume data (fields specified in the rule depend on swap type)
 - Inter-affiliate trades excluded (assumption in the market is that this exclusion also covers inter-branch swaps)
 - FX swaps and FX forwards subject to exclusion by the Secretary of the U.S. Treasury are exempt from Part 43
 - Compliance is required starting **April 10, 2013**
 - Block trades (large notional amount swap transactions)
 - A delay is required in real-time reporting
 - CFTC rules not yet final (proposed 15 minute delay)
 - Reporting is required “as soon as technologically practicable” following execution for uncleared swaps:
 - means as soon as possible, taking into consideration the prevalence, implementation and use of technology by comparable market participants
 - timing may differ based on the type of market participant and the type of execution

Swap Reporting; LEI/CICI (cont'd)

- Part 43—real-time public reporting (cont'd)
 - Part 43 data will be dissemination publicly while protecting the anonymity of market participants
 - For off-facility trades, one counterparty must report the swap:
 - If only one counterparty is an SD, the SD reports.
 - If one counterparty to a swap is an MSP and the other counterparty is a non-SD/MSP, the MSP reports.
 - If both counterparties are non-SD/MSPs and only one is a financial entity, the financial entity reports.
 - If both counterparties are SDs, or both are MSPs, or both are non-SD/MSPs and are financial entities, or both are non-SD/MSPs (and neither is a financial entity), then the counterparties must select one counterparty between them to report the swap.
 - Hierarchy does not apply to block trades

Swap Reporting; LEI/CICI (cont'd)

- Part 45—swap data reporting
 - Creation data
 - **Primary economic terms data** (52 possible fields for IRS, including LEI/CICI, USI and UPI)
 - Timing for end users: 48 hours after execution for first year, 36 hours for second year, 24 hours thereafter
 - **Confirmation data**
 - For the first 180 days following the compliance date, reporting end-users may report an image of the confirm
 - After 180 days, must report data fields
 - Timing for end users: 48 hours after confirmation for first year, 36 hours for second year, 24 hours thereafter
 - Continuation data
 - Life cycle vs. snapshot
 - May choose to report **life cycle events** (a change occurs in any of the primary economic terms data fields, such as a novation or termination of the swap) (within 2 business days of relevant change during first year of compliance, and within 1 business day thereafter) or
 - Daily **snapshot** (if applicable for the swap in question) of “state data” (daily view of the PET of the swap); plus

Swap Reporting; LEI/CICI (cont'd)

- Part 45—swap data reporting (cont'd)
 - Continuation data (cont'd)
 - Quarterly **valuation data** report
 - Daily mark as of last day of each fiscal quarter (report submitted within 30 calendar days of quarter end)
 - If daily mark not available, may report current valuation of swap on its books
 - Compliance is required starting **April 10, 2013**
 - Reporting hierarchy for off-facility swaps same as for Part 43, but where only one counterparty to a swap is a U.S. person, the U.S. person must report the swap
 - Inter-affiliate trades do have to be reported under Part 45
 - No exemption for FX swaps and FX forwards
 - Timing for end-user reporting counterparties
 - As soon as technically practicable, but with phased-in reporting deadlines

Swap Reporting; LEI/CICI (cont'd)

- Part 46—historical swaps
 - For swaps outstanding as of April 25, 2011
 - **Initial data report** to an SDR of the minimum primary economic terms in party's possession on or after such date
 - For each Pre-Enactment Swap or Transition Swap in existence on or after April 25, 2011 that remains uncleared, throughout the existence of the swap following April 10, 2013, the reporting counterparty will report all continuation data required to be reported as described above (except that when reporting changes to primary economic terms data under Part 46, only changes to the minimum primary economic terms data reported in the initial report made for such swap will need to be reported)
 - For expired or terminated historical swaps
 - Expired pre-enactment swaps—the information related to the transaction terms possessed by the reporting counterparty as of October 14, 2010, in any format selected by it
 - Expired transition swaps—the information related to the transaction terms possessed by the reporting counterparty as of December 17, 2010, in any format selected by it

Swap Reporting; LEI/CICI (cont'd)

- Part 46—historical swaps (cont'd)
 - Compliance is required starting **April 10, 2013**
 - As with Part 45, inter-affiliate trades do have to be reported under Part 46
 - Reporting hierarchy same as for Part 45
 - No exemption for FX swaps and FX forwards
- Legal entity identifier (“**LEI**”)
 - To enter into a swap, an end-user will need to provide its LEI to its counterparty
 - CFTC Interim Compliant Identifiers (“**CICIs**”) are an interim solution to the LEI requirement. LEIs are intended to be suitable for trading globally, and implementation of an LEI system has been delayed by the CFTC until a global LEI solution has been implemented, at which time it is anticipated that CICIs will become LEIs.
 - An LEI/CICI can be obtained from DTCC-SWIFT’s CICI Utility at <http://www.ciciutility.org>.

Swap Data Repositories

- Swap data repositories (“**SDRs**”) are new creatures of Dodd-Frank. They exist in order to provide central facilities for swap data reporting and recordkeeping.
 - Under Dodd-Frank, all swaps that fall under the CFTC’s jurisdiction, whether cleared or uncleared, are required to be reported to a registered SDR.
 - Dodd-Frank added new Section 21 to the CEA, governing registration and regulation of SDRs and establishing registration requirements and core duties and responsibilities for SDRs.
 - SDRs are required to register with the CFTC and comply with rules promulgated by the CFTC, including real-time public reporting of swap transaction and pricing data.

Swap Data Repositories (cont'd)

- Currently four SDRs are provisionally registered with the CFTC:
 - Chicago Mercantile Exchange Inc. (pending; provisionally registered)—interest rate, credit, foreign exchange and other commodities.
 - DTCC Data Repository (pending; provisionally registered)—interest rate, credit, equity, foreign exchange and other commodities.
 - ICE Trade Vault (pending; provisionally registered)—commodity, credit and foreign exchange.
 - INFX SDR, Inc. (pending)—foreign exchange.
- The SDRs appear to be open to establishing direct lines to reporting counterparties. Market participants should evaluate their own reporting obligations to determine whether it is cost effective to open a direct electronic uplink with an SDR.

Swap Data Repositories (cont'd)

- As with other areas where Dodd-Frank has added new layers of onerous obligations, middleware solutions are springing up to help market participants comply. Among other service providers are:
 - MarkitWire (interest rates)
 - SWIFT (FX)
 - CLS Group (FX)
 - SunGard (focus on energy)

Swap Execution Facilities

- To promote pre-trade price transparency, Dodd-Frank requires that all swaps that are required to be cleared be executed on a designated contract market (“**DCM**”) or swap execution facility (“**SEF**”), unless the swap type is not available for trading on any DCM or SEF, or another clearing exception applies.
- SEFs are a brand new type of regulated marketplace created by Dodd-Frank.
- The CFTC has proposed rules governing SEFs (amendments to the CFTC’s Part 37 Rules). The proposed rules subject SEFs to specific transparency requirements related to making bids, offers and trades available to all market participants. The proposed rules permit requests for quotes subject to specific requirements and apply cross-trading rules on the timing of trades.

Swap Execution Facilities (cont'd)

- With phased-in mandatory clearing rapidly approaching for specified IRS and CDS, there is concern in the marketplace that the final SEF rules are not yet in place.
- Recent reports reflect a lot of continuing conflicts about how this is going to work out.
- There is also concern among the buy-side that the five request for quotes (RFQ) rule proposed by the CFTC would result in increased transaction costs.

Extraterritoriality

- Perhaps the most controversial issue to be addressed relates to the extraterritorial application of Title VII and the harmonization of Title VII requirements (and effective dates under Title VII) with foreign (non-U.S.) requirements
- In June 2012, the CFTC issued an exemptive order and also proposed cross border guidance, which permitted delayed compliance with certain Title VII requirements for foreign entities.
- The guidance
 - distinguished between “Entity-level” requirements and “Transaction-level” requirements of Title VII
 - defined who is a U.S. Person for cross-border purposes
 - addressed how Title VII should apply to foreign branches, subsidiaries and affiliates of U.S. Persons, as well as how guarantees by U.S. Persons might impact these considerations
 - contemplated, in the case of some Entity-level requirements, potential “Substituted Compliance” based on comparably robust home country regulation

Extraterritoriality (cont'd)

- Market participants commented extensively.
- The CFTC and SEC had committed to provide definitive guidance before December 2012 (registration deadline for SDs).
- In December 2012, the CFTC extended the exemptive order delaying compliance and modifying the “U.S. person” definition. The SEC staff has stated that finalizing cross-border guidance is an important priority for the agency.

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- In January 2013, the OCC published guidance notifying federally-chartered insured depository institutions that the OCC was prepared to grant applications to delay compliance with Section 716 (the “Swaps Pushout Rule”) for up to two years.
- The Swaps Pushout Rule will become effective on July 16, 2013.
- According to media reports, several banks were granted the additional two years.
- There are legislative proposals that also would address the Swaps Pushout Rule.