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The ISDA and Markit Compliance Solution

ISDA<sup>®</sup> | Safe,  
Efficient  
Markets  
markit<sup>®</sup>

# ISDA and Markit: Documentation Compliance Webinar

June 2012

## Welcome and intro

**Eric Maldonado** \ Managing Director, Markit

## External preparation for the CFTC External Business Conduct Rule

**Jeff Robins** \ Partner, Cadwalader Wickersham & Taft LLP

## ISDA's role in this initiative

**Katherine Darras** \ General Counsel Americas, ISDA

## Markit/ISDA Solution

**Eric Maldonado** \ Managing Director, Markit

**C A D W A L A D E R**

Cadwalader, Wickersham & Taft LLP  
New York London Charlotte Washington Beijing

**International Swaps and Derivatives Association**

**Dodd-Frank Initiative:**

**Preparation for the CFTC External  
Business Conduct Rule**

**June 27, 2012**

Jeffrey L. Robins

# Impact on Buy-side

- CFTC business conduct rules regulate the activities of swap dealers (and major swap participants) in transacting swaps with buy-side institutions.
  - Direct impact is on swap dealers and MSPs but counterparties are also affected.
- SDs and MSPs are required to obtain certain information and must conduct intrusive diligence on their counterparties, unless the counterparty provides adequate representations and certain safe harbors are used.
- Buy-side must be prepared to provide information and assess ability and willingness to give various representations.
- Parties should prepare now to ensure that trading can continue uninterrupted.

# Scope of the EBCR

- **Know Your Counterparty.** SDs must collect “essential facts” about counterparties.
- **True Name and Owner.** SDs must collect specified name and address information from counterparties, guarantors and control persons.
- **Disclosures.** Relationship and transaction-specific.
- **Confidentiality.** New regulatory standards for treatment of customer confidential information.
- **Counterparty Eligibility.** SDs must verify ECP and Special Entity status.
- **Suitability.** Requirements apply when an SD makes a “recommendation” to a counterparty.
- **Special Entities.** SDs subject to burdensome rules when advising or transacting with SEs.

# Issues that require active Buy-side Preparation to Trade

- **Know Your Counterparty.**
  - All information needed to comply with rules and regulations.
  - Authority of persons to act for CP.
- **True Name and Owner.**
- **Counterparty Eligibility.**
  - CPs will need to identify how they meet ECP status.
- **Suitability.**
  - In order to avoid burdensome and time-consuming regulations, CPs must provide certain representations to qualify for “institutional suitability.” This includes policies and procedures and qualified agent requirements.
- **Duties to Special Entities.**

# Reliance on Representations and Standardized Disclosures

- **CP Representations**
  - SDs may reasonably rely on the representations of CPs in lieu of diligence if the CP agrees to update representations.
- **Disclosures**
  - SDs may provide CPs with standardized disclosures for certain swaps (e.g. for swaps that are commonly used), if CP agrees to receive disclosures in this manner.
  - Disclosures must be provided prior to trading.
  - Parties to a swap must agree upon the methods for disclosure.
  - Disclosures are not generally required for anonymous exchange- or SEF-based transactions.

# “Know Your Counterparty”

- **In General**

- General CP information must be obtained before trading commences.
- The KYC rule does not apply for anonymous exchange-based transactions.

- **“Essential Facts”**

- Broadly defined, all facts necessary to comply with regulation, for SD risk management, and authority of CP personnel.

- **Financial Entities**

- Extremely complicated definition; end-users should consider immediately whether they meet this status.

# True Name and Owner

- Most information will already have been provided at the time the relationship was established
- Rule requires specific information that may not have been provided in all cases, or that may have become outdated, including:
  - “principal occupation or business”;
  - name and address of any guarantors; and
  - name and address of persons exercising control with respect to positions of the counterparty.

# Eligibility to Trade

- **Eligible Contract Participants (ECPs)**
  - Status is required for all non-exchange-based swaps.
  - Detailed, extensive definition. CPs must identify how they meet it.
  - Particularly complex for small funds/commodity pools; SDs will be required to inquire into assets and, in some cases, types of trading activities.
- **Special Entities**
  - Generally includes: (1) governmental entities (federal/state/local); (2) ERISA plans; (3) government plans; (4) endowments; (4) employee benefit plans electing for SE status.

# Continuing Eligibility as an ECP after December 31

- **ECP Status Changes for certain entities after December 31. The change will affect:**
  - Commodity Pools that currently meet the ECP definition exclusively through 1a(18)(v) (e.g., having total assets in excess of \$10 million).
  - Commodity Pools entering into Retail FX transactions (pass-through statutory amendments).
- **Parties may wish to represent in advance (*i.e.*, as to continuing status), so that documentation does not need to be changed both before October business conduct deadline and in 2013.**

# Institutional Suitability (General)

- In general, an SD that makes a “recommendation” to a CP is subject to suitability requirements.
  - Rules similar to current FINRA rules.
  - Require “reasonable diligence” and a “reasonable basis” to establish suitability.
  - Will require CPs to request detailed information from CP to comply.

# Institutional Suitability (Safe Harbor)

- **Safe Harbor Requirements**

- SD must determine that the CP or its agent is capable of “independently” evaluating the risks of a swap and is exercising independent judgment.
- Can be established through representations of CP and or its agent, BUT
- CP must represent that it has complied in good faith with written policies and procedures reasonably designed to ensure that the persons responsible for evaluating recommendations and making trading decisions are capable of doing so.

# Duties to Special Entities

- **Swap Dealers are subject to heightened duties when acting either as counterparties or as advisors to Special Entities.**
- **As Counterparty:** SD must establish a reasonable basis to believe the SE has a qualified independent representative meeting specified criteria.
- **As Advisor** (applies when SD “recommends” a “tailored swap” to an SE): unless safe harbor met, SD must determine that a swap/strategy is in the “best interests” of the SE.

# Duties to Special Entities: Safe Harbors

- As Counterparties

- SD must conduct independent diligence unless both the SE and its designated representative make specified representations to the SD (and each requires representations as to the existence of relevant written policies and procedures in most cases).

- As Advisors

- SD must conduct intrusive diligence to satisfy the “best efforts” standard, unless both the SE and its designated representative make specified representations and the safe harbor is otherwise satisfied.
- ERISA SEs: can use a “strong” or more limited safe harbor.
- Other SEs: limited safe harbor only

# Other Issues – Time is of the Essence

- **Dealers required to provide pre-trade marks to counterparties.**
  - Could result in material trading delays.
- **Rapid Timing in Reporting Obligations.**
  - Trade reporting obligations require extremely fast determinations. SDs will need CPs to act with speed in order to meet obligations.
- **Disclosures, Diligence Requirements.**
  - Trading will be materially slowed by these various requirements.
  - Safe harbors can alleviate the burdens; but delays may be inevitable for certain types of swaps and swap counterparties.

# Rules Yet to Come ...

- Beyond focus on near term requirements, buy-side participants should be mindful that of forthcoming rules that will require preparation, including:
  - Margin;
  - Swap documentation;
  - Portfolio reconciliation and compression;
  - Swap confirmations.

# ISDA DF Protocol (I)

- **ISDA is preparing a DF Protocol that is designed to supplement all master agreements under which swaps are traded between a swap dealer and another party.**
  - Will cover ISDA Master Agreements and other agreements governing swaps.
- **The DF Protocol is generally intended to cover the CFTC External Business Conduct Rules and other final CFTC rules under Dodd-Frank that affect swap documentation.**
  - The Protocol will cover core standardized provisions required under the rules; however, parties may need to further amend documentation to meet specific needs.
  - Further amendments may be required as additional SEC and CFTC rules are adopted.

# ISDA DF Protocol (II)

- **Parties may enter into the DF Supplement by exchanging Questionnaires.**
  - This may be accomplished bilaterally or through a third-party vendor.
  - ISDA is working with Markit to provide a vendor solution.
- **The DF Protocol will consist of:**
  - **(1) A Protocol** (mechanism for amending documents);
  - **(2) A Supplement** (material terms being added);
    - The Supplement will contain general terms, and schedules covering safe harbors that parties may elect to enter into (*e.g.*, for institutional safe harbor, and for each type of Special Entity safe harbor).
  - **(3) A Questionnaire** (information about parties, elections).

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## ISDA mandate

- ISDA D-F Protocol has Schedules that provide agreements between Swap Dealers and their counterparties
- The ISDA and Markit online questionnaire which accompanies the Protocol allows sell side and buy side to amend multiple Masters at once

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### General Questions

All participants answer certain basic questions (name, address, type of entity)

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### Entity Specific Questions

Other (eg  
hedge  
fund)

Swap Dealer

Special Entity

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### Amend ISDA Master by accepting Schedules

Schedules  
1, 2,3

Schedules  
1-6

Schedules  
1, 2, 4, 5, 6

The ISDA Compliance Solution offers an online interface that provides users with an automated execution facility for

- Confirming counterparties
- Delivering a completed questionnaire to each relevant counterparty
- Reporting that allows users to see the status of their existing counterparties as it relates to accepting schedules
- Downloading to Excel or CSV in case a user wants to analyze the data

## ISDA

## Complete Questionnaire

PCA PRINCIPAL TYPE 

Save

QUESTIONS 1-5 COMPLETION METHOD:  Upload Enter

Cancel

 Fiduciary Same as Third Party Control Person

Eligible Contract Participant:

 iii) Financial Institution ix) Employee Benefit Plan Subject to ERISAFinancial Entity 

Special Entity Type:

 iii) ERISA Special Entity

ERISA Special Entity:

 Agrees to Schedule 5 Agrees to Schedule 6

Fiduciary:

 Agrees to Schedule 5 Agrees to Schedule 6

# Answer questionnaire

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Welcome, User | Logout | Support | Settings | Search MDE...

Doc Exchange | ISDA | FATCA | LEI | MDE

### ISDA

Complete Questionnaire

PCA PRINCIPAL TYPE: Swap Dealer [Save]

QUESTIONS 1-5 COMPLETION METHOD: Upload [Save] / Enter

Legal Entity ID: Enter Legal Entity ID

True Name: Enter True Name

Address Line 1: Enter Address Line 1

Address Line 2: Enter Address Line 2

City, ST ZIP: Enter City [ST] ZIP

Phone: ( ) -

Fax: ( ) -

Email Address: Enter Email Address

Contact for Complaints

Address Line 1: Enter Address Line 1

Address Line 2: Enter Address Line 2

City, ST ZIP: Enter City [ST] ZIP

Phone: ( ) -

Fax: ( ) -

Email Address: Enter Email Address

Principal Occupation or Business: Enter Principal Occupation or Business

Guarantor Name: Enter Guarantor Name

Address Line 1: Enter Address Line 1

Address Line 2: Enter Address Line 2

City, ST ZIP: Enter City [ST] ZIP

Phone: ( ) -

Fax: ( ) -

Email Address: Enter Email Address

Third Party Control Person Name: Enter Third Party Control Person Name

Address Line 1: Enter Address Line 1

Address Line 2: Enter Address Line 2

City, ST ZIP: Enter City [ST] ZIP

Phone: ( ) -

Fax: ( ) -

Email Address: Enter Email Address

Eligible Contract Participant:

- i) Swap Dealer or Security-Based Swap Dealer
- ii) Financial Institution
- iii) investment company
- iv) assets exceeding \$10,000,000
- v) broker or dealer
- vi) broker or dealer
- vii) investment bank holding company
- viii) FCM (other than person or a foreign person)
- ix) FCM is person or foreign person
- x) floor broker or trader

Swap Dealer:

- Agrees to Schedule 3
- Agrees to Schedule 4
- Agrees to Schedule 5
- Agrees to Schedule 6

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The Questionnaire is divided into 3 sections:

- Reference data
- Principal Type selection
- Free form text and multiple choice

## PCA principal type

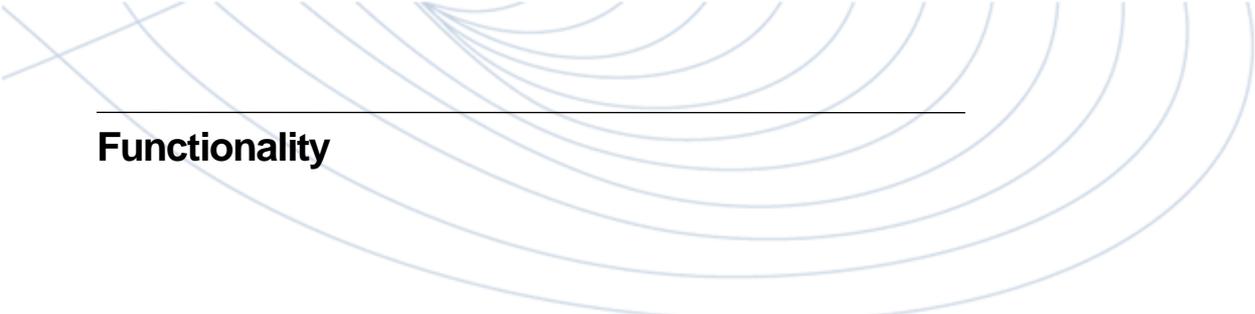
- Depending on the PCA Principal Type selected, the system will ask only a subset of all the questions
- The PCA Principal Type, combined with the answers to the selected questions, will lead to the user to the Schedules for Acceptance

**Manage Questionnaire Response Sets**

PCA PRINCIPAL TYPE:  LEGAL ENTITY IDENTIFIER (LEI):

INCLUDE SMT

Accts		Count to CPs		Primary	Type	FCP	Fin. Entry	SE	Sub	Primary	Govt
20		20		Best Fd	ERISA	g	N	ff	5	5,6	
150		20		Best Fd	ERISA	cc	N	ff	6	5,6	
200		20		Best Fd	ERISA	vb	N	ff	6	5,6	

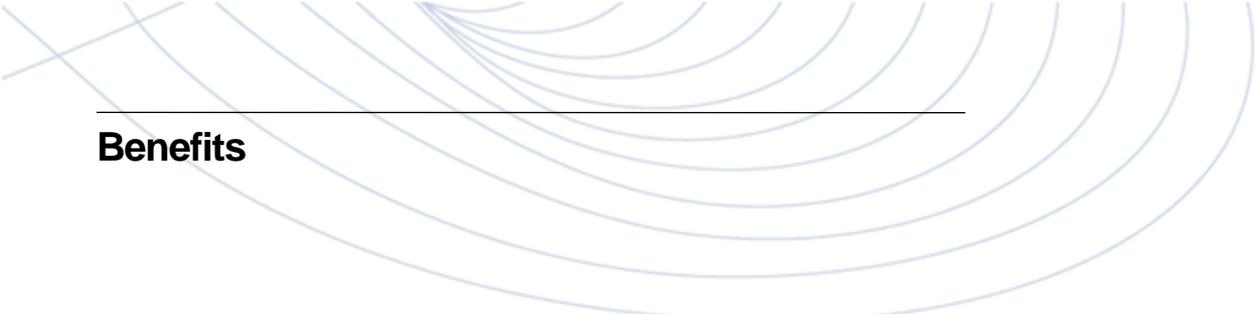


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## Functionality

## Dashboard

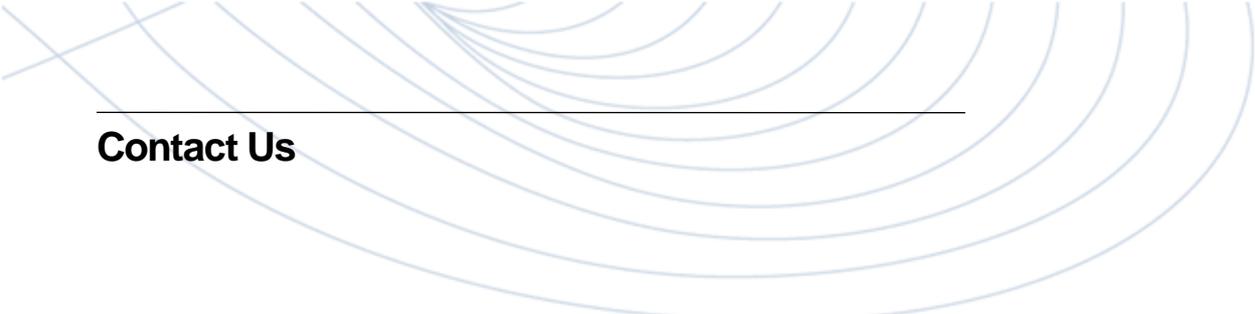
- Count of Matched
- Count of not Matched
- Missing (Sent – Received)
- Requests Received
- Messages and Alerts



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## Benefits

- Reduce Costs
- Provides technology based solution
- Stores complete audit trail and reporting capabilities
- Leverages secure, redundant MDE infrastructure
- Extensible platform for wider and future use
- No fee for buy side



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## Contact Us

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Thank you.

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