TEIGLAND-HUNT LLP

CLIENT ALERT
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Ready, Set, Clear: FIA and ISDA publish standardized agreement addressing execution issues for cleared swaps

- *"FIA-ISDA Cleared Derivatives Execution Agreement" now published*
- *Standardized swap addendum for clearing agreements to follow*

Background

In anticipation of growing demand for swap clearing with the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] (the "Dodd-Frank Act"), the Futures Industry Association (FIA) and the International Swaps and Derivatives Association, Inc. (ISDA) today published their first standardized form of agreement covering cleared swaps. The "Cleared Derivatives Execution Agreement" will allow parties entering into swaps that are intended to be cleared to address certain issues that may arise in connection with the *execution* of such transactions. In the near future FIA also will be publishing a standardized form of addendum for futures clearing agreements between customers and their futures commission merchants (FCMs) that addresses terms related to the *clearing* of swaps. A brief description of these two documentation initiatives is provided below.

Purpose of the FIA-ISDA Cleared Derivatives Execution Agreement (the "Execution Agreement")

As participants in the energy and rate swap markets know, swaps in these asset classes have been cleared for nearly 10 years without the use of an industry standard agreement that governs execution. However, industry demand for a standardized document addressing certain issues related to the execution of swaps that are intended to be cleared emerged with the prospect of a larger and more diverse cleared swap market.

The Execution Agreement attempts to address some potential execution issues by:

- Requiring each party to a swap that is intended to be cleared to represent that it has appropriate clearing arrangements in place to allow a trade to clear and that it

[1] Section 723 of the Dodd-Frank Act mandates that certain swaps be cleared by a derivatives clearing organization.

will comply with applicable rules and regulations in engaging in swap transactions that are intended to be cleared;
- Requiring each party to assume specific responsibilities in confirming trades that are intended to be cleared and submitting them for clearing;
- Allocating liability for damages (or "breakage") between the parties should a trade fail to clear.

While the main purpose of the Execution Agreement is to allow swap counterparties to address the above terms bilaterally, the agreement also includes two optional annexes that, if applied, would require one or both of the parties' FCMs to be a party to the agreement as well. The annexes effectively require an FCM to commit to clear swaps submitted by the parties and give the FCM the ability to impose limits on the amount and kinds of trades that the parties can execute with each other. During the development of the Execution Agreement, several buy side members of the working group raised a number of questions and concerns about how this potential "trilateral" arrangement would be administered in practice, and it is expected that these issues will be discussed further in future working group meetings.

FIA and ISDA also have published an explanatory memo addressing the purposes and content of the Execution Agreement. The memo notes that the Execution Agreement is not necessary or appropriate under all circumstances and that FIA and ISDA recognize that many provisions may be superseded by new regulatory requirements as well as the specific rules of individual swap execution facilities and derivatives clearing organizations (DCOs). Nonetheless, it is expected that certain firms will seek to put the Execution Agreement in place with their counterparties, particularly if they have reason to believe that the breakage that may result from the failure of a swap to clear could be material.

The Execution Agreement is available from FIA's website (www.futuresindustry.com) and ISDA's website (www.isda.org) as a free download. FIA also intends to make the Execution Agreement available through its Electronic Give-Up Agreement System (EGUS) in the coming weeks.

Purpose of FIA's Cleared Derivatives Transactions Addendum (the "FIA Addendum") for Futures Clearing Agreements

As noted above, the FIA Addendum will be published separately in the near future. It is intended to supplement the terms of a futures clearing agreement between an FCM and its customer to allow for the clearing of swaps. The FIA Addendum is considered to be necessary because futures clearing agreements typically do not expressly cover cleared swaps, and the clearing of swaps can present unique issues (due, for example, to the fact that many swaps are executed off-exchange). Unlike the addenda published previously that were specific to particular DCOs[2], the FIA Addendum is generic in nature and is expected to replace the DCO-specific addenda.

The provisions of the FIA Addendum are for the most part finalized, with only a few issues remaining to be resolved (namely, issues related to tax, ERISA and the enforceability of close-out netting in bankruptcy). FIA is working to resolve these remaining issues as soon as possible so that a final version of the FIA Addendum can be published by FIA. When published, the FIA Addendum will be available from FIA's website (www.futuresindustry.org) as a free download.

Despite the few remaining open points cited above, several market participants have begun to negotiate the FIA Addendum in its current form with their FCMs in an effort to ensure they have the necessary documentation in place prior to the date on which final rules that mandate clearing become effective (expected as early as year-end 2011 or first half 2012). Proactive customers should consider approaching their FCMs now about negotiating the FIA Addendum if they expect to engage in swap clearing.

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If you have any questions regarding the FIA-ISDA Execution Agreement or the FIA Addendum, please contact one of the following:

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[2] For example, clearing addenda were previously developed for clearing swaps through the Chicago Mercantile Exchange (CME) and ICE Trust.