



## CLIENT ALERT

August 17, 2012

# ISDA Publishes August 2012 DF Protocol to Address Swap Dealer Business Conduct Standards, Other Rules

Earlier this week ISDA published the [ISDA August 2012 DF Protocol](#) (the “**DF Protocol**”), which is now open for adherence.

- o ***What It Does:** By adhering to the DF Protocol, parties will amend and supplement swap trading documentation to facilitate compliance with a number of final Commodity Futures Trading Commission (“**CFTC**”) rules, including the CFTC’s new business conduct standards for swap dealers (the “**Business Conduct Standards**”).*
- o ***Why:** The October 15, 2012 compliance deadline for the Business Conduct Standards is rapidly approaching. Consequently, market participants that intend to trade swaps on and after this deadline must address these requirements in a timely manner in order to comply with the relevant rules. ISDA expects that the DF Protocol will facilitate compliance by reducing the likelihood of “disruptions to trading” that could accompany a slower, bilateral approach to amending swap trading documentation.*

## Introduction

The DF Protocol was developed by ISDA in response to various CFTC rules<sup>1</sup> (the “**Relevant Rules**”) that were recently promulgated under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Many of the Relevant Rules come into effect in October 2012 and impose new and detailed compliance obligations on swap dealers and major swap participants.

One of the primary functions of the DF Protocol is to facilitate the gathering of information that swap dealers need to determine and satisfy certain compliance obligations with respect to individual counterparties. In addition the DF Protocol provides a mechanism for obtaining the representations and agreements needed to allow swap dealers to rely on various safe harbors available under the Relevant Rules and an efficient means by which swaps dealers can deliver new required disclosures to their

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<sup>1</sup> The rules addressed by the Protocol are: (1) CFTC, Final Rule, *Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties*, 77 Fed. Reg. 9734 (Feb. 17, 2012); (2) CFTC, Final Rule, *Large Trader Reporting for Physical Commodity Swaps*, 76 Fed. Reg. 43851 (July 22, 2011); (3) CFTC, Final Rule, *Position Limits for Futures and Swaps*, 76 Fed. Reg. 71626 (Nov. 18, 2011); (4) CFTC, Final Rule, *Real-Time Public Reporting of Swap Transaction Data*, 77 Fed. Reg. 1182 (Jan. 9, 2012); (5) CFTC, Final Rule, *Swap Data Recordkeeping and Reporting Requirements*, 77 Fed. Reg. 2136 (Jan. 13, 2012); (6) CFTC, Final Rule, *Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants*, 77 Fed. Reg. 20128 (Apr. 3, 2012); and (7) CFTC, Final Rule, *Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps*, 77 Fed. Reg. 35200 (June 12, 2012).



counterparties. The DF Protocol also addresses certain practical problems that appear to arise from the Relevant Rules.

More specifically, much of the DF Protocol is aimed at addressing the requirements of the Business Conduct Standards, such as the new “know-your-counterparty” rules that require swap dealers to collect certain information from their counterparties. In addition the DF Protocol addresses a swap dealer’s obligations to assess the suitability of swap transactions for counterparties and additional duties when dealing with “special entities” (such as pension funds and governmental entities) and the safe harbors available in respect of such obligations and duties under the Relevant Rules.

### ***DF Protocol Architecture***

The architecture for the DF Protocol is unique and somewhat complex relative to other ISDA protocols given the variety of counterparties that it is intended to address. Adherence to past ISDA protocols was achieved by the submission of a duly executed adherence letter to ISDA. With the DF Protocol, ISDA has introduced a new step in the protocol process – the bilateral exchange of questionnaires - in order to provide confidentiality to the information that must be submitted by adherents to the DF Protocol. Only the exchange of DF Questionnaires (described below) between two parties will cause the swap trading documentation between them to be amended by the DF Protocol.<sup>2</sup>

The DF Protocol documentation consists of the following four documents:

- the ISDA August 2012 DF Protocol Agreement (the “**DF Protocol Agreement**”);
- the ISDA August 2012 DF Protocol Questionnaire (the “**DF Questionnaire**”);
- the ISDA August 2012 DF Supplement (the “**DF Supplement**”); and
- the ISDA August 2012 DF Terms Agreement (the “**DF Terms Agreement**”).

The following is a brief description of the purpose of each of these documents. All of these documents, an FAQ guide and a description of the adherence process are available on ISDA’s website at <http://www2.isda.org/dodd-frank-documentation-initiative/>.

#### **a. DF Protocol Agreement**

Only parties that have adhered to the DF Protocol Agreement can supplement existing swap trading agreements and enter into DF Terms Agreements (described below) using the DF Protocol. Adherence to the DF Protocol Agreement is evidenced by the execution and online delivery (via ISDA’s website) of an adherence letter in the form attached to the DF Protocol Agreement as an exhibit. ISDA will publish a list of adhering parties on its website so that DF Protocol participants can see which of their counterparties have adhered to the DF Protocol.

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<sup>2</sup> Market participants should also note that the DF Protocol architecture is designed to allow an agent, such as an investment manager, to adhere on behalf of multiple principals but only if the agent signed the original swap trading documentation.

## **b. DF Questionnaire**

The DF Questionnaire solicits information that confirms the identity and address of an adherent to the DF Protocol and, if applicable, those of its agents that are responsible for evaluating swaps on the adherent's behalf. In addition the DF Questionnaire requires information that will establish the adherent's entity status under the Relevant Rules (e.g., whether the adherent is a Special Entity, Swap Dealer, Financial Entity) to allow swap dealers to determine their compliance duties with respect to the adherent as a trading counterparty. It also allows parties to agree to incorporate parts of the DF Supplement into their swap trading documentation.

## **c. DF Supplement**

The DF Protocol allows parties to amend and supplement their swap trading documentation with certain provisions by electing to incorporate schedules set out in the DF Supplement. The DF Supplement is comprised of six schedules. Similar to the questions set out in the DF Questionnaire, not all of the schedules are relevant to all market participants.

Schedule 1 (containing definitions used throughout the DF Supplement) and Schedule 2 of the DF Supplement apply automatically to all adherents to the DF Protocol. Schedule 2 in particular serves several purposes and addresses a number of topics that are broadly applicable (although certain of its provisions will not be relevant to some market participants). Its initial provisions establish the basis on which swap dealers can rely on the representations and agreements made in the DF Questionnaire and the DF Supplement in order to satisfy their compliance obligations under the Business Conduct Standards. Importantly, Schedule 2 provides that an event of default, termination event or other similar event will not occur under any contract between adhering parties solely on the basis of a misrepresentation provided only in the DF Questionnaire or the DF Supplement or a breach of a covenant under the DF Supplement.<sup>3</sup> Schedule 2 then sets out representations and agreements addressing various subjects, including reporting, the treatment of certain material confidential information, and rights concerning daily marks and scenario analyses. It also contains several notifications that swap dealers are required to deliver to their counterparties under the Business Conduct Standards.

The applicability of Schedules 3 through 6 depends on a counterparty's entity status. Each of these schedules is designed primarily to provide swap dealers with the representations and agreements necessary to permit them to rely on certain safe harbors set out in the Business Conduct Standards. Schedule 3 addresses suitability obligations of swap dealers to entities that are not Special Entities. Schedule 4 relates to non-ERISA Special Entities and contains representations and agreements designed to ensure that a swap dealer will not be considered to be acting as an advisor when dealing with such an entity. Schedules 5 and 6 serve substantially the same purpose with respect to ERISA Special Entities.

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<sup>3</sup> It should be noted, however, that parties adhering to the Protocol expressly acknowledge that reliance will be placed on the representations given in these documents.



**d. DF Terms Agreement**

The DF Terms Agreement gives DF Protocol the opportunity to apply the DF Protocol to swap trading activities (e.g., swaps that are intended to be cleared or given up to prime brokers) that are not governed by an existing written agreement between the executing parties.

***DF Protocol Adherence***

**a. Adherence Letters**

Duly executed adherence letters must be submitted through the “Protocol Management” section of ISDA’s website prior to the “Adherence Cut-off Date”. Presently there is no fixed Adherence Cut-off Date, but ISDA has reserved the right to establish a deadline for adherence by giving 30 days’ notice on the “ISDA August 2012 DF Protocol” section of its website.

**b. Exchanging DF Questionnaires**

As noted above, DF Protocol participants must exchange DF Questionnaires in order to effectively amend and supplement their swap trading documentation based on the terms of the DF Protocol. When adhering to the DF Protocol, adherents must specify the methods by which they are willing to receive these DF Questionnaires from other adherents. To facilitate the exchange of the DF Questionnaires, ISDA and Markit have developed an online platform called “ISDA Amend” as one of the possible methods for receiving DF Questionnaires from trading counterparties. The DF Protocol Agreement also permits adherents to elect to receive DF Questionnaires in hard copy, by fax or via e-mail or other electronic messaging system.

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***If you have any questions regarding the ISDA August 2012 DF Protocol,  
please contact one of the following:***

**Lauren Teigland-Hunt +1 212 269 1002 [lteigland@t-hllp.com](mailto:lteigland@t-hllp.com)**

**GuyLaine Charles +1 212 269 1016 [gcharles@t-hllp.com](mailto:gcharles@t-hllp.com)**

**Alex Hunt +1 212 269 5371 [ahunt@t-hllp.com](mailto:ahunt@t-hllp.com)**

Teigland-Hunt LLP  
127 West 24th Street, 4th Fl, New York, NY 10011  
[www.t-hllp.com](http://www.t-hllp.com)



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