ISDA PUBLISHES DF PROTOCOL EXTENSION AGREEMENT LINKING DODD-FRANK PROTOCOL TO EMIR PROTOCOL

The European Market Infrastructure Regulation ("EMIR") is a comprehensive European Union regulatory regime created to increase the stability and oversight of European OTC derivatives trading. EMIR applies generally to European entities trading in OTC derivatives, including trading activities with non-European counterparties.

As part of this oversight, EMIR requires parties to OTC derivatives transactions to adopt processes and procedures to mitigate and track risk by conducting portfolio reconciliation. The EMIR requirements regarding portfolio reconciliation and dispute resolution became effective on September 15. In July, ISDA published the ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol (the "ISDA July EMIR Protocol"), to help trading parties amend their existing ISDAs to meet the EMIR portfolio reconciliation requirements.

On September 10, 2013, ISDA published the ISDA OF Protocol Extension: EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure agreement (the "Extension Agreement") to address portfolio reconciliation requirements set forth under EMIR. The Extension Agreement provides an alternative to adhering to the ISDA July EMIR Protocol.

EXTENSION AGREEMENT BUILDS ON DODD-FRANK PROTOCOL ADHERENCE

The Extension Agreement allows parties that have adhered to the ISDA March 2013 DF Protocol ("DF Protocol 2") to adopt the EMIR portfolio reconciliation requirements without adhering to the ISDA July EMIR Protocol. Only parties that have adhered to DF Protocol 2 and that have matched as counterparties may enter into an Extension Agreement. The Extension Agreement amends Schedule 4 of DF Protocol 2 to reference the portfolio reconciliation requirements under EMIR.

The portfolio reconciliation requirements under EMIR are similar (but not identical) to Dodd-Frank; several provisions in the Extension Agreement change references in Schedule 4 to DF Protocol 2 to refer to the terms and requirements of EMIR regarding portfolio reconciliation. However, since there are differences between the dispute resolution requirements under Dodd-Frank and EMIR, the Extension Agreement incorporates the dispute resolution provisions from the ISDA July EMIR Protocol.

ISDA notes that the Extension Agreement is not intended to achieve "super-compliance", which means that it does not include provisions that are strict enough to meet all of the relevant CFTC requirements under the Dodd-Frank Act and all of the relevant EMIR requirements in relation to portfolio reconciliation and dispute resolution.

BILATERAL AGREEMENT

Unlike the ISDA July EMIR Protocol, the Extension Agreement is a bilateral agreement. End-users must enter into a separate Extension Agreement with each swap dealer counterparty. Because the Extension Agreement is bilateral, end users may apply different terms between counterparties. For example, an entity could elect to send portfolio data to one dealer, but to receive portfolio data from other dealers.

TERMINATION OPTION

Parties to the Extension Agreement may include an optional termination provision, which would allow the agreement to be terminated by either party. Under the ISDA published form, the parties may select from one of the several forms of termination mechanisms. The termination right gives the Extension Agreement greater flexibility than a protocol in light of uncertainty regarding equivalent regulatory regimes. If, in the future, parties are able to comply solely with the portfolio reconciliation and dispute resolution rules in the Dodd-Frank Act - and not those set forth under EMIR - the Extension Agreement could be terminated. The ISDA July EMIR Protocol, by contrast, may not be revoked by an adhering party.

To view ISDA's explanatory memorandum, click here.

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