

FS Regulatory Brief

CFTC delivers holiday gift to Wall Street

Delays EBC and Documentation Requirements

December 2012

The Commodity Futures Trading Commission (CFTC) gave swap dealers a just-in-time reprieve from the year-end deadline to comply with most of the external business conduct and swap documentation duties to counterparties. A new **Interim Final Rule** released on December 18, 2012 goes beyond the no-action relief offered by the CFTC thus far to provide a formal extension of compliance deadlines from January 1, 2013 to May 1, 2013 for most external business conduct duties, and to July 1, 2013 for portfolio reconciliation and swap documentation rules. The extension is further evidence that the CFTC is listening to legitimate industry concerns.

Our **FS Reg Brief** from last week, ***Is your Counterparty Documented? ISDA Protocol adherence slower than expected***, anticipated the CFTC's grant of this relief as a result of slower than expected adherence to the new ISDA Dodd Frank Protocol. This **FS Reg Brief** describes the impact of the Interim Final Rule on registering swap dealers as well as the significant deadlines that remain.

What was delayed?

Among the key requirements delayed by the Interim Final Rule are the external business conduct duties that have been the subject of concerted efforts by ISDA and Markit to provide standard documentation through the ISDA Dodd-Frank Protocol. Through the protocol, the industry has been seeking to streamline and standardize information exchanged between swap dealers and their counterparties. However, the uptake has been very slow with fewer than 5% of market participants adhering to the protocol thus far.

The following table details the rules that have been delayed and provides the new deadlines:

External Business Conduct and Documentation Rules Delayed

Topic	Rule	Rule Number	New Deadline
External Business Conduct – General Duties	Due Diligence Policies and Procedures	23.402(a)	May 1, 2013
	Know Your Counterparty	23.402(b)	May 1, 2013
	True Name and Owner	23.402(c)	May 1, 2013
	Reliance on Representations, Manner of Disclosure, Format of Disclosure, Record Retention	23.402(d)-(g)	May 1, 2013
Confidential Information	Confidential Treatment of Counterparty Information	23.410(c)	May 1, 2013
Verification of CP Eligibility	Eligible Contract Participant or Special Entity Verification	23.430	May 1, 2013
Disclosures of Material Information	Material Risk Disclosure (risks, characteristics, incentives, conflicts of interest, material economic terms, pre-trade mid-market mark ¹)	23.431(a)	May 1, 2013
	Scenario Analysis	23.431(b), (c)	May 1, 2013
Clearing Disclosures	Clearing Election Notice (elect DCO or elect to clear voluntarily)	23.432	May 1, 2013
Institutional Suitability	“Specific” suitability analysis for recommended swaps or trading strategy for a counterparty	23.434(a)(2), (b), (c)	May 1, 2013
Advisor to Special Entity	“Best interests” determination for swaps recommended to Special Entities	23.440	May 1, 2013
Swaps with a Special Entity	Special Entity must have an independent representative evaluation	23.450	May 1, 2013
Records re: Notice on Complaints	Keep records of notice to counterparty on where to complain	23.201(b)(3)(ii)	May 1, 2013
Portfolio Reconciliation	Reconciliation of swaps not cleared with DCO	23.502	July 1, 2013
Swap Trading Relationship Documentation	Written documentation, including CSAs, regarding terms of trading relationship	23.504	July 1, 2013
End-User Exception Documentation	Documentation of end-user ability to elect exemption from clearing	23.505	May 1, 2013

¹ Separate no action relief was granted on December 18, 2012 for pre-trade mid-market marks for certain credit default swaps and interest rate swaps required by Rule 23.431. Similar relief for certain foreign exchange transactions was issued on December 6, 2012. Generally, swap dealers will not have to provide pre-trade midmarket marks where real-time trade-able bid and offer prices for the covered derivative transactions are available electronically in the marketplace to the counterparty, and the counterparty consents. The CFTC says it will consider extension of the relief to other asset classes as it continues to review the development of the markets.

What was NOT delayed?

The CFTC left the timing of some important external business conduct duties in place. Most importantly, swap dealers must still provide a **post-trade daily mark** to their counterparties beginning on the day they register as a swap dealer. They also must comply with rules pertaining to fraud, fair dealing, pay-to-play, and portfolio compression. The full list is below:

External Business Conduct and Documentation Rules NOT Delayed

Topic	Rule	Rule Number	Deadline
Anti-Fraud	No defrauding a Special Entity	23.410(a), (b)	Date of registration
External Business Conduct	Daily Mark	23.431(d)	Date of registration
Communications and Fair Dealing	Must communicate in a fair and balanced manner	23.433	Date of registration
General Institutional Suitability	Swap recommendation requires general suitability determination	23.434(a)(1)	Date of registration
Political Contributions	Pay-to-play prohibitions	23.451	Date of registration with limited no-action relief
Confirmations	Confirmations must be provided to counterparties as required	23.501	Date of registration
Portfolio Compression	Must perform compressions as required	23.503	Date of registration

What does delay mean for swap dealers registering by year-end?

This last minute reprieve for swap dealers offers a few weeks to pause and enjoy the holidays without worrying about a regulatory big-bang on January 1st.

Nevertheless, operations staff at swap dealers will need to remain engaged as delivery of the **daily mark** and compliance with requirements regarding **confirmations** and **portfolio compressions** begin simultaneously with registration. Of course, the extensive **record keeping** obligations and **swap data reporting** also begin with registration, although the CFTC has already issued no-action relief for some of the more challenging aspects of these requirements.

After returning from the holiday break, newly registered swap dealers will have to renew their efforts to comply with the delayed external business conduct and documentation rules. This effort will not only require a continuing push to get clients to participate in

the ISDA Dodd-Frank Protocol (or other documentation solution), it will also require addressing some challenging questions posed by clients that remain skeptical of the new protections.

Does it matter that relief is in an Interim Final Rule and not a No-Action letter?

The CFTC's use of an Interim Final Rule offers a more robust form of relief than a no-action letter by *formally* moving the compliance date. No-action relief does not suspend a compliance requirement, but instead shelters a swap dealer from adverse regulatory action for non-compliance. Non-compliance with these EBC and documentation requirements may have created a private right of action. No-action relief does not protect firms against private litigation because the compliance obligation still exists. The Interim Final Rule delayed the effective date of the compliance obligation, removing that risk.

The CFTC's decision to issue an interim final rule is a positive sign that the agency appreciates the challenges faced by the industry as firms work toward compliance.

What are next steps now that these deadlines are extended?

For firms and their counterparties that have adhered to the ISDA Dodd-Frank Protocol and matched prior to the official rule compliance date, there remains a question about whether there are any duties owed to those counterparties under the protocol during this interim period. To avoid any misunderstandings, firms are advised to notify counterparties about their intentions during the interim period. We would recommend that business lines work closely with their legal and compliance teams to develop a consistent approach in order to manage counterparty expectations during this interim period.

Remember, the CFTC's action is just a delay. Firms should continue to reach out to counterparties that have yet to match as well as continue to on-board clients that have matched. This effort will avoid a last minute rush that, up until receiving this relief, dealers were experiencing.

For the future: Foot on the gas and eye on good faith compliance

Throughout the rulemaking process, the CFTC has emphasized the importance of "good faith" efforts by the industry to comply with the many new requirements. In issuing the Interim Final Rule, the CFTC was clearly persuaded of the genuine need for relief and made good on its stated commitment to smooth the process of compliance for entities operating in "good faith." Firms will need to continue their "good faith" efforts as they work toward compliance, which will encourage continued flexibility by the CFTC during this implementation phase.

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