
ADOPTING THE MARCH 2013 ISDA PROTOCOL FOR DODD FRANK SWAP REQUIREMENTS

Thompson & Knight Notes on the ISDA March 2013 DF Protocol (also known as Dodd Frank Protocol 2.0) (the “*Protocol*”)

I. Introduction¹

The Protocol is intended to address the requirements of a series of rules adopted by the Commodity Futures Trading Commission (the “*CFTC*”) pursuant to the Dodd–Frank Wall Street Reform and Consumer Protection Act (“*Dodd Frank*”). These rules relate to clearing, portfolio reconciliation, and swap trading documentation.

The CFTC rules covered by the Protocol became effective on July 1, 2013. After that date, swap participants that have not entered into either the Protocol or bilateral arrangements with their swap dealers to ensure compliance with CFTC rules may have difficulty in entering into new swap transactions or materially modifying existing transactions.

In August 2012, ISDA published a protocol (the “*August 2012 Protocol*”) similar in form to the Protocol relating to reporting requirements under Dodd Frank with respect to swaps. The Protocol covers different topics from those covered by the August 2012 Protocol. Even if you have entered into the August 2012 Protocol, you should still enter into the Protocol.

Some banks have developed form amendments to ISDA Master Agreements in order to deal with the requirements of the CFTC rules, and these amendments may be useful to customers that deal with only one or two banks. For market participants that deal with multiple counterparties (or, if participants prefer, even with a single counterparty), ISDA has developed the Protocol to allow the relevant information to be exchanged on a more general basis and to provide a process for amending all ISDA master agreements of a swap participant (each such ISDA master agreement is defined as a “*Protocol Covered Agreement*”). We believe that most independent oil companies will prefer to use the Protocol. The Protocol involves the following documents, which are hyperlinked in this memorandum:

- [ISDA’s online introduction to the Protocol and accompanying FAQ](#) (the “*Introduction*”)
- [The ISDA March 2013 DF Protocol Agreement](#) (the “*Protocol Agreement*”)
- [The ISDA March 2013 DF Supplement](#) (the “*DF Supplement*”)
- [The Adherence Letter to the Protocol](#) (the “*Adherence Letter*”)

¹ This memorandum has been prepared to provide background information for clients and friends of Thompson & Knight. It is not intended as legal advice or a legal opinion with respect to any specific circumstances or any specific client.

- [The ISDA March 2013 DF Protocol Questionnaire](#) (the “*Questionnaire*”)
- [The Questionnaire Answer Sheet](#) (the “*Principal Answer Sheet*”)

The number of documents listed above makes the process of becoming a party to the Protocol seem complicated, but fundamentally it is relatively simple:

- Obtain a CICI number, if you do not already have one.
- Fill out online, print out on letterhead, sign, scan as a PDF document, and return to ISDA an Adherence Letter, a conformed copy of which will be posted on ISDA’s website.
- Answer the questions in the confidential Questionnaire (which are straightforward and are summarized below); elect, if desired, to have Schedules 3 and 4 of the DF Supplement (discussed below) apply; and deliver the Questionnaire to swap counterparties, either directly or online.

These notes are a simplified summary of the Protocol Agreement and related documents.

II. Obtaining a CICI Number.

A CICI number can be obtained at the following linked website: <https://www.ciciutility.org>.

The cost is \$200, and payment is made by credit card.

III. Protocol Agreement and Adherence Letter.

The Protocol Agreement is not intended to be modified. It contains basic representations and warranties (due organization, corporate power, no conflict with law or contract, enforceability, etc.) by the parties (the “*Protocol Participants*”). It also permits the Protocol Participants, through their Questionnaires, to elect to make certain representations, to enter into certain agreements and, in the case of most independent oil companies, elect, if they desire, to enter into certain other optional agreements. These are discussed below. Swap participants adhere to the Protocol by delivering an Adherence Letter to ISDA.

The form of Adherence Letter is Exhibit 1 to the Protocol Agreement. Blanks in the Adherence Letter can be filled in online at ISDA’s website. The Adherence Letter may not be modified except to complete information regarding your company’s name, insert the date of the letter, and set up the signature. The letter can then be downloaded, put on your letterhead, signed, scanned as a PDF document, and uploaded for return to ISDA.

Scanned Adherence Letters should be saved to your computer and then uploaded to ISDA’s website by clicking an upload button at the website. (They are not sent by e-mail to an ISDA e-mail address.)

It may take one or two days for ISDA to process and accept an Adherence Letter. Until it is accepted, you cannot proceed to fill out and deliver the Questionnaire.

A \$500 fee must be paid to ISDA in connection with submitting an Adherence Letter. Credit cards are accepted for payment.

Conformed copies (signatures will be typed) of Adherence Letters will be posted publicly on ISDA's website.

An Adherence Letter will not be effective with respect to the Protocol Participants party to a Protocol Covered Agreement unless those Protocol Participants exchange Questionnaires.

IV. Questionnaire and Principal Answer Sheet

Protocol Participants supplement their Protocol Covered Agreements and make the Protocol effective by completing and delivering Questionnaires to each other.

Questionnaires can be delivered directly in accordance with the notice provisions specified in the Protocol Participants' Adherence Letters. Questionnaires can also be filled out and delivered online through ISDA Amend by Markit by going to the following website:

<http://www.markit.com/en/products/distribution/counterparty-manager/isda-amend.page>.

Using ISDA Amend by Markit for filling in and delivering Questionnaires is free for buy-side Protocol Participants.

Whether delivered directly or online, different Questionnaires can be given to different counterparties. Questionnaires are available only to other Protocol Participants to which they are delivered or that are authorized to receive them online.

If a buy-side Protocol Participant delivers its Questionnaires online via ISDA Amend, the swap dealers that the buy-side Protocol Participant has authorized to receive those Questionnaires automatically will be deemed to have delivered their Questionnaires to it.

The Questionnaire, if not completed online, includes both questions and a separate Principal Answer Sheet. Applicable questions must be answered on the Principal Answer Sheet.

The questions relevant to a swap participant that is not a swap dealer or Special Entity are summarized below, with a special focus on independent oil and gas companies. You can also get helpful information from the annotated Questionnaire form found at <http://assets.isda.org/media/0decb4a0-5/b875d911.pdf/>.

Part I of the Questionnaire contains defined terms. Parts II and III of the Questionnaire contain questions to be answered and certain elections to be made. Following is a brief discussion of possible ways to complete Parts II and III of the Questionnaire. Some of the factors and issues related to these questions and elections are then discussed in the remainder of this memorandum.

Part II of the Questionnaire

1. **What is your LEI/CICI?** Insert the CICI number you have obtained.
2. **Are you a CFTC Swap Entity** (essentially, a swap dealer)? Most independent oil companies and other non-financial companies would answer "No".
3. **Are you a Financial Entity?** Most independent oil companies would answer "No". If your company is a "private fund" as defined in Section 202(a) of the Investment Advisors Act, or if your company is predominantly engaged in financial businesses, rather than in

the active operation of oil and gas properties or other non-financial business assets, further analysis is needed with respect to this question.

4. **Are you a Financial Company?** Most independent oil companies would answer “No”. Again, if your company is predominantly engaged in financial businesses, rather than in the active operation of oil and gas properties or other non-financial business assets, further analysis is needed with respect to this question.
5. **Are you an Insured Depository Institution?** For most companies, the answer is “No”.
6. **What is your e-mail address for delivery of notices pursuant to the DF Supplement?** Insert your desired address, which could be the address you use in your ISDA Schedules.
7. **What is your e-mail address for delivery of risk valuations given pursuant to DF Schedule 3?** You can use the same or a different address. Or, if you do not intend to elect Schedule 3, you can answer “none”.
- i. **What is your e-mail address for delivery of portfolio data given pursuant to DF Schedule 4?** You can use the same or a different address. Or, if you do not intend to elect Schedule 4, you can answer “none”.

Part III of the Questionnaire

1. What city determines your **Local Business Day**? You may, if you wish, elect to have one or more cities be designated for purposes of determining what is a Local Business Day. The term Local Business Day is used in the DF Supplement for purposes of daily risk valuations and portfolio reconciliations under Schedules 3 and 4 of the DF Supplement. If you don’t make an election, your counterparty’s chosen Local Business Day will apply. We suggest that you insert the name of your home city, spelled without abbreviations.
2. **DF Schedule 3 Election for Non-Financial Entities.** Schedule 3 to the ISDA March 2013 DF Supplement applies automatically to all financial entities. If you are not a financial entity, you may elect whether or not you want to receive or exchange risk valuations using the procedures in DF Schedule 3. This election is discussed below.
3. **DF Schedule 4 Elections.** Schedule 4 to the ISDA March 2013 DF Supplement applies automatically to all persons who have been designated as CFTC Swap Entities (swap dealers, etc.) If you are not a CFTC Swap Entity, you may elect whether or not you want to exchange or receive portfolio data under the procedures of Schedule 4 of the DF Supplement. This election is discussed below.
 - (a) Answer “No” if you do not want Schedule 4 to apply. If you answer “Yes” or leave this question blank, Schedule 4 will apply. If you answer “No”, you do not need to answer questions 3(b) and 3(c).
 - (b) If you choose to have Schedule 4 apply, you should answer “Review” if you want your swap dealer counterparty to supply you with mark-to-market information under Schedule 4, and you should answer “Exchange” if you want both you and your counterparty to be obligated to supply this information.

(c) If you choose to have Schedule 4 apply, you should answer “Yes” if you want a swap data repository provide the information rather than your counterparty. If you answer “No” or if you give no answer, the swap data repository will not provide the information.

4. You can elect **Use of the End-User Exception** (defined and discussed below) in order to be free from CFTC clearing requirements if (as is likely for an independent oil company) it is applicable. Most counterparties that are eligible for this exception will wish to elect for it to apply, since persons who make an End-User Election for a swap are not required to submit the swap for mandatory clearing. (Mandatory clearing generally requires the posting of liquid collateral for out-of-the-money positions; if you want to avoid posting collateral, you should seek to obtain the End-User Exception, but if you are concerned about your counterparty’s creditworthiness you may want to reconsider this issue). If you elect to have the End-User Exception apply, you must answer the following questions:

(a) Do you make a **Standing End-User Exception Election**? If you elect “Yes”, you are notifying your counterparty that you intend to make an End-User Election for all your swap transactions. If you elect “No”, you will need to make an End-User Election at the time of each transaction.

(b) Do you elect the **Standing Opt-Out of Annual Filing**? If you elect “Yes”, you are telling your counterparty that it will need to note your End-User Election on a trade-by-trade basis (a “Trade Filing”) each time it reports a transaction with you to a swap data repository. If you elect “No”, you are obligating yourself to make an annual filing (an “Annual Filing”) of certain information confirming that you are eligible to use the End-User Exception. We assume that most independent oil companies and other End-Users would rather not become obligated to make Annual Filings and would prefer for their swap dealer counterparties to make Trade Filings.

(c) If you elect for your counterparty to make Trade Filings, you need to give it certain information to include in its Trade Filings. This is done by answering the following questions:

(i) Are you electing the **Finance Affiliate Exception**? Most companies will answer “No”, since this exception is available exclusively to companies whose primary business is to finance the purchase or lease of products manufactured by an affiliate.

(ii) Are you electing the **Hedging Affiliate Exception**? Answer “No” unless you are a Financial Entity that is an affiliate of another entity that is able to use the End-User Exception and you use swaps to hedge or mitigate the risk of your eligible affiliate.

(iii) Are you a bank that is exempt under the **Small Bank Exemption**? If not, answer “No”.

(iv) Specify how you intend to meet your financial obligations with respect to non-cleared swaps. A company can give more than one answer to this question. Most operating companies likely would specify (D) “available

financial resources” and those that provide collateral to their counterparty would also specify (B) “pledged or segregated assets.”

- (v) Are you an **SEC Issuer/Filer** (that is, are you an issuer of securities that are registered under Section 12 of, or are you required to file reports under Section 15(d) of, the Securities Exchange Act of 1934)? If so, answer “Yes”, and if not, answer “No”.
- (vi) If you are an SEC Issuer/Filer, insert your **SEC Central Index Key Number**. If not, answer “none” or leave blank.
- (vii) If you are an SEC Issuer/Filer, specify whether an appropriate committee of your board of directors (or equivalent body) has approved the decision to use the End-User Exception rather than have your swaps cleared through designated clearing organizations. This approval is called an **Election Approval** and is required for SEC Issuer/Filers under CFTC regulations. Election Approval is not required if you are not an SEC Issuer/Filer.

5. You may elect to enter into a deemed master agreement for swaps that are not covered by existing swap agreements and not intended to be cleared by a derivatives clearing organization. If you have not entered into your own negotiated master swap agreements with your swap dealers, you may want to answer “Yes” to this election, but we suggest that you consult counsel about this decision. If you have entered into master swap agreements with your counterparties, or intend to do so before you enter into any swaps with them, you may wish to answer “No” to this election.

V. DF Supplement

The DF Supplement sets forth certain standardized representations, acknowledgments, notifications, and agreements relating to the CFTC rules. These are set forth in Schedules. The Protocol Covered Agreements between any two Protocol Participants that have delivered completed and executed Adherence Letters to ISDA and exchanged Questionnaires will be automatically deemed to have supplemented their Protocol Covered Agreements by DF Supplement Schedules 1 and 2. Most independent oil companies can elect in their Questionnaires to incorporate Schedules 3 and 4.

Schedule 1 contains defined terms used in the Protocol documents.

Schedule 2 contains representations and agreements between the parties to a Protocol Covered Agreement. These are not elective. They are, however, intended to be neutral and not controversial.

Schedule 2 includes the following:

- (a) Each party represents as to the accuracy of information provided under the DF Supplement and that the other party will rely on that information in entering into swaps. The failure of such information to be true will not, however, of itself, cause an event of default or termination event under any ISDA Master Agreement.
- (b) Each party agrees to update the information that it provides under its DF Supplement to keep it true.

- (c) Unless the parties have otherwise agreed, each party agrees that a confirmation of a swap transaction may be created by the delivery of written terms by each party, so long as the terms match and they are delivered in a manner that permits such terms or have a third party confirm that the terms match.
- (d) The Schedule establishes procedures for clearing swaps through designated clearing organizations. It also provides for notice of an election not to clear a swap subject to a mandatory clearing determination. An entity may, however, elect not to be subject to mandatory clearing if it is otherwise eligible if it is an “end user”, that is, if it is not a financial entity, uses swaps to hedge or mitigate financial risk as defined in the CFTC regulations, notifies the CFTC how it will meet its financial obligations with respect to non-cleared swaps and either has made and kept current an annual filing with the CFTC or notifies its swap dealer that it has not made such a report and gives its swap dealer the information sufficient for it to submit a report on a trade-by-trade basis (the “*End-User Exception*”).
- (e) Each party agrees to notify the other if it becomes or ceases to be an Insured Depository Institution or a Financial Company and is put on notice that, if a party is a “covered financial company” or an Insured Depository Institution there may be certain limitations on the other party’s rights to terminate, liquidate or net swaps if the FDIC appoints a receiver for that party and the FDIC may have certain rights to transfer swaps entered into by that party.

Schedule 3 concerns the calculation of risk valuations and provides a mechanism for dispute resolution. Schedule 3 is mandatory for financial entities but not for others. If a non-financial entity nonetheless elects to have Schedule 3 be applicable, the swap dealer will calculate the value of swaps between the parties as provided in the credit support annex to their swap agreement. If no such annex exists, the swap dealer will calculate the amount payable as pursuant to mechanics specified in the Schedule. A counterparty may dispute the swap dealer’s valuation. If there is a valuation dispute, the parties will resolve it through procedures otherwise agreed in writing or, if they have not otherwise agreed, pursuant to procedures specified in the Schedule.

Since the purpose of Schedule 3 seems tied to mandatory clearing, it appears that most End-Users do not need to have Schedule 3 apply. It may, however, be worth discussing this election with your swap dealer counterparty to obtain more details about the information you would receive if Schedule 3 did apply.

Schedule 4 concerns portfolio reconciliation. It is mandatory for CFTC Swap Entities but not for most of their customers. If a customer elects for Schedule 4 to apply to it, its swap dealer may require a portfolio reconciliation by notice to the customer at intervals specified by CFTC rules. Swap counterparties that elect to have Schedule 4 apply can elect to have portfolio reconciliation done either through a mutual exchange of information that will allow comparison of the terms of swaps or, for entities like most independent oil companies, by the swap dealer’s delivery of information to its counterparty, which then compares the terms of the swaps against its own records. Each party undertakes to notify the other of any discrepancy in the records, except for valuation discrepancies of less than 10%. Swap counterparties also can elect to reconcile terms of swaps against data from a swap depository to the extent possible. Since the purpose of Schedule 4 seems tied to mandatory clearing, it appears that most End-Users do not need to have Schedule 4 apply, and it appears to impose burdens that most End-Users would want to avoid.

VI. Summary

Companies that are End-Users of commodity swaps, as well as other End-Users of interest rate and foreign currency swaps, need to take certain steps in order to be able to trade in the over-the-counter derivatives markets, or to make material modifications to existing swap transactions. They must obtain a CICI number and either enter into bilateral arrangements with swap dealers modifying existing ISDA Master Agreements or become a party to the Protocol by delivering an Adherence Letter and exchanging Questionnaires with their swap dealers. If they elect the End-User Exemption, and provide the required information, they can avoid mandatory clearing for their swap transactions.

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