

Publications

Client Alert: Dodd Frank Compliance Date for Notification of Segregation on Horizon for Swap Dealers and Major Swap Participants

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In November of 2013, the U.S. Commodity Futures Trading Commission (CFTC) issued Final Rules on the Protection of Collateral of Counterparties to Uncleared Swaps (the Final Rules). The Final Rules generally provide:

- **Notification:** Prior to the execution of each swap transaction that is not submitted for clearing, a swap dealer (SD) or major swap participant (MSP) shall notify the counterparty to such transaction of the counterparty's right to require segregation of initial margin (IM) posted to secure the counterparty's obligations under the swap.
- **Requirements of Segregation:** Specific requirements for the segregation of collateral in the event the counterparty makes an election to require segregation of the collateral.
- **Requirements for Non-Segregated Margin:** Specific requirements for reporting required by a SD/MSP if the counterparty does not choose to require segregation.

The right to segregation or notice of segregation does not apply to variation margin (VM) under the Final Rules. However, the Final Rules do not restrict parties from negotiating segregation arrangements for VM.

The Final Rules became effective on **January 6, 2014**. For uncleared transactions that are entered after January 6, 2014 into with "new counterparties", the SD or MSP must be in compliance with the Final Rules by **May 5, 2014**. For uncleared transactions that are entered into after January 6, 2014 with "existing counterparties", the SD or MSP must be in compliance with the Final Rules by **November 3, 2014**.

NOTIFICATION OF RIGHT TO SEGREGATION

- **Custodian:** SD/MSPs must identify one or more third party custodians as acceptable depositories for segregated IM, one of which must be a credit worthy non-affiliate and each of which must be a legal entity independent of the SD/MSP and the counterparty.

- **Price:** SD/MSPs must disclose to the counterparty the price of segregation for utilizing a custodian to segregate IM, to the extent the SD/MSP has such information available.

MECHANICS AND TIMING OF NOTIFICATION OF SEGREGATION

- **Who:** SD/MSPs must send the notification of segregation to the “officer in the counterparty responsible for the management of collateral.” If such a person is not readily identifiable, SD/MSP should send the notice to the chief risk officer (if applicable), the CEO (if applicable) or the counterparty’s highest level decision maker.
- **When:** SD/MSPs must, prior to confirming the terms of any uncleared swap, obtain confirmation of receipt of the segregation notification and the counterparty’s decision whether to elect segregation.
- **How Often:** SD/MSPs must provide the notification of segregation to the counterparty at least once each calendar year.
- **Election Change:** The counterparty’s election of segregation may be changed upon the written notice delivered to the SD/MSP and the change is applicable to only those uncleared swap transactions entered after the delivery of the notice of change.

REQUIREMENTS FOR SEGREGATED MARGIN

- **Custodian:** The third party custodian must be a legal entity independent of both the SD/MSP and the counterparty.
- **Account:** The IM must be held in a designated account segregated for and on the behalf of the counterparty (such an account may also hold VM if agreed to by the parties).
- **Agreement:** Any agreement for segregation entered into by the SD/MSP and the counterparty must be in writing and shall provide that:
 - Any withdrawal of IM (other than with respect to turnover) shall only be made pursuant to the agreement of both parties;
 - Any withdrawing party shall provide immediate notification to the other party of any withdrawal; and
 - Turnover of control of margin (IM or VM) shall be made without the written consent of both parties promptly upon presentation to the custodian of a statement in writing, made under oath, by an authorized representative of either party that they are entitled to such control pursuant to the agreement between the parties. The party making the presentation for control shall immediately notify the other party of such turnover.
- **Investment:** The IM held in a segregated account may only be invested by the SD/MSP in ways that are consistent with Rule §1.25 of CFTC regulations.

NON-SEGREGATED MARGIN

- **Required Reports:** If the counterparty to an uncleared swap transaction does not elect to require segregation, the chief compliance officer of the SD/MSP is required to report to the counterparty on a quarterly basis whether or not the back office procedures of the SD/MSP relating to margin and collateral requirements were, at any point during the previous quarter, not in compliance with the

agreement of the SD/MSP and the counterparty.

- **Timing:** The above report shall apply as to the counterparty no earlier than the 90th calendar day after the date of the first swap between the parties.

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