

**Regulatory Reform**

## External Business Conduct Rules / Overview

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# Treatment of Foreign Exchange Instruments under Title VII of Dodd-Frank

Instrument type	Description	Application of CFTC Rules					
		Mandatory clearing / SEF electronic execution	Private regulatory reporting	Public real-time reporting	Business conduct obligations	Documentation requirements	Uncleared margin standards
<b>Foreign Exchange Spot</b>	Instrument involving physical exchange of two different currencies to be settled within T+2 business days, or to facilitate securities settlement within the ordinary securities settlement cycle	No	No	No	No	No	No
<b>Foreign Exchange Forward</b>	Instrument involving physical exchange of two different currencies to be settled on a specified future date that is beyond T+2 business days	No	Yes	No	Yes	Yes	Regulators still developing international framework
<b>Foreign Exchange Swap</b>	Instrument involving physical exchange of two different currencies on a specific date followed by a reverse physical exchange of the two currencies at a later date	No	Yes	No	Yes	Yes	Regulators still developing international framework
<b>Foreign Exchange Option</b>	Instrument provides holder, upon exercise, with right to exchange one currency for another currency or to receive payments as a result of changes in the value(s) of specified currencies (i.e., plain vanilla, non-deliverable options, barriers, binaries, knock-ins, knock-outs and options with other exotic features)	Not currently covered by mandate but could be in the future	Yes	Yes	Yes	Yes	Yes
<b>Foreign Exchange Non-Deliverable Forward</b>	Instrument where single currency payment on settlement date is determined by reference to a rate source that publishes an exchange rate for two currencies (i.e., where one of those currencies is subject to exchange controls or other restrictions)	Not currently covered by mandate but could be in the future	Yes	Yes	Yes	Yes	Yes

# CFTC External Business Conduct Rules

## Heightened KYC / Suitability Requirements

- Verification of ECP status
- Know your customer requirements
- End-user exception
- Institutional suitability requirement
- Verification of Special Entity status

## New Pre-Trade Disclosure Requirements

- Disclosure of material risks
- Disclosure of material characteristics
- Disclosure of conflicts and incentives
  - Relative compensation
- Scenario analysis
  - Notification of right to receive scenario analysis
- Daily mark
  - Pre-trade and post-trade obligation

## Special Entity Provisions

- Recommendations and advisor status
  - Safe harbors for:
    - ERISA
      - (i) plan represents that it has a representing fiduciary
      - (ii) fiduciary represents that it will not rely on recommendations
      - (iii) plan represents that it will comply with policies to ensure that recommendation is evaluated by fiduciary
    - Non-ERISA plans
      - (iv) SD does not express opinion as to whether Special Entity should enter into swap
      - (v) Special Entity represents that it will not rely on recommendations and will rely on advice from qualified independent representative
      - (vi) SD discloses that it is not undertaking to act in the best interests of the Special Entity
  - Best interest standard
- Independent Representative qualifications
- Special disclosure of SD capacity
- Political contributions

# Key Elements of Protocol 1- Action Required by May 1<sup>st</sup>

Issue	Necessary Action
<b>Eligible contract participant</b> status – required for all swap counterparties	Confirm ECP type (Part III, Question 2) <ul style="list-style-type: none"> <li>• Certain commodity pools must also provide additional ECP representation for FX instruments (Addendum 1, §4)</li> </ul>
<b>Financial entity</b> status – included in SDR reports and may affect reporting responsibility for non-dealer trades and eligibility for end-user exception	Confirm status (Part III, Question 5)
<b>Special Entity</b> status (e.g., pension plan or endowment) – additional business conduct obligations apply	Confirm status (Part III, Question 6) <ul style="list-style-type: none"> <li>• ERISA plan must identify representative that is an ERISA fiduciary (Part II, Question 8)</li> <li>• Non-ERISA Special Entity must identify qualified independent representative (Part II, Question 7) – could be third party trading advisor or an internal employee</li> </ul>
<b>Safe harbor election</b>	Incorporate additional schedule as follows: <ul style="list-style-type: none"> <li>• Non-Special Entity (Schedule 3 through Part III, Question 9)</li> <li>• Non-ERISA Special Entity (Schedule 4 through Part III, Question 7)</li> <li>• ERISA Special Entities (adhere to Schedule 5 or 6 through Part III, Question 8 or 9)</li> </ul>
<b>Pre-trade disclosures</b>	<ul style="list-style-type: none"> <li>• Provide e-mail address for delivery (Part III, Question 10)</li> <li>• Consent to initial oral disclosure (Part III, Question 11)</li> <li>• Consent to non-disclosure of pre-trade marks for highly liquid instruments (Addendum II, §2)</li> </ul>

First Addendum to Protocol 1 also includes question on Active Fund status.

Second Addendum to Protocol 1 also includes questions on Category 2 and U.S. person status.

# Pre-Trade Mid-Market Quotations

## Background and Issues

Jeff Lillien  
Associate General Counsel  
Deutsche Bank  
April 26, 2013

# ***I. Origins and Purpose of the Rule***

- Commentary
- Final rule version
- Stated purpose in final rule release

## ***II. Implementation Issues***

- What is pre-trade mid?
- Method of disclosure
- Recordkeeping

### ***III. FMLG Initial Request for Relief***

- Underlying rationale
- Data-based approach
- Scope of request
- Buy-side input



## ***IV. CFTC Relief and Issues***

- Scope of CFTC Relief
- Conditions of CFTC Relief
- Potential for Expansion
- Issues:
  - Consent requirement (bilateral; multilateral)
  - Compound products
  - Anonymous platforms

## ***V. Follow-up Requests for CFTC relief***

- Consent vs. Disclosure
- BIS 31: extended tenors
- Multilateral platforms
- Anonymous execution

## ***VI. What to expect on May 1***

- Additional Relief?
- Different approaches to consent?
- Different approaches to accomplishing PTMM disclosure?
- Different approaches on platforms?



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INVESTMENT PARTNERS

# External Business Conduct Rules -Buy-Side Perspective-

Foreign Exchange Committee  
Forum on the Dodd Frank Act and Foreign Exchange Market  
April 26, 2013

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## DF Protocol Adherence Process

### □ Communications

- Industry Technology - Markit ISDA Amend and CICI Utility
  - Fluid and Unpredictable
  - Monitoring System Changes
  - Monitoring and Modifying Data Inputs
  - Reconciling Discrepancies between Systems
  
- Counterparties
  - Inundated with Queries about Client Information
  - Revisiting Legal and Factual Analyses
  
- Clients
  - Regular Communications
  - Responding to Queries
    - Impact on Clients' Portfolios
    - Coordination of Adherence Efforts
    - Structure of DF Protocol Reporting Regime
    - Privacy and Client Confidentiality



## DF Protocol Adherence Process

### Regulatory Developments

- Impact on Internal Decisions
- Internal Resource Allocation
- Changing Regulations and Compliance Deadlines
- Planning for Forthcoming Rules

### Legal Documentation

- New Industry Documentation
- Form Investment Management Agreement Provisions

### Compliance Policies and Procedures

### Operational Readiness

- Analyzing Internal Infrastructure and Processes
- Keeping Clients Informed



## Cross-Border Considerations

### Internal Steering Committee

- Cross-Border Impact on Firm
- Coordination of Compliance Efforts
- Information Sharing

### Co-Managed Accounts

- U.S. Person Analysis
- U.S. Swap Dealer vs. Non-U.S. Swap Dealer
- Letters to Confirm U.S. vs. Non-U.S. Status of Dealers

### Coordination of Regulators

- U.S. Regulators' Coordination with Global Counterparts
- Impact on the Industry

