

# Special Considerations in Dealing with Non-Dealer Counterparties

## An overview



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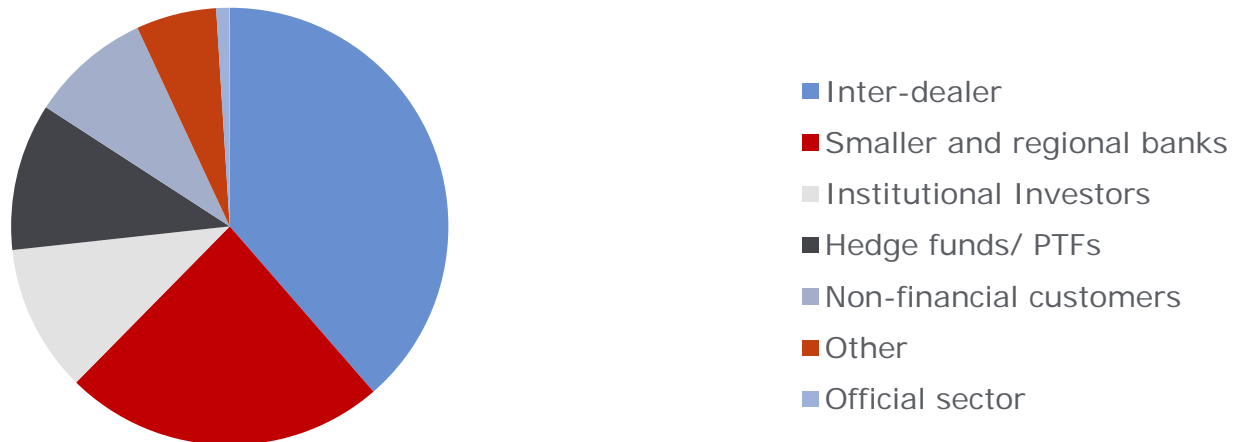
# Non-Dealer Counterparties



## Non-Dealers Market Participants

According to the most recent BIS Central Bank Survey published February 2014, non-dealer institutions are not only the largest segment of the \$5.3 trillion daily FX Market, they constitute the majority of it.

- Non-reporting dealer financial institution, local and cross border (covering customer needs; proprietary targets)
- Non-reporting banks institutional investors hedge funds and PTFs official sector (speculation and hedging)
- Non-financial customers, local and cross-border (buying/selling currency; hedging currency risk)



# Non-Dealer Counterparties – Current considerations for US Swap Dealer



## Entity Classification - Counterparty Types

- Swap Dealer / Major Swap Participant
- Financial Entity
- Eligible Contract Participant (ECP)
- Special Entity – Governmental; ERISA plans; Non-ERISA (QIR); Endowments includes endowments that are 501(c)(3) non-profits; Advisors (Best Interest / Capacity Disclosure)
- U.S. Person / Non-U.S. Person Designation
- End-user exemption (financial v. non-financial entities)
- Financial end-users (with and without material swap exposure)

# Client Account Set-Up at U.S. Dealer - examples



- **Dodd-Frank requirements driving new changes to the onboarding process and new documentation include:**
  - Entity Classification (e.g., Swap Dealer, Major Swap Participant)
  - Know Your Customer (KYC) - true name and owner/ address, principal business, name / address of guarantors
- Verification of counterparty eligibility
  - Eligibility (ECP verification)
  - Special entity and treatment election
  - Safe harbors
- Institutional Suitability
- Communications, marketing
- End-user exemption (financial v. non-financial entities)
- Regulatory Reporting / Real-time Reporting
- LEI
- Relationship Documents (STRD, authority)
- Clearing Docs
- Disclosures: Choice of DCO, Right to Segregate IA, Daily Mark, Scenario Analyses, Material Risks, Conflicts of Interest (Pre-Trade Mark), Material Characteristics
- Regulatory notices: where to complain, consent to record, right to clear, right to select DCO, right to segregate IA
- Tax Forms
- Counterparty Status / Representations
- Jurisdictional diligence; netting and enforceability
- Counterparty and Credit Due Diligence
- Client Preferences; SSIs; settlement arrangements

# Foreign Exchange Transactions: Execution to Settlement

## Recommendations for Non-Dealer Participants

### The New York Foreign Exchange Committee



- Originally drafted as an operational guide in 1999, the 2015 update supersedes prior versions.
- Will be conformed to the "Global Preamble" and other guidelines prior
- Drafting group consists of both sell- and buy-side market participants
- 22 highlighted issues that promote risk awareness for Non-Dealers Participants and provide "best practice" recommendations
- Addresses all 6 stages of trade process flow in order to ensure safe and sound conduct of business
- 2015 updates observe global regulatory market reform, but do not restate or align with particular regional rules
- Most notable new changes relate to confirmation practices, reconciliation, discrepancy resolution, trade allocation, documentation and more.

# Regional Regulatory Comparison – Examples of Rules affecting Non-Dealers



	US	EU
Clearing	<p>Once made mandatory, all must clear absent exemption.</p> <ul style="list-style-type: none"> <li>• non financial entities</li> <li>• small depository institutions</li> <li>• captive finance co hedging risk</li> <li>• majority-owned affiliates</li> </ul> <p>Use of exceptions requires regulatory reporting of use, and basis for qualification.</p>	<ul style="list-style-type: none"> <li>• EC and ESMA technical standards</li> <li>• If an NFC- is a counterparty, trade will not be subject to the clearing obligation.</li> </ul>
Trade Execution	<p>Mandatory SEF/DCM trading (MAT) = centralized order book on SEF/DCM or through a “request for quote system” on a SEF.</p> <p>Permitted SEF/DCM trading Footnote 195</p>	<p>EMIR does not impose mandatory venue execution requirements.</p> <p>ESMA (MIFID II) Inapplicable when a NFC- is a counterparty</p>
Trade Reporting	<p>All swaps (cleared and uncleared) must be reported to SDR</p> <p>Single CP reports bilateral swaps SEF and DCO</p>	<p>FCs, NFCs and CCPs must report</p> <p>All parties have reporting responsibility Delegated reporting</p>
Uncleared Swap Margining and Segregation	<p>CFTC margin requirements</p> <p>Initial margin segregation and notification requirement</p> <p>Proposed carve-outs for non-financial entities</p> <p>Prudential regulators – BCBS IOSCO</p>	<p>FCs and NFC+s</p> <p>ESMA - technical standards for implementing the BCBS IOSCO framework</p>
Customer Documentation	<p>Relationship Doc</p> <p>Valuation Procedures</p> <p>Confirmations</p> <p>Portfolio Recon</p> <p>Portfolio Compression</p>	<p>Confirmations</p> <p>Portfolio Recon</p> <p>Portfolio Compression</p> <p>Dispute Resolution. Reporting to trade repositories</p> <p>*May apply outside of EMIR</p>
Business Conduct	<p>Know Your Customer Confidentiality</p> <p>Risk and Other Disclosures</p> <p>Pre-Trade Marks</p> <p>Scenario Analysis</p> <p>Suitability</p> <p>Special Entities</p>	<p>Daily valuation</p> <p>*May apply outside of EMIR</p>

# What is Next for End-Users?



**“We will continue to look at ways that we can make sure commercial end-users can use these markets effectively, and to make sure that the new regulatory framework for swaps does not impose unintended consequences or burdens for them.”** Chairman Timothy Massad before the Natural Gas Roundtable (Washington, D.C.) May 26, 2015

**“Non-financial firms make up a significant part of the OTC derivatives markets but EMIR recognises that this does not necessarily make them systemic.”** Jonathan Hill, European Commissioner for financial stability, financial services and capital markets union, EMIR public hearing (Brussels) 29 May 201

Stated goal to ensure commercial end-users can continue to hedge risk effectively in the markets

- Contracts with Embedded Volumetric Optionality
- Trade Options – requirement modifications
- Utility Special Entities
- Treasury Affiliates
- Some RT Reporting Relief (long-dated, less-liquid swaps)
- Position regarding Clearing, Trade Execution, Reporting and Uncleared Swap Margining