

## **Security-based swaps documentation – The ISDA 2021 SBS Top-Up Protocol**

October 6, 2021 marks the compliance date for several Securities and Exchange Commission (“SEC”) rules with respect to security-based swaps (“SBS”).<sup>1</sup> To facilitate market compliance with these rules, the International Swaps and Derivatives Association (“ISDA”) has been working on creating SEC regulatory documentation for SBS, and buy-side firms and funds (“Funds” or a “Fund”) that transact SBS should prepare to work with the new documentation.

SBS include credit default swaps on single issuers, credit index swaps on narrow-based indexes (in general, indexes with nine or fewer underliers), and equity swaps on single securities and narrow-based securities indexes. Less than 10% of the U.S. over-the-counter (“OTC”) derivatives market by volume is SBS, which is regulated by the SEC; the remaining share of the OTC derivatives market (such as commodity swaps, rates swaps, broad-based index swaps, forex swaps and swaps on futures) is regulated by the Commodity Futures Trading Commission (“CFTC”).

### ***I. ISDA 2021 SBS Top-Up Protocol – for Funds that will trade SBS and that have previously adhered to the ISDA 2012 and 2013 Dodd-Frank protocols.***

ISDA has attempted to coordinate the new SBS documentation with the existing Dodd-Frank (“DF”) protocols and questionnaires for CFTC-regulated swaps. By doing so, Funds that have already completed the CFTC swap requirements will not have to repeat disclosures and agreement provisions for SEC-regulated SBS. Many, if not most, Funds that currently trade CFTC-regulated swaps have previously adhered to the ISDA August 2012 DF Protocol and its associated protocol supplements and questionnaire (the “2012 DF Protocol”). The 2012 DF Protocol allows swap-dealers registered with the CFTC to obtain the representations and agreements from their counterparties that are necessary for compliance with certain CFTC swap rules (primarily business conduct standards and reporting and recordkeeping). Regulatory information requested in the 2012 DF Protocol questionnaire can be completed manually and exchanged bilaterally or uploaded to the ISDA Amend electronic platform on IHS Markit, so that any counterparty that is given permission can access the information without having to request it.

Similarly, many Funds have adhered to the ISDA March 2013 DF Protocol and its associated protocol supplements and questionnaire (the “2013 DF Protocol”), which address additional CFTC swap rules (primarily confirmation, portfolio reconciliation and compression, and trading documentation) and again allow CFTC registered swap-dealers to obtain the required representations and agreements from their counterparties. The 2013 DF Protocol questionnaire can also be exchanged bilaterally or uploaded to ISDA Amend.

The ISDA 2021 SBS Top-Up Protocol (the “SBS Top-Up Protocol”) adds SBS regulatory provisions to the DF protocols to which a Fund has previously adhered where the DF protocols do not already meet

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<sup>1</sup> For key dates for registration of SBS dealers and major security-based swap participants see, <https://www.sec.gov/page/key-dates-registration-security-based-swap-dealers-and-major-security-based-swap-participants>

SEC requirements. Therefore, a Fund can only use the Top-Up Protocol if it already has adhered to at least one of the DF protocols and has uploaded or exchanged the associated questionnaire. If a Fund has used a bilateral agreement to cover the content of the DF protocols, it will not be able to use the SBS Top-Up Protocol and will be required to either use the ISDA SBS Protocol (discussed below) or a custom bilateral document.

The SBS Top-Up Protocol contains (i) the protocol agreement itself, which includes amending language and procedural provisions, (ii) the adherence letter, which is the Fund's agreement to the entire protocol package, (iii) Appendix I, which amends and supplements the 2012 DF Protocol, and (v) Appendix II, which amends and supplement the 2013 DF Protocol. There is no questionnaire for this protocol. Upon adherence, the SBS Top-Up Protocol will amend any ISDA or deemed ISDA, which has incorporated the terms of the 2012 DF Protocol and/or the 2013 DF Protocol, between a Fund and an entity regulated by the SEC with respect to its security-based swap trading.

The SBS Top-Up Protocol was published and opened to all on Monday, March 15, 2021. The SBS Top-Up Protocol can be downloaded for free by any person with an ISDA account at <https://www.isda.org/protocol/isda-2021-sbs-top-up-protocol/>.

## ***II. ISDA SBS Protocol – a new, SBS-only set of representations and agreements.***

ISDA is currently working on SBS-only protocol for SBS participants who (i) have not adhered to either one or both of the 2012 DF Protocol or the 2013 DF Protocol and (ii) will not use bilateral agreements to meet the regulatory requirements. This protocol, like the DF protocols, is expected to contain a protocol agreement, an adherence letter, protocol supplements and protocol questionnaires. Since the ISDA SBS Protocol will be SBS-only, it will contain all of the representations and agreements needed for basic compliance with the SBS rules (such as business conduct, trade reporting and recordkeeping, cross-border and risk mitigation requirements), but will not cover CFTC-regulated swaps.

This protocol is expected to be available on ISDA Amend this summer.

### **Conclusion.**

Because of the fragmentation of the U.S. derivatives regulatory system among the CFTC, the SEC and the prudential regulators, and the need to accommodate cross-border transactions that implicate foreign as well as U.S.-only transactions, the SBS documentation package is long, complex, and filled with non-intuitive elections that require careful consideration by lawyers, risk managers, portfolio managers and operations personnel. Questions regarding the SBS documentation may be directed to either GuyLaine Charles at [guylaine@charleslawpllc.com](mailto:guylaine@charleslawpllc.com) or Joseph Heyison at [joe@charleslawpllc.com](mailto:joe@charleslawpllc.com).

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