

2009 ISDA Collateral Dispute Resolution Procedure

September 30, 2009

The Method of Resolving Disputed Collateral Calls is Changing - Here's What you Need to Know!

Background Information

- At the direction of ISDA's Board of Directors, the ISDA Collateral Committee in consultation with the ISDA Product Steering Committees and other industry associations has developed a proposal for the 2009 Collateral Dispute Resolution Procedure (the "DR Procedure")
- The purpose of this proposal is to provide an agreed standard industry approach for dealing with disputed OTC derivative collateral calls that:
 - Achieves timely identification of the root causes of disputed collateral calls
 - Ensures the prompt movement of as much collateral as the parties can mutually agree
 - Provides the parties with a flexible range of methods to narrow and/or resolve their dispute to be consistent with their risk tolerance
 - Creates consistent and predictable process, timing and behavior in case of disputes across the market
 - Eliminates present uncertainties and delays that increase risk for the parties, and ensures there is an ultimate method for resolution of differences

Summary of Changes

- The new DR Procedure provides a clear structure for the dispute resolution process, including:
 - Defined timelines (4 days, with extension where appropriate)
 - An obligation to investigate portfolio differences, including via portfolio reconciliation
 - An obligation and specific structure to permit Consultation between the parties to resolve apparent differences
 - Provides guidelines for ring-fencing trades contributing to margin dispute
- Enforces a Preliminary Collateralization phase to ensure quick settlement of as much collateral as can be agreed between the parties, providing a measure of credit protection while the parties proceed through the resolution process
- Provides a range of alternative methods the parties may adopt for resolution of trade differences not resolved through consultation
- Establishes a definitive fallback method in case the parties cannot mutually agree which method to use
- Introduces the term Reference Independent Price source which defines the institutions qualified to play the role of a Market Making Party (as a party of the dispute) and institutions eligible to provide Reference Quotes (for purposes of a Market Poll)

Front to Back Impacts

- There are several key implications of the new Dispute Resolution proposal which will affect current market practice. The DR Procedure:
 - Requires Dealers (Reference Independent Price Sources) to provide Reference Quotes, subject to doing so in a commercially reasonable manner - addressing one of the key issues with Dealer Poll and the lack of market participation
 - Promotes the gathering of two-way firm executable quotes where possible. The purpose is to promote the making of markets, price discovery, and marking diligence.
 - Mandates disputing parties to undergo Market Polling if not mutually resolved otherwise
 - Requires an exchange of portfolio information upon margin dispute
 - Introduces the concept of longevity to be applied to any result obtained through the DR Procedure. Except as otherwise provided, the Results will continue to be used for the purpose of computing margin calls between the parties until relevant markets move or additional transparency of fair value develops.
 - Firms will need to decide if and/or when the result should be used as an input to fair market value determination

Anticipated Implementation and Key Dates

- 30 September 2009: Publish the final Dispute Resolution Procedure and Implementation Guidelines
- Implementation will become the subject of a future industry commitment letter to the Federal Reserve Bank of New York and other regulators.
- The DR Procedure is a complicated document that deals with a highly complex, cross-disciplinary and sensitive part of market practice. Therefore implementation will occur by stages:
 - Experimental Pilot Program: [October 15 – December 15, 2009]
A brief test program conducted by several volunteer firms that will apply the DR Procedure in parallel with actual disputes to detect and correct any obvious deficiencies with the procedure.
 - Trial Period: [January 15 – June 15, 2010]
An extended trial of the DR Procedure conducted on a mandatory basis by the Fed 15 firms (the “major dealers”), with voluntary participation by other firms. During the Trial Period, the DR Procedure replaces existing dispute resolution procedures but in a non-exclusive manner - in the event of problems with the new procedure, the parties may fall back to their existing contractual documentation.
 - Market Adoption: [July 15, 2010 onwards]
The formal adoption of the DR Procedure on an exclusive basis by market participants. Exact details of this stage of implementation will be developed based upon the experience of the earlier stages.
- The DR Procedure text may be amended in response to findings and lessons learned from any of these stages. It will be re-published by ISDA as necessary in response to such updates.

High Level Summary of the new Dispute Resolution Procedure and Key Implementation Considerations

