



CLIENT ALERT
AUGUST 6, 2009

ISDA proposes new dispute resolution process for collateral calls in derivatives markets

- *Comments due to ISDA by Friday, August 7th*

Background

In order to satisfy recent industry commitments to regulators, the ISDA Collateral Committee has issued a comprehensive proposal to improve collateral call dispute resolution processes for OTC derivatives (the “DR Proposal”). A complete draft of the proposal is available on ISDA’s website (www.isda.org). The public comment period on the proposal closes Friday, August 7, 2009.

Although ISDA’s Credit Support Annexes (or CSAs) already contain dispute resolution provisions for collateral calls,¹ the DR Proposal seeks to improve and enhance these provisions as well as processes currently used in the marketplace to resolve call disputes in response to concerns raised by regulators last fall. Specifically the DR Proposal aims to:

- achieve timely identification of the root causes of disputed collateral calls;
- ensure the prompt movement of as much collateral as the parties can mutually agree;
- provide the parties with a flexible range of methods to narrow and/or resolve their dispute consistent with their risk tolerance;
- create consistent and predictable processes, timing and behavior in case of disputes across the market; and
- eliminate uncertainties and delays that increase risk for market participants.

ISDA’s New Dispute Resolution Proposal: Four Key Steps

The DR Protocol consists of the following four steps:

- Step 1: “Preliminary Collateralization”

This step attempts to ensure that the maximum amount of “undisputed” collateral is transferred so that the calling party is as protected as possible pending resolution of the dispute.

¹ See our client alert at <http://www.teiglandhunt.com/publications/53> regarding the *VCG v. Citibank* case for a discussion of the significance of these provisions under New York law.

- Steps 2 and 3: “Portfolio Reconciliation” and “Consultation”

These steps are intended to allow the parties to analyze the causes of the dispute and isolate those transactions or other factors that need resolution. As part of these steps, the parties are expected to identify any administrative or operational errors that have contributed to the dispute.

- Step 4: “Dispute Resolution”

This step provides for a range of methods to resolve items in dispute, including informal/mutual settlement methods and more formal mechanisms, as discussed in further detail below.

New Twists on Resolution of Valuation Disputes

According to the DR Proposal, the parties are to use dispute resolution methods described in Step 4 to resolve their collateral call dispute if they are unable to resolve their differences using Steps 1 – 3. Step 4 consists of two parts: “Mutual Informal Dispute Resolution” and “Formal Dispute Resolution”.

Mutual Informal Dispute Resolution (Step 4a)

There are four possible informal resolution methods set forth under Mutual Informal Dispute Resolution:

- Temporary Collateral Adjustment
- Common Reference Pricing
- Mutually Agreed Exit Of Position
- Other Resolution Method (as mutually agreed).

Each of these methods is elective and may be utilized only upon mutual consent of the parties. If the parties are unable or unwilling to resolve their dispute using one of these methods, they are mandated to attempt the resolution process set forth under Formal Dispute Resolution.

Formal Dispute Resolution – Market Poll (Step 4b)

This process is intended to produce a “market-based determination” of the value of a disputed trade. Formal Dispute Resolution effectively relies on the conduct of a “market poll” to resolve a valuation dispute and, in that regard, is similar to the CSA’s existing dispute resolution provisions. However, there are several key distinctions:



- Prices published by clearing houses for a particular product or instrument are deemed to be presumptively correct;
- Both parties to the trade are expected to use commercially reasonable efforts to obtain prices for disputed trades;
- Two-way, firm executable prices are given priority over any indicative prices;
- If a party to the trade is a “Reference Market-maker” (a term that remains undefined in the DR Proposal), then its two-way, firm executable quote (a “Market Maker Quote”) will be included as part of the market poll;
- If a single party to the trade provides a Market Maker Quote and no third party firm quotes are available, then the mid-point between the bid and offer of the Market Maker Quote shall be deemed to be the mid-market value for the trade(s) in question.²

Intractable Dispute Disclosure to Regulators

In the event that the parties have failed to achieve a resolution to their disputed margin call via any of the methods set forth in the DR Proposal, an “Intractable Dispute” shall be declared. The DR Proposal provides that each party will be required to notify its primary regulatory supervising agency of the details of an Intractable Dispute within 30 days. The DR Proposal does not specify how such reporting should be made or whether any other consequences will result at this stage; however, it is expected that further details will be provided in ISDA’s final dispute resolution documentation.

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If you have any questions regarding the DR Proposal, please contact one of the following:

Lauren Teigland-Hunt +1 212 269 1002 lteigland@teiglandhunt.com

GuyLaine Charles +1 212 269 1016 gcharles@teiglandhunt.com

Teigland-Hunt LLP
127 West 24th Street, 4th Fl, New York, NY 10011
www.teiglandhunt.com

² Please note that the DR Proposal states that this point is “still under consideration” and includes special commentary addressing the differing views that have been expressed with respect to this aspect of the proposal.