Milbank Insights

Sponsor’s Guide to Hedging:

Practical Steps and Considerations

August 5, 2026

SPONSOR'S GUIDE TO HEDGING:
Practical Steps and Considerations

By Tiiu Lemsalu, Robert Wyse Jackson and Elizabeth A. Martinez

This guide covers key legal and practical steps that sponsors and corporates should consider when planning a hedging strategy with respect to debt financing (e.g., when entering into loan-linked interest rate or cross-currency swaps), together with commentary reflecting recent market practice. The commentary also includes points of comparison in the London vs. New York markets, as many sponsors and corporates operate on a cross-jurisdictional basis and a large majority of debt financing arrangements are governed by English or New York law. This guide is intended as a reference point for treasury, in-house legal, compliance, and other professionals navigating the hedging process.

Contents

TRANSACTION DOCUMENTATION AND NEGOTIATION

Overview of ISDA Documentation Architecture

Ordinary course hedging transactions form part of a bilateral ISDA Master Agreement [1], which is universally accepted as the industry-standard agreement governing derivatives transactions. "ISDA" is the acronym for the principal derivatives industry trade association, International Swaps and Derivatives Association, Inc., which was created in 1985 to develop standardized legal documentation and best practices for a growing over-the-counter derivatives market.[2] However, market participants generally refer to "ISDA Master Agreement" and "ISDA" interchangeably.

While the first 14 Sections (or the "front-end") of an ISDA Master Agreement is in a standard, pre-printed form which sets out the parties' key legal rights and obligations (including default termination provisions), the deal- and relationship-specific elections and modifications will be made in the Schedule to the ISDA Master Agreement (or the "back-end"). Individual transactions are typically entered into over the phone on a recorded line and evidenced by transaction confirmations which will be generated by the hedge provider's back office and delivered to the company for review and signature. The confirmation will set out the economic terms of the trade and incorporate applicable product-specific definitions, e.g., the 2021 ISDA Interest Rate Derivatives Definitions for interest rate hedges and/or the 1998 FX and Currency Option Definitions for FX hedges.[3] The ISDA Master Agreement (including the Schedule) and the individual transactions all form a single agreement governing the contractual relationship between the parties.

ISDA Master Agreement – 2002 vs. 1992 Form

The two most widely used derivatives master agreements are the 1992 ISDA Master Agreement and the 2002 ISDA Master Agreement. [4] There are multiple factors to consider when deciding whether the 1992 or 2002 form is more appropriate for your transaction needs. We have listed a few distinguishing features between the two forms below. While each of these may be modified in the ISDA Schedule, it is helpful to be aware of the differences, particularly when a counterparty suggests transacting under the 1992 form. The 2002 form is commonly used in the loan-linked hedging context, given favorable industry-wide updates compared to its predecessor.[5]

Concept	*1992 ISDA Master Agreement*	*2002 ISDA Master Agreement*
Close-out Valuation Methodology (Section 6(e))	Parties can choose between "Market Quotation" and "Loss" payment measures:	Market Quotation and Loss were replaced with **"Close-out Amount" methodology** as the single measure of damages. Close-out Amount effectively combined Market Quotation and Loss under the 1992 ISDA and is considered

[1] Typically in the form of a 1992 ISDA Master Agreement or the 2002 ISDA Master Agreement, as discussed below.

[2] ISDA continues to actively engage with market participants and policymakers to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 78 countries. *See* https://www.isda.org/ for further details.

[3] ISDA and the Emerging Markets Traders Association have recently published the new 2026 FX Definitions. The implementation date for the new definitions is November 22, 2027, after which Swift will no longer support the 1998 FX Definitions

[4] For the purposes of this guide, we focus on the English and New York law-governed ISDA Master Agreements; however, ISDA has also published amendment agreements to change the governing law to Irish or French law. In the German market, parties often use the German law governed master agreement *"Deutscher Rahmenvertrag für Finanztermingeschäfte."*

[5] The 2002 form was developed in response to certain perceived deficiencies in the 1992 form by market participants. For example, the dual valuation methodology ("Market Quotation" vs. "Loss") proved impractical during market distress when reference-dealer polling broke down or quotes were otherwise unavailable or meaningless.

	• **Market Quotation** – based on quotations from reference dealers for replacement transactions. • **Loss** – a fallback measure allowing a non-defaulting party to determine total losses/gains.	more robust in stress scenarios or illiquid markets.
Termination Events – Force Majeure (Section 5(b))	Does **not** contain a Force Majeure Event.	Introduced **Force Majeure Event** as a new mid-market Termination Event triggered when performance becomes impossible or impracticable due to uncontrollable events (e.g., systems disruption, natural disasters). Includes waiting period and fallback to termination if not resolved.
Events of Default – Failure to Pay (Section 5(a))	Standard grace period for a failure to pay event of default is **3 Local Business Days** following delivery of a notice of such failure to the defaulting party.	Reduced from 3 Local Business Days to **1 Local Business Day**.
Events of Default – Bankruptcy (Section 5(a))	Standard grace period is **30 days** for dismissal or satisfaction of insolvency petitions or similar creditor actions.	Reduced from 30 days to **15 days**.
Delivery of Notices by Email (Section 12)	Email is **not a permitted** method of delivering notices. Notices typically must be delivered by fax, courier, mail, or in person.	Email is a **permitted** method of delivering notices, ***except* for delivery of critical notices** under Section 5 (*Events of Default and Termination Events*) and Section 6 (*Early Termination; Close-Out Netting*). Please see further discussion in the *'Notices'* section below.
Set-off (Section 6(f))	Does **not** contain set-off provision.	Introduced an express right of set-off (Section 6(f)), permitting a Non-Defaulting or Non-affected Party to set off any Early Termination Amount against obligations owed between the parties (whether arising under the ISDA or otherwise), broadening the options available upon close-out.

ISDA Schedule – Drafting & Negotiation Process

In financing transactions, hedge providers typically benefit from the same security package and rank *pari passu* with senior lenders.[6] As such, hedge providers' default and termination rights in the ISDA may be modified or limited to align with those of the lenders to avoid the borrower being subject to different standards in the loan-linked hedge transaction. In the majority of English law-governed financings, the first stage of the negotiation is to agree hedge providers' default and termination rights and related hedging provisions in the financing documents (e.g., the intercreditor agreement or common terms agreement), which are then reflected in the ISDA, with the terms of the financing documents prevailing over the terms of the ISDA in the event of inconsistency. By contrast, in the majority of New York law-governed financings,

[6] Certain structures have super senior hedge providers, e.g., in respect of long-dated inflation hedges or treasury locks.

the financing documents are less prescriptive with respect to hedging arrangements and therefore the bulk of the commercial negotiation occurs when drafting the ISDA.

In a syndicated deal, drafting counsel typically holds the pen on preparing a “template” ISDA Schedule, which aligns with the requirements of the financing documents. The template is then negotiated among the borrower’s counsel and the banks’ counsel (the latter usually taking instructions on behalf of the whole syndicate but periodically working with each bank on a bilateral basis), with the goal of agreeing a template ISDA Schedule with substantively identical terms (principally regarding default rights and termination rights) for all hedge providers. Once the template is agreed, the hedge providers separately provide bank-specific details and regulatory provisions, which are used to break out the bank-specific ISDA Schedules from the agreed template.

Commonly Negotiated Provisions: Overhedging, Orphan Hedge Providers, Lender Replacement & Refinancing

Overhedging: In most debt financing transactions (in particular in the project and infrastructure financing space, where borrowings have long tenors), the floating interest rate payable on the loan(s) is subject to a minimum hedging requirement and often a maximum hedging requirement. The minimum (and if applicable, maximum) hedging requirements are documented in the financing documents (e.g., by way of a hedging covenant in the credit agreement or hedging policy in the common terms agreement) or a separate hedging strategy letter. From the sponsor’s perspective, it is desirable to have as much flexibility in the management of the hedging levels as possible, for example by:

- setting a band within which the outstanding hedge notional can fluctuate at the sponsor’s discretion (e.g., 50% to 110% of loan profile);
- providing for an extended grace period within which to eliminate hedging excess when it occurs (e.g., due to partial prepayments);
- permitting overhedging reductions on a non-pro rata basis across hedge providers, either generally or specifically where the reduction is below a certain (often de minimis) threshold (e.g., less than 10% of outstanding loan principal); and/or
- allowing for overhedging reductions through discretionary offsetting transactions (i.e., equal and opposite trades) pursuant to which the borrower’s exposure to the hedged risk is reduced by such offsetting transactions. This can be an appealing alternative to reduction of overhedging by partial termination of excess hedging transaction(s) because the latter can result in termination amount(s) becoming payable by the borrower.

There are multiple variables and industry-specific conventions that impact whether the foregoing options are included in a particular financing structure. Optionality regarding overhedging continues to evolve in light of the introduction of new players and capital structures.

Orphan Hedge Providers: The same is true with regard to the position of ‘orphan’ hedge providers. Hedge providers are generally lenders (or lender affiliates) which adds a layer of comfort for them as far as voting rights and accessibility of information is concerned. However, increasingly (particularly in private credit transactions), hedge providers are not otherwise participating in the related debt financing, which is referred to as holding an “orphan” hedge. In order to avoid information asymmetry, an orphan hedge provider may expect additional information and voting rights as the lenders or creditors in the related debt financing. These additional information needs must be operationalized by the borrower and built into the financing documents and/or the ISDA.

Lender Replacement: Where a hedge provider is both a lender (or lender affiliate) and hedge provider on day one, whether and when a hedge provider can terminate (or would be required to novate) its outstanding hedge transactions if it (or its affiliate) ceases to be a lender is often a point of negotiation. A hedge provider that ceases to be a lender due to a voluntary transfer of its loan position is often restricted from terminating its hedge transactions in order to avoid the borrower potentially having to make a termination payment and being under-hedged solely as a result of a decision by the hedge provider (or its affiliate) to voluntarily transfer its loans. However, sometimes the loan and hedge are required to be “stapled.” Many financial institutions have strict policies on their ability to hold an orphan hedge should they cease to be a lender, so this should be discussed at the onset of the transaction.

Refinancing: Another often negotiated scenario is whether a hedge provider can terminate its hedge transactions upon a refinancing of the loans. Often the borrower would not want its hedges to terminate upon a refinancing, particularly where the financing is long-dated, to avoid a resulting termination payment in case of any adverse movement in rates at the time of the refinancing. The hedge providers, on the other hand, are concerned about the robustness of the refinanced collateral arrangements and the borrower’s ongoing creditworthiness and therefore want the flexibility to terminate and reprice the hedges in this scenario. While we see varying solutions to address these concerns, a common compromise is that the hedge provider will waive its termination right if it or its affiliate participates in the refinancing as a lender.

Deliverables under Part 3 of the ISDA Schedule

Similar to conditions precedent to be satisfied under the relevant financing documents before a borrowing can be drawn, the borrower must provide certain deliverables to the hedge provider under an ISDA. This is set out in Part 3 of the ISDA Schedule. Some of the usual deliverables include:

- Certificate of authority and specimen signatures of individuals executing the ISDA and any transaction confirmations thereunder;
- Certified copies of the company’s organizational documents and authorizing resolutions with respect to the execution, delivery and performance of the ISDA;
- Copies of annual reports, financial statements and material notices delivered to lenders under the related financing documents; and
- Where applicable for secured hedge transactions, copies of security/collateral documents.

To reduce the operational burden on the borrower having to deliver the same documents to the bank both in its capacity as lender and in its capacity as hedge provider, the ISDA Schedule often includes language to the effect that the relevant documents shall be deemed delivered under the ISDA if they have been delivered to the bank in its capacity as lender under the financing documents.

Depending on the financing structure, the hedge providers may also execute accession or joinder agreements to the financing documents to benefit from the security package and to acknowledge their agreement to the financing terms, including any specific hedge-related obligations or requirements.

HEDGING STRATEGIES IN DEBT FINANCING TRANSACTIONS

Interest Rate Caps vs. Swaps

Aside from any pricing differences, whether the parties enter into hedge transactions in the form of interest rate caps vs. swaps can have a material impact on the required documentation. This is especially true where the caps are "pre-paid" (i.e., the premium for the cap is paid upfront by the borrower in full). Because the hedge provider is not subject to ongoing credit risk of the borrower in a pre-paid transaction, the related documentation often provides that such hedge provider:

- is unsecured;
- does not have any voting rights;
- is not able to withhold payment or performance due to an Event of Default or a Potential Event of Default in respect of the borrower; and
- is subject to limited default and termination rights.

An important practice point is that unsecured pre-paid cap transactions and secured interest rate swap transactions should not be governed by the same ISDA to avoid secured and unsecured trades being subject to a single close-out netting set. Where payable by the borrower, such net termination amount would be paid with collateral proceeds, effectively allowing unsecured hedge obligations to be satisfied with resources allocated solely to secured hedge obligations. This is a nuance that is sometimes overlooked but should be considered carefully depending on the collateral structure of the financing.

Deal Contingent Hedging and Other Pre-hedging Structures

Deal-contingent hedges ("**DCHs**") are useful for locking in a rate for a future financing or acquisition when the related closing is contingent upon the satisfaction of then unsatisfied conditions and/or the date of satisfaction of such conditions is uncertain. The defining feature of a DCH is that if the relevant contingency (e.g., closing of an underlying financing) is not satisfied by a date certain, the trade does not materialize and neither party is required to make any payments thereunder. This presents an attractive cashless walk-away solution for the sponsor, subject to a phoenix event (see below). On the flip side, if the contingency is satisfied by the agreed date, the trade materializes (either in the form of a live trade or a cash settlement), but the borrower will be subject to payment of a contingency premium.

In addition, if the contingency is not satisfied by the agreed date but is satisfied, or an economically equivalent transaction is consummated within a (negotiated) period of time after such date, then the parties will settle the value (i.e., the mark-to-market) of the DCH. Such settlement amount may be payable by either party. This is known as the 'phoenix' clause because the payment obligation is revived despite the DCH having terminated. The purpose of the phoenix clause is to disincentivize the company from taking action that would lead to the non-satisfaction of the contingency (i.e., the non-consummation of the underlying deal, perhaps by delaying satisfaction of conditions precedent or terminating the acquisition agreement early) solely to avoid a payment under the DCH as a result of adverse market movements.

There are many other legal and commercial variables that are idiosyncratic to DCHs and impact the nature of the contingency, the timing of the long-stop date by which the contingency should be satisfied, and the scope and timing of the phoenix clause mechanics, all of which depend on the extent of available information with respect to the related contingency. The company can expect multiple due diligence calls with the hedge provider given that the assessment of the likelihood of the deal contingency being satisfied is the main driver for the settlement of (and payout on) the DCH.

From a documentation perspective it is worth noting that DCHs are predominantly documented under a 'long-form' confirmation, rather than a standalone ISDA Master Agreement, Schedule and related trade confirmation. The DCH long-form confirmation will (i) specify certain primary elections you would otherwise see in the Schedule, (ii) set out the deal contingency terms, and (iii) state that the parties are deemed to have entered into an ISDA Master Agreement as of the trade date of the DCH. This approach allows parties to accelerate the execution process and to isolate the DCH from any other transactions that might otherwise be entered into under any pre-existing or negotiated ISDA Master Agreement.

While deal-contingent hedges are increasingly common in acquisition and other event-driven financings, they are not the only available pre-hedging structure. Depending on the level of certainty around the underlying transaction, parties may instead consider a swaption or a forward-starting swap. The choice between these products involves a trade-off between flexibility, pricing and execution risk, with the optimal structure depending on the likelihood and timing of the underlying financing, available liquidity and risk appetite.

A **swaption** gives the borrower the right, but not the obligation, to enter into an interest rate swap at a specified future date on pre-agreed commercial terms. If market rates move adversely before the underlying debt financing closes, the borrower can exercise the option and enter into the swap at the agreed rate. Conversely, if rates move favorably or the financing does not proceed, the borrower can simply allow the option to lapse. This provides valuable protection against adverse rate movements while preserving upside from favorable market movements and eliminating settlement risk if the transaction does not close. The principal drawback is cost as the borrower must pay a non-refundable upfront premium, which can be significant depending on market conditions and the tenor of the option.

A **forward-starting swap** offers a simpler and generally less expensive alternative where there is a high degree of certainty that the underlying debt financing will close. Similar to a swaption, the parties commit to making payments on the swap on a specified future date, typically aligned with the anticipated closing date of the underlying debt financing. However, unlike a swaption, the hedge transaction is binding from trade date and there is no upfront option premium, but the borrower forfeits the benefit of any favorable movements in interest rates and remains exposed if the underlying debt financing is delayed in closing or fails to close altogether. As the hedge provider assumes ongoing counterparty credit exposure from execution, collateral arrangements are also typically required.

DCHs occupy a middle ground between these two structures. Like a forward-starting swap, they generally avoid the need for an upfront premium, but unlike a forward-starting swap, a DCH only becomes effective if a specified contingency is satisfied. In return for this flexibility, the borrower pays for the contingency through wider pricing, together with bespoke contractual provisions, such as phoenix clauses (as discussed above) designed to allocate the risk of failed or delayed transactions. As a result, DCHs are often the preferred solution where closing remains uncertain but the borrower wishes to avoid paying the potentially significant upfront premium associated with a swaption.

Execution Bank(s)

From a trade execution perspective, especially in larger syndicated debt financing structures, one or two relationship banks might act as the "execution banks" or "hedge coordinators." Such relationship banks would execute the full size of the required hedging with the company and would thereafter novate[7] a portion of their respective allocations to other hedge providers. This ensures alignment of pricing and simplifies the hedge execution process. Novation is typically documented pursuant to an ISDA-published industry-standard tri-party novation agreement or novation confirmation.

Specialist Financial Advisors

Sponsors are increasingly engaging specialist treasury and risk management consultants to provide impartial pricing and structuring advice, assist with the economics of the alternative product offerings and coordinate and leverage relationships with potential hedge providers. Sponsor's external counsel and the relevant advisor work closely to achieve the client's desired hedging strategy, with counsel negotiating the terms of the ISDA documentation and the advisor interfacing with the hedge providers' trading desks to facilitate client onboarding and agree pricing and execution timing.

[7] Novation (or transfer by way of novation) is a legal concept where an existing contract is replaced by a new contract, with the consent of all parties. The original contract between the remaining party and the transferor is extinguished and replaced by the new contractual relationship between the transferee and the remaining party.

PRE-TRADE MANAGEMENT

Hedge Provider Onboarding Process

The regulatory landscape applicable to over-the-counter derivatives transactions has grown exponentially since the 2008 financial crisis. The good news is that most regulatory requirements in England and New York have been implemented and are part of well-established market infrastructure.

Unfortunately, given the piecemeal nature of implementation across jurisdictions and regulators, there is a significant amount of documentation that the hedge providers require their counterparties to complete. These documents establish the representations, disclosures, information-sharing arrangements and allocation of responsibilities necessary for regulated financial counterparties to maintain compliant trading relationships.

Regulatory onboarding with the hedge providers can be a lengthy process, and adequate time should be allocated for completing this exercise. While external counsel is always a helpful resource, many of the regulatory and KYC requirements go to factual questions about the sponsor's or the relevant group's day-to-day activities, and therefore care should be taken to supplement legal review with a hands-on approach as much as possible.

Entity Categorization

While numerous regulatory requirements apply to every derivative transaction, the threshold question for any borrower or sponsor counterparty is its entity categorization. This categorization is important because it determines whether the relevant transactions are subject to clearing[8] and/or regulatory margining[9] requirements.[10]

EMIR: Under EU EMIR[11] and UK EMIR[12], the key question is whether an entity is a "financial counterparty" or a "non-financial counterparty" (and in this case, whether the entity is above or below the "clearing threshold").[13] In most instances a corporate borrower with no other outstanding trades (or only with other hedging transactions) would be a "non-financial counterparty below the clearing threshold" (i.e., an NFC-entity); however, this determination is ultimately a facts-and-circumstances assessment and is subject to the entity calculating its clearing threshold on an annual basis.

---

8 A post-trade process pursuant to which the transaction is novated to a clearinghouse which becomes the middleman to the transaction with the aim of reducing counterparty credit risk (clearinghouses impose their own collateral requirements), increasing transparency and protecting against contagion in stressed markets.

9 This refers to the mandatory collateralization requirements applicable to certain non-centrally cleared bilateral derivatives depending on the counterparty and transaction type. It consists of initial margin (which is segregated, posted upfront and held for the life of the trade) and variation margin (which requires daily margining of the change in the market value of the derivative).

10 Sponsors operating across both the EU and the UK should note that the EU EMIR and UK EMIR regimes have diverged in certain respects since Brexit, including in relation to clearing thresholds, reporting requirements and the scope of the clearing obligation. The applicable regime will depend on where the relevant counterparty is established, and dual compliance may be required.

11 *Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, as amended.*

12 UK EMIR means *Regulation (EU) No 648/2012 as it forms part of UK domestic law by virtue of the European Union (Withdrawal) Act 2018, as amended by the Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2019 and related UK legislation.*

13 EU EMIR and UK EMIR require counterparties to monitor their positions against prescribed clearing thresholds by asset class. For NFCs, exceeding a clearing threshold in any asset class, or choosing not to calculate the relevant position, can result in NFC+ status and clearing obligations for relevant OTC derivative contracts that are subject to the clearing obligation. Sponsors should confirm the applicable thresholds and calculation methodology at onboarding, as the EU and UK regimes continue to evolve.

Dodd-Frank: For the purposes of US Dodd-Frank rules[14], the key questions are:

1. Whether an entity is an Eligible Contract Participant ("**ECP**")[15]: To enter into over-the-counter (i.e., uncleared) trades subject to the US rules and regulations, the company and any entity that is a guarantor of the company's swap obligations must be an ECP. The statutory definition includes a list of specific categories of entities that are deemed sophisticated enough to engage in bespoke over-the-counter derivatives. For borrowers, the most common categories are: (i) a corporation with more than $10 million in total assets; and (ii) an entity with a net worth of at least $1 million entering into transactions to manage commercial risk. It is unlawful for a non-ECP to enter into a swap unless the swap is traded on a regulated exchange.

2. Whether an entity is a Financial End-User ("**FEU**")[16]: Broadly speaking, when facing a US swap dealer on a swap (whether for hedging purposes or not), the parties would have to exchange regulatory variation margin if the company counterparty is an FEU. The statutory definition has multiple prongs; however, often the most pertinent one in this context is whether the company is an entity that "raises money from investors, accepts money from clients, or uses its own money primarily for the purpose of investing or trading or facilitating the investing or trading in loans, securities, swaps, funds or other assets for resale or other disposition or otherwise trading in loans, securities, swaps, funds or other assets." This is ultimately a facts-and-circumstances assessment with significant nuance. The outcome of an FEU determination depends on the activities of the company which should be closely reviewed together with the relevant regulations.

3. Whether an entity is a Financial Entity ("**FE**")[17]: Transactions with FEs are generally subject to the mandatory clearing requirement.[18] In most instances a corporate borrower would not be a FE and therefore not subject to mandatory clearing so long as the corporate borrower satisfies certain conditions, including delivery of required notifications to the regulators and implementation of appropriate internal corporate authorizations and risk management procedures. Similar to the definition of FEU, the definition of FE has multiple prongs (and it is important to note that the definitions of FEU and FE are not the same). The last prong of the definition of FE includes "a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature,", which includes, among other things, activities that are deemed to be "investing for others."[19] Similar to Financial End-User determination, this is ultimately a facts-and-circumstances assessment.

Legal Entity Identifier

Any entity executing over-the-counter derivative transactions must have a Legal Entity Identifier (**LEI**), which is a unique 20-character alphanumeric code based on the ISO 17442 standard. The LEI requirement was imposed by the regulatory bodies post-financial crisis for transaction reporting and increased market transparency. The Global Legal Entity Identifier Foundation (**GLEIF**) maintains a list of LEI issuing organizations.[20] The primary LEI issuers in New York and England are Bloomberg and the London Stock

[14] *Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, Title VII (2010), as implemented by the Commodity Futures Trading Commission and Securities and Exchange Commission regulations.*

[15] *See 7 C.F.R. § 1a(18) (definition of "eligible contract participant" for margin requirements for uncleared swaps).*

[16] *See 17 C.F.R. § 23.151 (definition of "financial end user" for margin requirements for uncleared swaps).*

[17] *See Commodity Exchange Act § 2(h)(7)(C), 7 U.S.C. § 2(h)(7)(C) (definition of "financial entity" for the commercial end-user exception).*

[18] The mandatory clearing requirement currently applies only to specified classes of interest rate swaps and credit default swaps that have been made subject to a clearing determination; it does not apply automatically to all OTC derivatives.

[19] *See Section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. § 1843(k)).*

[20] *See* here.

Exchange, respectively. An LEI must be issued prior to executing your first derivatives transaction[21], renewed on an annual basis (for so long as a company continues transacting in derivatives) and routinely updated to reflect any corporate change (e.g., any change in name, entity type or address). The fee for new LEI registration is approximately $60-$70 and the annual renewal fee is approximately $40-$50. More information on LEIs is available on the GLEIF website, here.

Ancillary Documentation

Business conduct agreements, Dodd-Frank and EMIR protocols, ISDA disclosure letters and transaction reporting agreements are necessary to facilitate compliance with the conduct, disclosure, transaction reporting, record-keeping and risk-mitigation requirements imposed by financial markets regulation.

Among the ancillary documentation that can be expected are the following:

Reporting Agreements: The default position is that the hedge provider will perform regulatory trade reporting to trade repositories both for itself and on behalf of the corporate counterparty, either because it is required to do so under applicable law[22] or otherwise at the request of its counterparty[23]. Any delegated reporting service is often provided free of charge pursuant to a standard form reporting agreement as a relationship matter and therefore reporting agreements are typically subject to very little (if any) negotiation. The sponsor will have to inform the reporting counterparty if a material event occurs in respect of the borrower (e.g. corporate restructuring) that would need to be reported.

Business Conduct Agreements and Dodd-Frank/EMIR Protocols: Business conduct agreements and industry protocols (such as ISDA Dodd-Frank and EMIR protocols) are designed to facilitate compliance with regulatory conduct requirements applicable to derivative transactions. These documents typically obtain representations regarding a counterparty's regulatory status and eligibility, document required disclosures and acknowledgements and amend existing trading documentation to reflect new regulatory requirements.

ISDA Disclosure Letters: These are commonly used to provide counterparties with information required under applicable regulations and to capture acknowledgements or representations needed for regulatory compliance. These letters form part of the broader compliance framework supporting derivative trading relationships.

[21] With respect to fund structures, the fund management entity or umbrella/feeder fund must have obtained an LEI before the fund itself can register for an LEI.

[22] Both as a matter of UK/EU EMIR and Dodd-Frank, the financial counterparty/swap dealer is required to report certain counterparty and transaction data on behalf of the NFC- entity/commercial end user if they are subject to the same reporting regime.

[23] If the financial counterparty/swap dealer and the NFC- entity/commercial end user are not subject to the same reporting regime, the parties may contractually agree that the financial counterparty/swap dealer will provide delegated regulatory reporting services on behalf of the NFC-entity/commercial end user.

PRE-TRADE MANAGEMENT

Reviewing Transaction Confirmations

EMIR and Dodd-Frank impose risk-mitigation requirements on counterparties to over-the-counter derivatives, including obligation to ensure the timely confirmation of transactions. These rules require firms to maintain processes that enable such transactions to be confirmed within prescribed regulatory deadlines, thereby reducing operational and counterparty risk. The timelines differ depending on the counterparty categorization and the underlying product[24]. From the borrower's perspective, it is important to promptly review each transaction confirmation received from a hedge provider and to notify the hedge provider immediately if there are any errors (in particular as hedge providers often rely on "negative affirmation"[25]). Individual trade confirmations are typically generated by the banks' back offices and do not route through external counsel, so it is important to ensure that the relevant financial officer(s) and/or treasury functions are actively monitoring for any trade-related communications.

Notices

While there is no shortage of commercial, legal and regulatory points to work through in a hedging context, an important practical consideration is the approach to delivery of notices. Most corporates are accustomed to communicating via email or other electronic means; however, as previewed above, the standard 1992 ISDA form does not provide for delivery of notices by email, and the standard 2002 ISDA form expressly states that termination and close-out notices may not be delivered by email. There are certainly benefits to delivering critical notices by post, courier or in person (such as certainty of delivery itself and the timing). However, notice details can easily become stale or there can be difficulties with "snail mail" delivery (as most recently seen during the Covid pandemic). In this context, there are two specific ISDA-facilitated solutions to consider:

Amendment to the Notices provision

In 2023 ISDA published amendment language to the standard Notices provision to permit delivery of Section 5 and 6 notices by email. Such notices will be deemed effective on the date they are "relayed to the recipient's email infrastructure" unless this occurs on a non-Local Business Day or after the "Notice Delivery Cut-off." The parties can stipulate in the Schedule what the relevant "Notice Delivery Cut-off Time" would be in respect of each party as the recipient at its "Notice Delivery Location."

ISDA Notices Hub

The ISDA Notices Hub was made available to market participants in 2025[26]. It is an online platform (which is free for buy-side firms) operated via S&P Global Market Intelligence's Counterparty Manager site. To make effective use of the Notices Hub's features, a participant has to (i) adhere (at no cost) to the ISDA 2025 Notices Hub Protocol and (ii) "match" with its counterparties on the platform (by sending a "Match Invitation") in respect of specific Notices Hub Modules. Both ISDA members and non-ISDA members can adhere to the Notices Hub Protocol. Users will be able to maintain their address information on the Notices Hub and update it for all their "Matched Counterparties" via a single entry.

[24] For example, the timely confirmation deadline in respect of an interest rate swap between a bank and a non-financial counterparty (such as a project financing borrower) would be two business days from trading.

[25] I.e., if the borrower has not notified the hedge provider that any corrections are required within (e.g.) three business days of receiving the relevant transaction confirmation, the confirmation will be deemed to be agreed (absent manifest error).

[26] As of the date of this Client Insight, the Notices Hub Protocol had 186 adhering parties.

CONCLUSION

A sponsor's hedging strategy is most effective when it is treated as an integral part of the financing process rather than as a last-minute execution item. Early coordination among treasury, legal, financial advisors and hedge providers can help align the ISDA documentation, financing documents, regulatory onboarding, trade execution and post-trade processes before pricing pressure or closing deadlines make changes more difficult.

Market practice continues to evolve across both the London and New York markets. Please feel free to discuss any aspects of this guide with your regular Milbank contacts or any member of our Alternative Investments Practice.

Contacts

John Williams, Partner
+1 212.530.5537
jwilliams@milbank.com

Alex Martin, Partner
+44 20.7615.3875
alexmartin@milbank.com

Elizabeth A. Martinez, Partner
+1 212.530.5652
eamartinez@milbank.com

Claire Bridcut, Partner
+44 20.7615.3084
cbridcut@milbank.com

Robert Wyse Jackson, Partner
+44 20.7615.3254
rwysejackson@milbank.com

Tiiu Lemsalu, Associate
+44 20.7615.3079
tlemsalu@milbank.com

This Milbank Insight is a source of general information for clients and friends of Milbank LLP. Its content should not be construed as legal advice, and readers should not act upon the information in this Milbank Insight without consulting counsel.

Milbank Insights