



CLIENT ALERT
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OTC Derivatives Reform in a Nutshell: **U.S. Regulatory Agencies to Play Major Role in Determining Scope and Impact of New Derivatives Regime**

- *CFTC, SEC to embark on unprecedented rulemaking effort to implement market reforms*

Background

Earlier this week President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”). As has been well publicized, the Act contains extensive reforms impacting the United States financial sector and will impose a new comprehensive regulatory regime on the OTC derivatives markets. Most provisions of the Act applicable to derivatives become effective 360 days after the date of the Act’s enactment.

While some of the changes will be self-executing, many others require further determinations or rulemakings by the Commodity Futures Trading Commission (CFTC), the Securities Exchange Commission (SEC) and other prudential regulators. Both the CFTC and the SEC are expected to write rules in nearly 30 new topic areas that will determine the scope and specifics of the new requirements related to derivatives.¹ These agencies are required to promulgate most of these rules within 360 days of the Act’s passage, and such rules are to become effective no less than 60 days after publication of the final implementing regulation.

Summary of New Requirements and Necessary Rulemaking

This Client Alert provides a brief overview of the most significant new requirements applicable to the OTC derivatives market and highlights those areas where significant regulatory rulemaking and determinations are necessary before the extent and precise details of these new requirements are clear.

¹ See the CFTC’s press release at <http://www.cftc.gov/PressRoom/PressReleases/pr5856-10.html>.

NEW REQUIREMENT	REGULATORY ACTION REQUIRED
Certain swaps will be required to be cleared absent an exemption.	CFTC to determine which contracts must be cleared and whether/to what extent an exemption for commercial end-users will apply.
Going forward, swaps that are subject to the mandatory clearing requirement must also be executed on a regulated exchange or “swap execution facility”.	CFTC to determine which contracts must be cleared and therefore traded on an exchange, and whether/to what extent an exemption for commercial end-users will apply. CFTC and SEC to clarify which entities qualify as a swap execution facility.
“Swap Dealers” and “Major Swap Participants” (MSPs) will be subject to comprehensive regulatory regime. MSP includes entities with a “substantial position” in swaps (excluding certain hedges).	CFTC to clarify which entities meet the definition of Swap Dealer and MSP and who is exempt from provisions applicable to these entities; for example, with respect to MSPs, CFTC to define “substantial position” at a threshold that it determines to be prudent for the effective oversight of systemically important entities.
Business conduct standards, as well as registration, recordkeeping and reporting requirements, will apply to Swap Dealers and MSPs.	CFTC to define applicable business conduct standards and establish specific registration, recordkeeping and reporting requirements. CFTC and SEC are expected to publish criteria for reporting of existing swaps that are not centrally cleared within 90 days of enactment of the Act, with reporting to begin 30 days thereafter.
Capital and margin requirements will be applicable to uncleared swaps.	Relevant prudential regulators will set capital and margin requirements for uncleared swaps executed by regulated entities and are expected to clarify whether/to what extent existing swaps will be exempt from new requirements.
Position limits will apply to swaps as well as related positions on an aggregate basis.	CFTC to set aggregate position limits (including related hedge exemption provisions) on (i) U.S. futures contracts; (ii) OTC contracts that settle against prices from domestic futures markets or foreign futures markets with U.S. access; and (iii) swap contracts that perform a significant price discovery function. CFTC may establish various exemptions from position limits. CFTC also to establish limits on swap positions (other than bona fide hedge positions) that are economically equivalent to listed futures or options contracts.
Swap desk “spin off” provision will require certain depository institutions to move their swap operations into separately capitalized affiliates in	Banking agencies, in consultation with CFTC/SEC, may grant a covered “swap entity” an extension of up to 3 years to divest itself of, or cease to conduct, the activities that would otherwise require it to be a



order to retain access to federal assistance.	registered as a swap entity
Certain banking entities will be prohibited from engaging in proprietary trading (the “Volcker rule”).	Financial Stability Oversight Council to study and make recommendations on implementing the Volcker rule. Based on study, banking agencies, SEC and CFTC will adopt rules to carry out the Volcker rule.
Ownership restrictions are to apply to derivatives clearing organizations (DCOs), swap execution facilities and contract markets.	CFTC to adopt rules that may limit the ability of certain banking/financial entities, Swap Dealers or MSPs to control (i) any DCO that clears swaps or (ii) any swap execution facility or contract market that makes swaps available for trading.
Futures commission merchants (FCMs) must segregate customer collateral for cleared swaps. MSPs and swap dealers must segregate collateral for uncleared swaps if requested by counterparty. Segregation does not apply to variation margin payments for uncleared swaps.	CFTC may provide additional guidance for the treatment of customer collateral.

The CFTC has proposed a series of public meetings and plans to start publishing rules in the fall. Teigland-Hunt LLP will continue to track these efforts as they develop.

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If you have any questions regarding the Wall Street Reform and Consumer Protection Act, please contact one of the following:

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