TITLE VII: Wall Street Transparency and Accountability

Throughout the financial regulatory reform debate, designing a regulatory framework for the derivatives market has been one of the most contentious issues. While the business community has supported bringing transparency, accountability, and stability to the market, it has been concerned that Congress and regulators could impose burdens on derivatives trading that would disincentivize businesses from hedging their own risks. The derivatives title in the conference report, passed by the Senate on July 15, 2010, is generally opposed by business groups as applying many of the same costs and requirements on end-users as will be applied to swap dealers. How much the final position will burden companies depends largely on the implementation of the law by regulators.

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act establishes a regulatory structure for derivatives. The title requires banks to spin off certain swaps-dealing activities determined by Congress to not constitute "*bona fide* hedging and traditional bank activities." It effectively requires derivative contracts that can be cleared, to be cleared—and exchange-traded. The title provides a narrow exemption for derivatives end users from the clearing and exchange trading requirements, but does not exempt end users from margin requirements. The title requires regulators to set minimum capital requirements and minimum initial and variation margin requirements. While, as noted, end users will not be exempt from the bill's margin requirements, Senators Dodd and Lincoln have written a letter to Representatives Frank and Peterson clarifying that the bill was not intended to impose margin requirements directly on end users. This, of course, does not mean costs will not be passed on to end-users from their counterparties. The title grandfathers existing contracts for purposes of the clearing provision, but not from margin requirements

The title gives the CFTC and SEC one year to implement most of the required rulemaking and regulations.

The following summary addresses the final Dodd-Frank language.[37]

A. Regulation of Over-the-Counter Swaps Markets—Regulatory Authority

1. Short Title

The short title is the "Wall Street Transparency and Accountability Act of 2010." **Sec.**

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37 For ease of reference, the term "[security-based] swap" refers to security-based swaps and non security-based swaps. The "relevant Commission" for swaps is the CFTC, and for non-security-based security-based swaps is the SEC.

701 (p. 271).

B. Regulatory Authority

The CFTC and SEC each must prescribe regulations necessary to carry out the title in consultation and coordination with each other and taking into consideration the views of the prudential regulators. Regulations must be issued not later than 360 days after enactment. Regulations must treat functionally or economically similar products in a similar manner. The CFTC and SEC, after consultation with the Fed, must prescribe joint regulations for mixed swaps. If either Commission objects to a regulation, the Commission may appeal the regulation to the United States Court of Appeals for the District of Columbia Circuit within 60 days after the regulation's publication. **Sec. 712(a)-(c) (pp. 271-274)**.

The SEC, CFTC, and the Fed must jointly make rules governing the books and records that must be kept regarding security-based swap agreements by registered swap data repositories. If the regulators fail to jointly prescribe rules in a timely manner, the Council will resolve the dispute at the request of either Commission. **Sec. 712(d) (pp. 274-276)**.

The title provides that unless otherwise specified, the SEC and CFTC must promulgate rules and regulations separately, not jointly, and the rules and regulations required of each Commission must be promulgated no later than 360 days after the enactment date. **Sec. 712(e) (p. 276)**.

The title provides that a broker or dealer registered with the SEC and registered with the CFTC as a futures commission merchant may hold cash and securities in a portfolio margining account carried as a futures account or a securities account. **Sec. 713 (pp. 276-77)**.

The 360 day time frame for issuing regulations represents a significant improvement from the House and Senate bills, which would have required regulations to be issued within 210 days or 180 days, respectively. Previous versions of the Act also included emergency authority for the SEC and CFTC to promulgate their rules and regulations, which would allow them to bypass the notice and comment periods. CFTC and SEC staff members, however, have stated publicly that they are eager to have the public's input on their rules and regulations.

C. Abusive Swaps

The CFTC or SEC may collect information regarding the markets for any types of [security-based] swap and issue a report with respect to any type of [security-based] swap that the CFTC or SEC determines to be detrimental to the stability of a financial market or participants in a market. **Sec. 714 (p. 277)**.

D. Authority to Prohibit Participation in Swap Activities

If the CFTC or SEC determines that a foreign company's regulation of [security-based] swaps undermine the U.S. financial system stability, then either Commission, in consultation with the Secretary, may prohibit an entity domiciled in the foreign country from participating in the United States in any [security-based] swap activity. **Sec. 715 (p. 278)**.

E. Prohibition Against Federal Government Bailout of Swaps Entities (Swap Desk Spin-Off Provision)

No federal assistance may be provided to any swaps entity with respect to any [security-based] swap or activity of the swaps entity. "Federal assistance" includes the use of any funds, including advances from any Fed credit facility or discount window, FDIC insurance, or guarantees for the purpose of making a loan to or purchasing stock in a swaps entity, purchase any swaps entity's assets, or guaranteeing their debt.

"Swaps entities" include [security-based] swaps dealers, major [security-based] swap participants, swap execution facilities, designated contract markets, national securities exchanges, central counterparties, clearing houses, clearing agencies, and registered derivatives clearing organizations. The term specifically excludes any major swap participant ("MSP") that is an insured depository institution and any insured depository institution or Title II CFC which is in conservatorship, receivership, or a bridge bank operated by the FDIC.

The prohibition on federal assistance does not prevent insured depository institutions from establishing swaps-entity-affiliates, so long as the insured depository institution is part of a BHC or SLHC supervised by the Fed.

Insured depository institutions still may engage in "*bona fide* hedging" of their own risks and engage in less "risky" [security-based] swap contracts, including those "permissible for investment by a national bank." They may not, however, act as a swaps entity for credit default swaps ("CDS") activity, unless the CDS are cleared.

Insured depository institutions will have up to 24 months to divest themselves of their swaps entity or cease activities that require registration as a swaps entity. When determining the length of the transition period, banking regulators must make written findings regarding the effects that the divestiture or cessation of activities will have on mortgage lending, small business lending, job creation, and capital formation. In consultation with the SEC and CFTC, the banking regulators may extend the transition period up to one additional year. [Security-based] swaps entered into prior to the end of the transition period are excluded from Section 716's prohibitions. The swaps-desk spin-off must take place two years following the Act's effective date.

FDIC-insured institutions that are put into receivership or declared insolvent because of [security-based] swap activity may have that activity terminated. The provision states that no taxpayer funds may be used to prevent any swap entity's receivership. Institutions subject to heightened prudential regulation under Section 113 because they pose a systemic risk will have their [security-based] swap activities terminated if they are put into receivership or declared insolvent. Again, no taxpayer funds may be used to prevent their receivership, nor may they be used to prevent the receivership of any other institution because of [security-based] swap activities.

In prescribing rules for swaps entities, the prudential regulators must consider the expertise and managerial strength of the entity, its financial strength, its risk control systems, and its systems for monitoring and controlling its participation in existing and new markets. The

Council may determine that if other provisions are not sufficient to mitigate systemic risk, swaps entities may not access federal assistance with respect to any [security-based] swap or other activity of the swaps entity. **Sec. 716 (pp. 278-281)**.

This provision was one of the most contentious during the conference. The House bill contained no swap desk spin-off provision, while the Senate bill, at Senator Lincoln's behest, contained a stronger provision which would have required all FDIC-insured institutions to spin off all their derivatives activities. Members on both sides of the aisle had concerns about the provision.

F. New Product Approval—CFTC-SEC Process

Title VII amends the Commodity Exchange Act and the Exchange Act of 1934 to give the CFTC authority to regulate swaps and the SEC authority to regulate security-based swaps. Certification of new products is stayed pending the determination by the relevant Commission that the product is a swap or security-based swap. **Sec. 717 (pp. 281-283)**.

G. Determining the Status of Novel Derivative Products

A person filing a proposal to list or trade a novel derivative product that may have characteristics of both a security and contracts of sale of a commodity for future delivery may file concurrently with the SEC and CFTC. Even if no notice of concurrent filing is given, however, the SEC or CFTC may ask the other Commission to render judgment on the product's category. The SEC or CFTC must issue the determination within 120 days of the receipt of the request. The SEC or CFTC may petition the D.C. Court of Appeals regarding a final order of the other Commission with respect to a novel derivative product. **Sec. 718 (pp. 283-285)**.

H. Studies

Title VII requires the CFTC and SEC to conduct a number of studies. The CFTC, in consultation with entities designated as contract markets, must conduct a study on the effects of position limits imposed under the title on excessive speculation and the migration of transactions offshore. The CFTC chairman also must submit biennial reports on the growth or decline of the U.S. and foreign derivatives markets. The SEC and CFTC must conduct a joint study regarding the feasibility of requiring the derivatives industry to adopt standardized, computer-readable algorithmic descriptions for complex and standardized financial derivatives. The SEC and CFTC must conduct a joint study regarding international swap regulation. They also must study whether stable value contracts fall within the "swap" definition. **Sec. 719 (pp. 285-288).**

I. CFTC-FERC Memorandum of Understanding

Within 180 days of enactment, the CFTC and FERC must negotiate a memorandum of understanding to establish procedures for applying their respective authorities, resolving conflicts of overlapping jurisdiction, and avoiding conflicting or duplicative regulation. They also must negotiate a memorandum of understanding to share information regarding investigations into potential market manipulation, fraud, or power abuse. **Sec. 720 (p. 288)**.

J. Regulation of [Security-Based] Swap Markets

1. Definitions

The definitions sections include numerous definitions. The most important ones are:

Major [Security-Based] Swap Participant

The MSP definition includes "any person who is not a [security-based] swap dealer, and – (i) maintains a substantial position in [security-based] swaps for any of the major [security-based] swap categories as determined by the Commission, excluding – (I) positions held for hedging or mitigating commercial risk; and (II) positions maintained by any employee benefit plan . . . for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan; [or] (ii) whose outstanding [security-based] swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or (iii)(I) is a financial entity, that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and (II) maintains a substantial position in outstanding [security-based] swaps in any major [security-based] swap category as determined by the Commission." The relevant Commission must define the term "substantial position." In setting capital requirements for a person that is designated as an MSP for a single type of [security-based] swap, the prudential regulator and relevant Commission must consider the other swaps and the value and quality of collateral held against counterparty exposures.

The MSP definition excludes captive finance companies, which the text defines as "an entity whose primary business if providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company." Thus, those affiliate companies wholly owned by a parent company, whose purpose is to provide financing for customers purchasing the parent company's products—will be exempt from clearing requirements for swaps entered to mitigate risk. **Sec. 721 (p. 294) and Sec. 761 (pp. 387-388)**.

The MSP definition has been a point of contention throughout the debate on derivatives regulation reform. The House definition was more narrowly tailored and less likely to capture end users using swaps to hedge their risk. The broader Senate definition was drafted several months after the House version and reflected the rising tide of populist sentiment. The final conference position incorporates more of the Senate definition, but adds the exclusion for captive finance companies.

[Security-Based] Swap

The terms "security-based swap" and "swap" include a wide variety of derivative transactions enumerated in the definitions. Significantly, the definitions explicitly include foreign exchange swaps and state that foreign exchange swaps and forwards are to be considered swaps unless the Treasury Secretary makes a written determination that they should not be regulated as swaps. Even if they are not regulated as swaps, they must be reported to a swap

data repository or the CFTC. The definitions specifically exclude any contract of sale of a commodity for future delivery, leverage contract, security futures product, and any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled. **Sec. 721 (pp. 296-300) and Sec. 761 (pp. 388-389)**.

[Security-Based] Swap Dealer

"[Security-based] swap dealer" means "any person who (i) holds itself out as a dealer in [security-based] swaps; (ii) makes a market in [security-based] swaps; (iii) regularly enters into [security-based] swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in [security-based] swaps."

The definition provides that no insured depository institution may be considered a [security-based] swap dealer to the extent it offers to enter into swaps with customers in connection with issuing a loan to the customers. It excludes a person that buys or sells [security-based] swaps for the person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business. The definition also excludes entities that engage in a *de minimis* quantity of [security-based] swap dealing in connection with transactions with or on behalf of its customers. **Sec. 721 (pp. 300-301) and Sec. 761 (p. 390)**.

The final language provides a *de minimis* exception, which previous drafts did not.

2. Jurisdiction - Preemption of State Insurance Law

Title VII provides that a swap is not to be considered to be insurance and may not be regulated as an insurance contract under state law. **Sec. 722 (p. 303)**.

This preemption provision has been strongly supported by end-users and others engaged in the OTC market who fear that the cost of complying with a patchwork of state insurance regulations would far outweigh the benefits of continuing their hedging activities in the derivatives market, and thereby eliminating one of their key risk-reduction tools. The National Conference of Insurance Legislators, which consists of state legislators whose main area of public policy concern is insurance, considered model legislation last year to regulate derivatives as insurance, and legislation has been offered in the New York State Assembly.

3. Clearing, Reporting, and Trade Execution

Title VII provides that any person who is a party to a [security-based] swap must submit the swap for clearing to a derivatives clearing organization ("DCO") (for swaps) or to a clearing agency (for security-based swaps). Before clearing a new type of [security-based] swap, the DCO or clearing agency must submit the type of [security-based] swap to the relevant Commission for prior approval. The Commission must provide at least a 30-day public comment period regarding any determination about clearing requirements for a type of swap. The Commission must take action within 90 days after the submission of the request. The Commissions individually must adopt rules within one year from the date of enactment to govern the submission requirements and also to govern the clearing of the [security-based] swaps once they are accepted. A Commission may stay the clearing requirement while it reviews a

submission. The Commissions also must identify [security-based] swaps required to be accepted for clearing. The Commissions individually must prescribe rules to prevent evasion of the mandatory clearing requirement.

Both counterparties to an uncleared [security-based] swap must report the [security-based] swap to a registered [security-based] swap repository, or if there is no repository that will accept the [security-based] swap, then to the relevant Commission. [Security-based] swaps entered into before the enactment date must be reported to a registered repository or the relevant Commission not later than 180 days after the effective date. [Security-based] swaps entered into on or after the enactment date but before the effective date must be reported not later than 90 days after the effective date, or such other time as prescribed by the relevant Commission.

[Security-based] swaps entered into before the enactment date are exempt from the clearing requirements if they are reported, as are [security-based] swaps entered into before application of the clearing requirement. **Sec. 723 (pp. 306-310) and Sec. 763 (pp. 394-397)**.

Counterparties to [security-based] swaps subject to the clearing requirement must execute the transactions on a board of trade designated as a contract market (for swaps) or on an exchange or swap execution facility (for security-based swaps). This requirement will not apply if no board of trade or exchange or swap execution facility makes the [security-based] swap available to trade or if a commercial end user counterparty opts to use its clearing exemption. **Sec. 723 (p. 312) and Sec. 763 (pp. 399-400)**.

4. End-User Clearing Exemption

The Act provides that the clearing requirements do not apply to a [security-based] swap if one of the counterparties "(i) is not a financial entity; (ii) is using [security-based] swaps to hedge or mitigate commercial risk; and notifies the Commission . . . how it generally meets its financial obligations associated with entering into non-cleared swaps." Financial entities include [security-based] swap dealers, MSPs, commodity pools, private funds, employee benefit plans, and persons "predominately engaged in activities that are in the business of banking, or in activities that are financial in nature." The relevant Commission must consider whether to exempt small banks, savings associations, farm credit system institutions, and credit unions. The definition of "financial entity" exempts captive finance companies, whose primary purpose is to provide financing for consumers of its parent companies' or other subsidiaries' products and who use derivatives to hedge underlying commercial risks related to interest rate and foreign currency exposures.

The Act provides that if a [security-based] swap otherwise would be subject to the mandatory clearing requirement and one of the counterparties is a commercial end user, the end user counterparty may elect not to clear the [security-based] swap, but if it does choose to clear the swap, then the end user may select the derivatives clearing organization at which the [security-based] swap will be cleared. Affiliates of end users only qualify for the exception if it is acting on behalf of the end user and using the [security-based] swap to hedge or mitigate the end user's commercial risk or another affiliate that is not a financial entity. The exception does not apply to any affiliate that is a [security-based] swap dealer, MSP, an issuer that would be an investment company, a commodity pool, or a BHC with over $50 billion in consolidated assets.

Captive finance arms of end users are exempt from the margin and clearing requirements with regard to [security-based] swaps entered into to mitigate the risk of financing activities for not less than two years beginning on the date of enactment. Counterparties that are issuers of securities must have an appropriate committee of their board approve any exemption from clearing and exchange trading of security-based swaps. **Sec. 723 (pp. 310-312) and Sec. 763 (pp. 397-399)**.

The final language removes the requirement for the SEC and CFTC to use expedited rulemaking procedures to establish the clearing and exchange trading regimes.

5. Segregation Requirements for Cleared [Security-Based] Swaps

For any person to accept remuneration from a [security-based] swaps customer to margin, guarantee, or secure a [security-based] swap cleared by a derivatives clearing organization or clearing agency, the person must register with the CFTC as a futures commission merchant or with the SEC as a broker, dealer, or security-based swap dealer. Futures commission merchants and brokers, dealers, and security-based swap dealers must treat all money, securities, and property of [security-based] swaps customers received to margin, guarantee, or secure a cleared swap as belonging to the [security-based] swaps customer. They are not to be commingled with the funds of the futures commission merchant, broker, dealer, or security-based swap dealer or used on behalf of any person other than the person for whom they are held. The funds, however, may be commingled and deposited in the same one or more bank accounts with any bank, trust company, or derivatives clearing organization. The money may be invested in obligations of the United States or any state or in obligations guaranteed by the United States. **Sec. 724 (pp. 313-315) and Sec. 763 (pp. 407-410)**.

6. Segregation Requirements for Uncleared [Security-Based] Swaps

[Security-based] swap dealers and MSPs will be required to notify their counterparties at the beginning of a transaction that the counterparties have the right to require segregation of funds or other property supplied to margin, guarantee, or secure the obligations of the counterparty. If a counterparty requests segregation of assets, the [security-based] swap dealer or MSP must segregate the funds and maintain them in a separate account. The segregation requirement does not apply to variation margin payments. If the counterparty does not choose to require segregation of the funds or property, then the [security-based] swap dealer or MSP must report to its counterparty on a quarterly basis that the it is in compliance with the back office procedures agreed upon by the parties. **Sec. 724 (pp. 315-316) and Sec. 763 (pp. 408-409)**.

7. Derivatives Clearing Organizations and Clearing Agencies

DCOs must register with the CFTC. A depository institution or clearing agency registered with the SEC that is now required to be registered as a DCO with the CFTC is deemed to be registered to the extent that, before the enactment date, the depository institution cleared swaps as a multilateral clearing organization or the clearing agency cleared swaps. The SEC must share relevant information with the CFTC.

The CFTC may exempt a DCO from registration if it determines that the DCO is subject to comparable regulation by the SEC or its home country regulators. Each DCO must designate

a chief compliance officer who will report to the DCO's board or senior officer, review the DCO's compliance with enumerated core principles, resolve conflicts of interest in consultation with the board, administer policies and procedures in relation to this Act, and prepare and sign an annual report. Among other topics, the core principles address reporting, recordkeeping, maintenance of sufficient capital, systemic safeguards, public disclosures, and governance standards.

The CFTC must adopt rules mitigating conflicts of interest in connection with the conduct of business by a swap dealer or MSP with a derivatives clearing organization, board of trade, or swap execution facility that clears or trades swaps in which the swap dealer or MSP has a material interest. Reported information from the DCOs will be shared with the SEC and other regulators. **Sec. 725 (pp. 316-325)**.

To reduce systemic risk, the Act provides that under no circumstances should a DCO be compelled to accept the counterparty credit risk of another clearing organization. **Sec. 725 (p. 326)**.

Similarly, clearing agencies must register with the SEC and comply with standards set by the SEC. They must designate a chief compliance officer to report to the board, resolve conflicts of interest in consultation with the board, administer policies and procedures, ensure compliance with this title, and prepare and sign annual reports. The SEC must adopt rules governing clearing agencies for security-based swaps. The SEC may exempt clearing agencies from registration if the SEC finds that the agency is subject to comparable regulation by the CFTC or its home country authorities. **Sec. 763 (p. 401)**.

8. Conflict of Interest Rulemaking

Within 180 days of enactment, the CFTC must adopt rules which may include numerical limits on the control of any DCO that clears swaps, or any swap execution facility or board of trade that posts swaps or makes swaps available for trading, by a bank holding company with total consolidated assets of $50 billion or more, a nonbank financial company supervised by the Fed, its affiliate, a nonbank financial company, a swap dealer, MSP, or associated person of a swap dealer or MSP. **Sec. 726 (pp. 326-327)**.

Likewise, within 180 days of enactment, the SEC must adopt rules which may include numerical limits on the control of any clearing agency that clears security-based swaps, or any security-based swap execution facility or board of trade that posts security-based swaps or makes security-based swaps available for trading, by a bank holding company with total consolidated assets of $50 billion or more, a nonbank financial company supervised by the Fed, its affiliate, a nonbank financial company, a swap dealer, MSP, or associated person of a swap dealer or MSP. **Sec. 765 (pp. 429-30)**.

9. Public Reporting of [Security-Based] Swap Transaction Data

The relevant Commission is required to provide by rule for the public availability of [security-based] swap transaction and pricing data. The CFTC or SEC must require real-time public reporting for all cleared and uncleared [security-based] swaps. "Real-time public reporting" means "to report data relating to a [security-based] swap transaction, including price

and volume, as soon as technologically practicable after the time at which the [security-based] swap transaction has been executed." Aggregate data on uncleared [security-based] swaps must be made available in a manner that does not identify individual transactions or positions. Parties to a [security-based] swap are responsible for reporting swap transaction information to the appropriate regulator in a timely manner, defined by the relevant Commission. **Sec. 727 (pp. 327-328) and Sec. 763 (pp. 412-413)**.

10. [Security-Based] Swap Data Repositories

[Security-based] swap data repositories must register with the relevant Commission, must comply with enumerated core principles, and must share information with the other relevant Commission upon request and with other regulators. [Security-based] swap data repositories are to accept data prescribed by the SEC or CFTC for each [security-based] swap, confirm the accuracy of the data submitted with both counterparties, and maintain the data as prescribed by the CFTC or SEC. If directed by the relevant Commission, [security-based] swap data repositories must establish automated systems for monitoring and analyzing [security-based] swap data, including compliance and frequency of end user clearing exemption claims. Each [security-based] swap data repository must designate a chief compliance officer who will report to the board or senior officer of the [security-based] swap data repository, review the repository's compliance with enumerated core principles, resolve conflicts of interest in conjunction with the board, administer policies and procedures, and prepare and sign an annual report. Among other topics, the core principles address antitrust concerns, governance, reporting, and conflict of interest concerns. **Sec. 728 (pp. 328-332) and Sec. 763 (pp. 414-417)**.

11. Reporting and Recordkeeping for Uncleared [Security-Based] Swaps

Each uncleared [security-based] swap must be reported to a [security-based] swap data repository or, if no [security-based] swap data repository will accept the swap, to the CFTC or SEC. [Security-based] swaps entered into before the date of enactment must be reported within 30 days after issuance of the interim final rule or other period of time established by the CFTC or SEC. Within 90 days of enactment, the CFTC and SEC must promulgate interim final rules providing for the reporting of each [security-based] swap entered into before the enactment date. The reporting provisions will be effective on the enactment date.

In a transaction in which only one counterparty is a [security-based] swap dealer or MSP, the [security-based] swap dealer or MSP will be responsible for reporting the transaction. If one counterparty is an MSP and the other is a [security-based] swap dealer, the [security-based] swap dealer must report the transaction. Otherwise, the counterparties to the [security-based] swap must select a counterparty to report the [security-based] swap.

Individuals who enter into uncleared [security-based] swaps whose [security-based] swaps are not accepted by a [security-based] swap data repository for reporting must provide reports regarding the [security-based] swaps to the CFTC or SEC upon written request from the relevant Commission and must maintain books and records relating to the [security-based] swaps which are open to inspection by the CFTC, SEC, and other regulators. **Sec. 729 (pp. 332-333) and Sec. 766 (pp. 430-433)**.

12. Large Trader Reporting

Title VII makes it unlawful for any person to enter into any swap that the CFTC determines performs a significant price discovery function with respect to registered entities if the person directly or indirectly exceeds the CFTC's daily position limits or other position limits. The title provides an exemption if the person files a report with the CFTC regarding the transaction and keeps books and records on the transaction which are open to the CFTC and SEC. **Sec. 730 (pp. 333-334)**.

The SEC also may require reporting of large positions in security-based swaps and securities, loans, or index of securities or loans or other instruments that relate to the security-based swaps. **Sec. 763 (p. 412)**.

K. Registration and Regulation of [Security-Based] Swap Dealers and Major [Security-Based] Swap Participants

[Security-based] swap dealers and MSPs must register with the relevant Commission. The CFTC and SEC must issue rules under these sections which will provide for the registration of [security-based] swap dealers and MSPs not later than one year after the enactment date. [Security-based] swap dealers and MSPs must register with the CFTC, even if they already are registered with the SEC, and vice versa. **Sec. 731 (pp. 335-336) and Sec. 764 (pp. 417-418)**.

1. Capital and Margin Requirements

[Security-based] swap dealers and MSPs that are banks must meet minimum capital and minimum initial and variation margin requirements for uncleared [security-based] swaps set by the appropriate federal banking agency in consultation with the SEC and CFTC. Nonbank [security-based] swap dealers and MSPs must meet minimum capital and minimum initial and variation margin requirements set by the relevant Commission.

In setting capital requirements for a person designated a [security-based] swap dealer or MSP for a single type of [security-based] swap, the prudential regulator and the relevant Commission must take into account risks associated with other types of [security-based] swaps or activities engaged in by that person.

Regulators must take into account the greater risk posed by uncleared swaps when setting capital and margin requirements. When setting the requirements, regulators must ensure that they help ensure the safety and soundness of the [security-based] swap dealer or MSP and be appropriate for the risk associated with the uncleared [security-based] swaps.

As written, the margin requirements will apply even if an end user is a counterparty to the swap. The language states that the regulators "shall adopt rules for swap dealers and major swap participants . . . imposing . . . both initial and variation margin requirements on all swaps that are not cleared by a registered derivatives clearing organization." We have been told by some that the conferees did not intend to authorize the imposition of margin on uncleared swaps to which an end user is a counterparty, but the language states otherwise and the aforementioned Dodd/Lincoln letter states only that margin cannot be imposed directly on end users.

Futures commission merchants, introducing brokers, brokers, and dealers must maintain sufficient capital to comply with the "stricter of any applicable capital requirements to which such futures commission merchant, introducing broker, broker, or dealer is subject to under this Act" or the Exchange Act.

The federal banking agencies and the SEC and CFTC must permit the use of noncash collateral for margin as the regulator or Commission determines to be consistent with preserving the financial integrity of markets trading [security-based] swaps and preserving U.S. financial stability.

The SEC, CFTC, and federal banking agencies must consult at least annually on minimum capital and margin requirements and to the maximum extent possible, maintain comparable requirements to each other. **Sec. 731 (pp. 336-338) and Sec. 764 (pp. 419-421).**

Previous versions of the legislation would have required that the capital requirements for banks must contain a capital requirement that is greater than zero for cleared [security-based] swaps and a "substantially higher" capital requirement for uncleared [security-based] swaps. Capital requirements for nonbanks would have been required to be "as strict as or stricter than" the capital requirements for the depository institutions. That language was removed from the final Act.

The final text explicitly states that existing contracts do not have to be cleared or exchange traded, though they must be reported. The Act, however, does not explicitly state that margin requirements will not apply to existing trades conducted by MSPs and swap dealers. CFTC Chairman Gensler and his staff have indicated that they are not certain that the bill provides authority to impose retroactive margin requirements but that, in any event, they do not intend to impose margin requirements retroactively even it they do have such authority, but the SEC and the prudential banking regulators also have authority to impose margin requirements.

Senator Collins made an effort to secure colloquy language making it clear that the bill is not intended to authorize the imposition of margin on existing derivatives contracts, but Senators Dodd and Lincoln refused to provide assurances to end users by entering into the colloquy.

2. Reporting and Recordkeeping By [Security-Based] Swap Dealers and Major [Security-Based] Swap Participants

Each registered [security-based] swap dealer and MSP must make reports required by the relevant Commission regarding transactions, positions, and financial condition of the entity and must maintain books and records as prescribed by the relevant Commission which they keep open for inspection. Each registered [security-based] swap dealer and MSP must maintain daily trading records and recorded communications as required by the CFTC or SEC and must maintain a complete audit trail for conducting trade reconstructions. **Sec. 731 (p. 338) and Sec. 764 (pp. 421-422)**.

3. Business Conduct Standards; Documentation and Back Office Standards

Each registered [security-based] swap dealer and MSP must conform to business conduct standards prescribed by the relevant Commission regarding fraud, manipulation, and other

abusive practices, supervision of its business, and adherence to position limits. [Security-based] swap dealers that provide advice to "Special Entities," which include federal, state, and local governments and pension plans, endowments, and retirement plans, may not defraud the Special Entity. Any [security-based] swap dealer that acts as an advisor to a Special Entity "shall have a duty to act in the best interests of the Special Entity." A [security-based] swap dealer or MSP offering to act as a counterparty or acting as a counterparty to a Special Entity must comply with "any duty" established by the CFTC or SEC that requires the [security-based] swap dealer or MSP to believe that the Special Entity has an independent representative.

The relevant Commission must adopt business conduct requirements establishing the standards of care for a [security-based] swap dealer or MSP in their interactions with eligible contract participants and to require the [security-based] swap dealer or MSP to disclose information to counterparties who are not also [security-based] swap dealers or MSPs regarding, among other things, information about the material risks and characteristics of a [security-based] swap, sources of remuneration in connection with the [security-based] swap, and daily marks of the [security-based] swap.

Each registered [security-based] swap dealer and MSP must conform to the relevant Commission's standards regarding the timely and accurate confirmation, processing, netting, documentation, and valuation of all [security-based] swaps. The relevant Commission must adopt rules governing documentation and back office standards. **Sec. 731 (pp. 339-341) and Sec. 764 (pp. 422-425)**.

The final version of the text, unlike the Senate draft, does *not* impose a fiduciary duty on swap dealers and MSPs engaging in transactions with Special Entities.

4. Duties of [Security-Based] Swap Dealers and Major [Security-Based] Swap Participants

Registered [security-based] swap participants and MSPs must monitor trading in [security-based] swaps to avoid violating position limits, must establish risk management systems, disclose information to regulators about their [security-based] swap transactions, and must establish internal systems to obtain necessary information to fulfill these duties. [Security-based] swap participants and MSPs must implement conflict of interest systems and must avoid violating antitrust principles. They must designate a chief compliance officer who will report to the board or senior officer, review compliance with duties, and resolve conflicts of interest in consultation with the board. The compliance officer must administer policies and procedures, ensure compliance with this Act, establish procedures for remedying noncompliance, and prepare and sign an annual report. **Sec. 731 (pp. 341-343) and Sec. 764 (pp. 425-427)**.

5. Futures Commission Merchants and Introducing Brokers Conflicts of Interest

The CFTC must require that futures commission merchants and introducing brokers implement conflict of interest systems which will establish firewalls between researchers and analysts on the one side, and those people involved in trading and clearing on the other. Futures commission merchants also must designate a chief compliance officer to report to the board,

review compliance with the Act, establish policies and procedures, and prepare and sign annual reports. **Sec. 732 (pp. 343-344)**.

6. [Security-Based] Swap Execution Facilities

To operate a facility for the trading or processing of [security-based] swaps, a person must register with the CFTC as a swap execution facility or as a designated contract market (for swaps) or a national securities exchange (for security-based swaps), even if the person is already registered with the SEC as a swap execution facility. After registration, a [security-based] swap execution facility may make available for trading any [security-based] swap and facilitate the trade processing of any [security-based] swap.

If a board of trade operates both a contract market and swap execution facility that use the same electronic trade execution system, the board of trade must identify whether the electronic trading of swaps is taking place on the contract market or the swap execution facility. The same requirement applies to national securities exchanges that also operate a security-based swap execution facility.

To be registered as a [security-based] swap execution facility, the facility must comply with enumerated core principles, including compliance with rules and enforcement of trading rules. The [security-based] swap execution facility must permit trading only in [security-based] swaps not readily susceptible to manipulation and must monitor trading and trade processing. It must have the ability to obtain internal information and must adopt position limits for speculators when necessary at a level no higher than the CFTC or SEC limitation. It must ensure the financial integrity of [security-based] swaps entered on its facility, have the ability to exercise emergency authority, and maintain books and records as required by the CFTC or SEC. The core principles also address conflicts of interest, financial resources, and system safeguards, and require the designation of a chief compliance officer. The SEC or CFTC may exempt a [security-based] swap execution facility from registration if the Commission finds that the facility is subject to comparable oversight by the other Commission. **Sec. 733 (pp. 344-349) and Sec. 763 (pp. 402-407)**.

7. Designated Contract Markets

To be designated as a contract market, a board of trade must comply with enumerated core principles and must establish, monitor and enforce the rules of the contract market including regarding access requirements, the terms and conditions of contracts to be traded on the market, and rules prohibiting abusive trading practices. The core principles include requirements that the board of trade may not list contracts readily susceptible to manipulation and the board must adopt position limits as necessary for speculators not higher than the CFTC's limit. The board must have the ability to use emergency authority. The board must make information regarding the terms and conditions of the contracts of the market, rules of the market, and information regarding the operation of the market available to regulators, market participants, and the public. It must make daily trading information public, protect the financial integrity of transactions, and protect market participants from abusive practices. It must have in place disciplinary and dispute resolution procedures and governance fitness standards and take into account antitrust considerations. **Sec. 735 (pp. 350-354)**.

8. Position Limits

The CFTC must set limits on the amount of positions, other than *bona fide* hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of the designated contract market. The CFTC must establish the limits within 180 days after the enactment date for exempt commodities and 270 days for agricultural commodities.

The CFTC also must establish limits, including related hedge exemption provisions, on the aggregate number or amount of positions in contracts based on the same underlying commodity that may be held by any person for each month across contracts listed by designated contract markets, contracts traded on a foreign board of exchange, swaps traded on a swap execution facility, and swaps that perform a significant price discovery function with respect to a registered entity. The CFTC may exempt any person, class of person, swap, or class of swaps from position limits. The section is effective on the date of enactment. **Sec. 737 (pp. 354-357)**.

Similarly, the SEC must establish position limits on the size of positions in any security-based swap that may be held by any person. In establishing the limits, the SEC may require any person to aggregate positions in security-based swaps and securities or group of securities or loans related to the security-based swap or any security-based swap with any security or index of securities which use the security's price, yield, value, or volatility as a material term for the security-based swap. The SEC may exempt any person, class of persons, security-based swap, or class of security-based swaps or transactions from any position limit requirements. The SEC also may direct self-regulatory organizations to adopt position limits. The SROs may require people to aggregate their positions. **Sec. 763 (pp. 410-411)**.

9. Foreign Boards of Trade

The CFTC may adopt rules requiring foreign boards of trade ("FBOTs") that provide their members and participants located in the United States direct access to electronic trading and order matching system to register with the CFTC. The CFTC must consider whether the FBOT is subject to comparable regulation by its home country authorities. The CFTC may not permit the FBOT to provide its members or participants located in the United States direct access to its electronic trading and order-matching system with respect to a transaction that settles against any price of any contracts listed for trading on a registered entity, unless the CFTC determines that the FBOT makes public daily trading information, adopts position limits, has authority to require participants to limit or reduce their positions to prevent manipulation and excessive speculation, and agrees to share information with the CFTC. The section will not affect FBOTs to which the CFTC already has granted direct access permission until 180 days after enactment. **Sec. 738 (pp. 357-359)**.

10. Legal Certainty for Swaps

The Dodd-Frank Act provides that hybrid instruments and swaps are not void for failure to comply with the Act or CFTC regulations. Swaps entered into before the date of enactment will not be subject to the mandatory clearing requirement. Position limits will not apply to a position acquired in good faith prior to the effective date of any rule, regulation, or order

establishing position limits, but those positions will be attributed to the trader if the trader's position is increased after the effective date of a position limit. **Sec. 739 (pp. 360-361)**.

11. Enforcement

The CFTC has primary authority to enforce the Subtitle A of the Title VII. The SEC has primary enforcement authority to enforce Subtitle B. The federal banking agencies have exclusive authority to enforce prudential requirements with respect to [security-based] swap dealers and MSPs that are depository institutions. The prudential regulators and relevant Commission may refer cases to each other if the relevant Commission believes that a [security-based] swap dealer or MSP has violated a prudential requirement or the prudential regulators believe a [security-based] swap dealer or MSP has violated a non-prudential requirement. If action is not taken on a referral after 90 days, the referring regulator may take action.

The SEC must censure, limit the activities of, or revoke the registration of any security-based swap dealer or MSP if the SEC finds after notice and opportunity for a hearing that the punishment is in the public interest and that the dealer or MSP has committed various violations of securities law. **Sec. 741 (pp. 361-362) and Sec. 764 (pp. 427-429)**.

12. Enhanced Compliance by Registered Entities

To be designated as and maintain the designation of a board of trade as a contract market, the board must comply with enumerated core principles. To accept a new product for trading or clearing or approve a new rule, it must certify in writing to the CFTC that the product or rule complies with the Act. Rules will become effective ten business days after the CFTC receives the certification, unless the CFTC notifies the registered entity otherwise, which will stay the certification up to 90 additional days. The rule will become effective after the 90 days unless the CFTC withdraws the stay or notifies the registered entity that it objects to the rule. The CFTC must provide at least a 30-day public comment period within the 90 days. The registered entity also can seek prior CFTC approval for contracts or rules. **Sec. 745 (pp. 367-369)**.

13. Insider Trading, Antidisruptive Practices

The title prohibits insider trading related to swaps or the sharing of nonpublic information for personal gain, as well as the knowing use of nonpublic information in swaps trading. **Sec. 746 (pp. 721-25)**. The title also prohibits engaging in disruptive practices, such as violating bids or offers or spoofing, as well as using swaps to defraud others. **Sec. 746-747 (pp. 369-371)**.

14. Whistleblowers

The title gives the CFTC authority to determine the amount of awards to give to whistleblowers and provides protections for whistleblowers, including protection from retaliation. It also establishes a fund to pay whistleblowers. **Sec. 748 (pp. 371-78)**.

15. International Harmonization

The SEC, CFTC, and prudential regulators must consult with foreign regulatory authorities to establish consistent international standards for the regulation of [security-based]

swaps and enter into information-sharing arrangements. **Sec. 752 (p. 382)**.

16. Effective Date

Unless otherwise provided, the derivatives provisions will take effect 360 days after enactment. **Sec. 754 (pp. 386-387) and Sec. 774 (p. 435)**.

The House Bill provided a blanket 210 days for implementation, while the Senate Bill provided 180 days. Regulators would have been hard-pressed to issue the number of rules required by the derivatives title within either of those amounts of time.