

A DFA DERIVATIVES PRIMER

Impact of Dodd-Frank on U.S. swaps activities:

- Not all derivatives are swaps under Dodd-Frank
 - need to consider full range of derivatives activities and identify those that will or might fall under “swaps” definition
 - “Swaps” definition will be addressed in CFTC and SEC regulations that are now being developed and debated
- CFTC covers all swaps other than security-based swaps, while SEC covers all security-based swaps
- A market participant will need to evaluate whether its swaps activities require that it register as a “swap dealer” or a “major swap participant”
 - There are separate registrations with the CFTC and SEC depending upon the type of swaps engaged in by a market participant
 - CFTC and SEC regulations will provide guidance for applying the swap dealer and major swap participant definitions, though these regulations are also now being developed and debated
- If a market participant must register as a swap dealer or major swap participant, it will become subject to a vast array of new regulatory requirements under Dodd-Frank, including
 - Capital and margin requirements.
 - Segregation requirements for initial margin.
 - Reporting and recordkeeping requirements, which may include detailed transaction and position records and pre-execution and post-execution trade information. Reporting will also be required for certain pre-enactment swaps
 - Maintenance of daily swap trading records, including related cash or forward transactions, and recorded communications, such as e-mail, IMs, and recorded telephone calls for required periods
 - Compliance with new business conduct standards
 - Compliance with new documentation standards
 - Additional duties and requirements (especially for swap dealers), including implementing risk management procedures, disclosing certain information to relevant regulatory agencies, and implementing conflict of interest systems
 - Requirement for a chief compliance officer, who must prepare certified annual compliance reports
- When executing a swap, a party will need to determine whether that swap must be cleared
 - Process for making this determination will be set forth in regulations that are still under development by the CFTC and the SEC
 - If a swap must be cleared, will also need to determine whether it must be executed on an exchange or other organized trading platform
- Swaps exempt from clearing will be
 - swaps executed by certain commercial end users who elect not to clear
 - swaps that haven’t been accepted for clearing by a derivatives clearing organization (DCO)
- New relationships and documentation will be necessary to permit clearing of swaps
 - will need to be or to have a relationship with a clearing member of a clearinghouse in order to clear trades
 - new cleared swap execution agreements and give-up agreements will be needed to facilitate execution and then clearing of swaps
- Margin requirements will apply not only to cleared swaps, but also to non-cleared swaps, with limited exception for certain commercial end users
- For banking entities that engage in U.S. swaps activities, the so-called “Lincoln Provision” will need to be considered
 - Some types of swaps activities may, in effect, be pushed out of a banking entity in order to preserve its access to federal assistance
 - The application of the Lincoln Provision to foreign banks with domestic branches remains unsettled because of an admitted oversight in the statutory wording

This is a summary, and only a very brief summary, and it is qualified in its entirety by reference to our more complete descriptions, analyses and reports on Title VII.