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LEGAL ALERT

June 30, 2010

Final Version of Financial Regulatory Reform Bill Establishes New Landscape - Critical Details Left to Regulators

One year after being proposed by the Obama Administration and after months of negotiation, which ended in an all-night conference session of key legislators, a final version of financial regulatory reform legislation has been produced. More than 2,000 pages long, the newly renamed "Dodd-Frank Wall Street Reform and Consumer Protection Act" (Dodd-Frank Bill) includes provisions that will dramatically change the derivatives market. Title VII of the Dodd-Frank Bill, governing derivatives transactions, is attached here, with an index to new definitions and sections of Title VII included here.

The bulk of the Dodd-Frank Bill consists of provisions crafted in the bills previously passed by the House and Senate. These provisions targeting derivatives include the mandatory clearing and trading on exchanges (or swap execution facilities) of most derivatives transactions; new requirements imposed on swap dealers, major swap participants and end users related to capital, margin, disclosure, reporting and recordkeeping; new authority to impose position limits on both exchange traded contracts and swap contracts; and imposition of the "Volcker Rule," which severely limits the ability of banks to engage in proprietary trading. A chart comparing key provisions relating to derivatives in the Dodd-Frank Bill against those provisions in proposals put forward by the Administration, House and Senate is attached here.

The Dodd-Frank Bill also includes a number of changes to prior financial reform legislative proposals that will have an impact on both how this legislation will be implemented and the effect it will have on market participants. Specifically, the Dodd-Frank Bill provides for joint rulemaking by the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC), as well as extending the date of effectiveness for most of the provisions and the promulgation of certain regulations to one year after enactment, rather than the six-month period provided for in prior proposals. Additionally, the Dodd-Frank Bill removed provisions such as an important exemption from the bill's margining and collateral requirements for certain end users with respect to uncleared swaps, and the fiduciary duty requirement originally imposed on swap dealers in transactions with certain counterparties. One extremely contentious provision, the requirement that banks spin off their derivatives desks, was included in the Dodd-Frank Bill in a modified form that allows banks to maintain certain derivatives transactions, which would likely include most interest rate and foreign exchange transactions directly related to the mitigation of risk, and certain cleared credit default swaps.

The legislation mandates a number of studies including a study concerning the impact of position limits on excessive speculation and on the movement of transactions from U.S. to foreign markets. Another study addresses "stable value contracts" and whether these contracts should be included in the definition of "swaps" for purposes of the new legislation. The Dodd-Frank Bill provides that current stable value contracts would not be considered swaps; however, the SEC and CFTC must conduct a study within 15 months of enactment of the Dodd-Frank Bill to determine whether such contracts should be considered swaps.

Now that the text of this financial reform legislation has been finalized, focus must shift to the potentially more important future rulemakings mandated by the bill that will dictate how the reforms within the Dodd-Frank Bill are put into practice. Nearly every key provision of this massive piece of legislation calls for some type of administrative rulemaking to be undertaken. Within these rules will lie the answers to most of the questions circulating throughout the derivatives market in response to this legislation. Myriad issues will be determined by the future rules, and an attached chart, available here, enumerates certain significant rulemakings related to the key issues identified in the other chart provided in this alert. The true impact of the legislative changes on various derivatives market participants cannot be determined until these rules have been promulgated.

Finally, although the Dodd-Frank Bill reflects the final legislative text negotiated by the House and Senate in conference, this bill will not become law until it is passed through both houses of Congress and signed by the President. While the bill is expected to be quickly approved in the House, a number of Senators have expressed reservations about changes made during the conference committee that made their way into the final bill. As a result, the House and Senate conferees met again to address concerns relating to last-minute changes in the bill, but did not alter the provisions in Title VII. Congressional leaders originally hoped to have the bill passed by both houses of Congress and signed into law by the President before the July 4th recess; however, it now appears that a final vote on this bill will not occur until after the holiday.

We will continue to monitor the status of the Dodd-Frank Bill and keep you updated on key events.

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If you have any questions about this Legal Alert, please feel free to contact the attorneys listed below or the Sutherland attorney with whom you regularly work.

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