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LEGAL ALERT

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Compromise on Derivatives Bill Adds to Debate

The ongoing debate over regulation of the over-the-counter (OTC) derivatives market recently picked up considerable steam following the release of Sen. Blanche Lincoln's (D-AR) much anticipated bill governing OTC transactions on March 16, 2010. Following quickly after Sen. Lincoln's bill, the Wall Street Transparency and Accountability Act of 2010 (Lincoln Bill), was passed out of the Senate Agriculture Committee, feverish negotiations between Sen. Lincoln and Sen. Chris Dodd (D-CT) led to a compromise between the two committee chairmen (Dodd/Lincoln Compromise) that will result in many of the Lincoln Bill's proposals being included in Sen. Dodd's Restoring American Financial Stability Act of 2010 (Dodd Bill) before such bill is sent to the full Senate for consideration.

The Dodd/Lincoln Compromise, like the Lincoln Bill upon which it is based, represents the most restrictive set of proposed regulations governing OTC transactions released to date, including the Dodd Bill, the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173) passed by the House, and the Obama Administration's proposal for derivatives regulation, put forth under the auspices of the Treasury Department. (For a discussion of these prior legislative proposals, see Sutherland Legal Alerts attached here and here.)

Provisions in the Dodd/Lincoln Compromise governing the mandatory clearing of OTC transactions on clearinghouses and the required trading of OTC transactions by exchanges are similar in scope to those proposed in previous legislative proposals, yet contain fewer exemptions. The Dodd/Lincoln Compromise also extends certain margin, capital, reporting and recordkeeping requirements to a wide variety of market participants, including many entities typically characterized as end-users. Additionally, the Dodd/Lincoln Compromise contains unique provisions prohibiting the federal government from providing financial backing to banks and other entities that already engage in OTC transactions, which could force U.S. banks to spin off their OTC trading activities or risk losing their status with the Federal Deposit Insurance Corporation or the Federal Reserve. Although attention has been given in recent days to a provision in the Lincoln Bill (purportedly requested by Warren Buffett, as reported by *The Wall Street Journal* and other media outlets) that would have grandfathered existing OTC transactions and thus allowed them to avoid onerous margining requirements, this exception was not included in the Dodd/Lincoln Compromise. Finally, the Dodd/Lincoln Compromise contains a new provision aimed at protecting customer funds used for OTC transactions cleared through a derivatives clearing organization during the bankruptcy of a customer's commodity broker. The aforementioned changes, as well as other provisions in the Dodd/Lincoln Compromise, are compared to previously proposed OTC legislation in the chart attached here.

Democratic leaders in the Senate are currently pushing forward in their attempts to bring a final financial regulatory reform bill to the Senate floor for debate this week. Although on three consecutive days these efforts were thwarted by Republican senators seeking more time to negotiate a bipartisan agreement for financial reform legislation, late yesterday the Senate agreed by unanimous consent to advance the Dodd Bill for debate in the full Senate.

We will continue to monitor these fast-changing events and keep you apprised of all relevant developments.

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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.

James M. Cain	202.383.0180	james.cain@sutherland.com
Paul B. Turner	713.470.6105	paul.turner@sutherland.com
Warren N. Davis	202.383.0133	warren.davis@sutherland.com
William H. Hope II	404.853.8103	william.hope@sutherland.com
Robin J. Powers	212.389.5067	robin.powers@sutherland.com
Mark D. Sherrill	202.383.0360	mark.sherrill@sutherland.com
Doyle Campbell	212.389.5073	doyle.campbell@sutherland.com
Richard E. Grant	202.383.0909	richard.grant@sutherland.com
Meltem F. Kodaman	202.383.0674	meltem.kodaman@sutherland.com