

# THE NEW REQUIREMENTS FOR THE OTC DERIVATIVES MARKET UNDER DODD-FRANK

QUADRILATERAL MEETING

SAN FRANCISCO

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# Entity Types

Swap Dealer (SD)**	Major Swap Participant (MSP)**	End-User	Other
<p>Any person who –</p> <ul style="list-style-type: none"> <li>• Holds itself out as dealer in Swaps, or</li> <li>• Makes a market in Swaps, or</li> <li>• Regularly enters into Swaps with counterparties in the ordinary course of business for its own account, or</li> <li>• Engages in activity causing such person to be commonly known in the trade as a dealer or market maker.</li> </ul> <p><u>Exceptions</u></p> <ul style="list-style-type: none"> <li>• Swaps entered into for a person’s own account (individually or in a fiduciary capacity) but not as a part of regular business.</li> <li>• De Minimis Swap dealing activities in connection with transactions with or on behalf of its customers (as most recently proposed, no more than \$100mm in aggregate gross notional over preceding 12 months or \$25mm with swaps with Special Entities and with limit on # of swaps)</li> </ul>	<p>A person – other than a SD –</p> <ul style="list-style-type: none"> <li>• Maintains a “Substantial Position”**** in a “Major Category of Swaps” (excluding positions for hedging or mitigating commercial risk),</li> <li>• Whose Swaps create “Substantial Counterparty Exposure” **** that could have serious adverse effects on the financial stability of the US banking system or financial markets, or</li> <li>• Is a “Financial Entity” that is “Highly Leveraged” relative to the amount of capital it holds and where such entity is (i) not subject to capital requirements established by a federal banking agency and (ii) maintains a “Substantial Position” in a “Major Category of Swaps”.</li> </ul> <p><u>MSP Exception</u></p> <ul style="list-style-type: none"> <li>• Primary business is providing financing, and use of derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign exchange exposure subject to specific requirements.</li> </ul>	<p>A person – a non-Financial Entity –</p> <ul style="list-style-type: none"> <li>• Uses Swaps to “Hedge or Mitigate Commercial Risk”,</li> <li>• If a publicly listed end-user, has board or appropriate committee thereof approval to use the exemption,</li> <li>• Notifies the CFTC how it generally meets its financial obligations associated with entering into non-cleared swaps.</li> </ul> <p>Where –</p> <p><u>Financial Entity</u> includes SD, MSP, Commodity Pool, Private Fund, ERISA Plan, or Person predominantly engaged in activities that are associated with the business of banking or are of a financial nature.</p> <p><u>Hedging or Mitigating Commercial Risks</u> where the Swap –</p> <ul style="list-style-type: none"> <li>• Qualifies as Bona Fide Hedge under CEA, or</li> <li>• Qualifies under FASB No. 133 for hedging treatment, or</li> <li>• Reduces risks in the conduct and management of commercial enterprise.</li> </ul>	<p>A person who is either–</p> <ul style="list-style-type: none"> <li>• A Financial Entity other than a SD or MSP or</li> <li>• Would qualify as an End-User but for failure to satisfy either requirement – “Hedging or Mitigating Commercial Risk” or CFTC Notification.</li> </ul>

\*Scope of “Swaps” defined under joint CFTC/SEC Proposed Regulation on Product Definitions Contained in the Derivatives Title.

\*\*As used herein, “Swap Dealer” includes “Security-Based Swap Dealer”.

\*\*\*Except as otherwise noted, “Major Swap Participant” includes “Major Security-Based Swap Participant”.

\*\*\*\***Substantial Position:** Proposed \$3bn CE/6bn CE+PE (uncollateralized) for IRS and \$1bn CE/2bn CE+PE (uncollateralized) for other Swaps.

**Substantial Counterparty Exposure:** Proposed \$5bn CE/8bn CE+PE in average uncollateralized aggregate exposure for Swaps and \$2bn CE/4bn CE+PE for SBS.

## Select Provisions Applicable to a Relevant Entity's Swaps Activity

	Swap Dealers and Major Swap Participants	End-users	Other (e.g., Non-MSP Financial Entities)
Clearing	All swaps that are subject to a clearing requirement are required to be cleared unless with end-user who elects not to clear	May elect not to clear but if elects to clear, has unilateral option to specify clearinghouse	All swaps that are subject to a clearing requirement are required to be cleared unless with end-user who elects not to clear
Execution	All swaps that are subject to a clearing requirement are required to be executed on an exchange or SEF unless swap is not listed and/or is entered into with end-user who elects to execute bi-laterally	May elect to execute bi-laterally and will have unilateral right to opt for Initial Margin segregation.	All swaps that are subject to a clearing requirement are required to be executed on an exchange or SEF unless swap is not listed and/or is entered into with end-user who elects to execute bi-laterally
Reporting	Recordkeeping and reporting requirements apply. Swaps reportable to swap data repositories and to public disseminator.	Recordkeeping and reporting requirements apply but can rely on U.S. Swap Dealer/MSP to satisfy reporting obligation.	Recordkeeping and reporting requirements apply but can rely on SD/MSP to satisfy reporting obligation.
Business Conduct	CFTC proposed rules governing business conduct by SDs and MSPs in their swap execution activity, which for trades with non dealers/MSPs would require , <i>inter alia</i> , disclosure of material risk and characteristics of swaps, material incentives and conflicts of interests, and daily marks and also require a separate standard of care when dealing with "Special Entities."	Not applicable, but will be subject to position limits except to extent eligible for bona fide hedge treatment	Not applicable, but will be subject to position limits except to extent eligible for bona fide hedge treatment

## Select Provisions Applicable to a Relevant Entity's Swaps Activity

	Swap Dealers and Major Swap Participants	End-users	Other
Registration	CFTC registration required Associated person registration required	No CFTC registration required	No CFTC registration required
Margin	CFTC and Prudential Regulators have proposed that all uncleared trades an SD executes with an SD, MSP or Financial End User*, be subject to minimum margin requirements specifying IM/VM thresholds, margin methodology, acceptable forms of collateral (with minimum haircuts) and custody and segregation requirements.	No margin requirements though under CFTC proposed rules must (i) have credit support arrangements in place (with initial/variation margin thresholds to be agreed upon between the parties) and (ii) hypothetical initial/variation margin to be calculated daily.  Can opt into IM segregation	CFTC and Prudential Regulators have proposed that all uncleared trades a Financial End User executes with an SD or MSP be subject to minimum margin requirements specifying IM/VM thresholds, margin methodology, acceptable forms of collateral (with haircuts) and custody and segregation requirements. The specific requirements will hinge on the whether the entity has "significant swaps exposure" and is therefore high, instead of low, risk.  Can opt into IM segregation.
Capital	CFTC recently published capital requirements for SDs and MSPs within its authority	No capital requirements.	No capital requirements specified under Derivatives Title.

\*"Financial End Users" – as defined for purposes of the margin requirements – are Financial Entities and (i) persons that would be commodity pools or private funds if organized under the laws of the United States or any State; (ii) foreign governments or political subdivisions; and (iii) any other person that the relevant agency may designate.

## Foreign Exchange Transactions Proposed Treasury Determination

- **U.S. SECRETARY OF TREASURY HAS ISSUED NARROWLY TAILORED NOTICE OF PROPOSED DETERMINATION PROVIDING :**
  - *FX SWAPS AND FORWARDS TO BE EXEMPT FROM THE DEFINITION OF “SWAP” AND THUS WILL NOT BE SUBJECT TO DODD-FRANK’S CLEARING AND EXECUTION REQUIREMENTS, CITING FOLLOWING REASONS:*
    - FIXED PAYMENT OBLIGATIONS
    - PHYSICALLY SETTLED TRANSACTIONS
    - PREDOMINANTLY SHORT-TERM INSTRUMENTS
    - RISK PROFILE CENTERED ON SETTLEMENT RISK, NOT COUNTERPARTY CREDIT RISK
    - HIGHLY TRANSPARENT, LIQUID AND EFFICIENT MARKET
    - EXISTING MECHANISMS AND PROCEDURES MITIGATE RISK AND HELP ENSURE STABILITY (E.G., TRANSPARENCY AND AVAILABILITY OF MARKET PRICING)
  - *FX SWAPS AND FORWARDS WILL BE SUBJECT TO THE BUSINESS CONDUCT RULES AND TRADE REPORTING REQUIREMENTS.*
  - *FX DERIVATIVES, INCLUDING FX OPTIONS, CURRENCY SWAPS AND NON-DELIVERABLE FORWARDS, WILL BE SUBJECT TO CLEARING AND EXECUTION REQUIREMENTS.*

**From a Bi-lateral Model**



**To the New Execution, Reporting and Clearing Model**

