

**THE WALL STREET TRANSPARENCY AND ACCOUNTABILITY ACT:  
IMPLICATIONS FOR DERIVATIVES MARKETS PARTICIPANTS**

The Wall Street Transparency and Accountability Act of 2010<sup>1</sup> (the “WSTAA”) has become law. The WSTAA will impose extensive oversight on the generally unregulated over-the-counter (“OTC”) derivatives markets. This memorandum summarizes the major points of the WSTAA and highlights certain related provisions of the Dodd-Frank Act which may be relevant to market participants. It is important to note that the WSTAA contains ambiguous provisions and requires various federal agencies to enact rules determining both the scope of the regulation under the WSTAA and the entities to which such regulation will apply. Given the uncertainty about the text of the law and its interpretation and enforcement by regulators, the full impact of the WSTAA will take time to assess and will in large part depend upon the results of the required administrative rulemaking process.

This memorandum considers both the OTC derivatives that will be under the jurisdiction of the Commodity Futures Trading Commission (the “CFTC”) (*e.g.*, swaps) and those that will be under the jurisdiction of the Securities and Exchange Commission (the “SEC”) (*e.g.*, security-based swaps (“SBS”). The two categories of instruments will be subject to largely analogous regulation under the WSTAA and will, therefore, be discussed together with any differences noted.

**Background**

The WSTAA brings a wide range of instruments under the jurisdiction of the CFTC and SEC. The WSTAA grants the CFTC jurisdiction over “swaps” and repeals certain safe harbors<sup>2</sup> of the Commodity Exchange Act (the “CEA”) that previously permitted transactions, including swaps, in excluded or exempt commodities<sup>3</sup> between eligible contract participants (each, an “ECP”) <sup>4</sup> to be excluded from most or all provisions of the CEA. The WSTAA also limits the scope of the

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<sup>1</sup> Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). Title VII is Congress’s reconciliation of the Wall Street Transparency and Accountability Act of 2010 passed by the U.S. Senate on May 20, 2010 and the Derivative Markets Transparency and Accountability Act of 2009 passed by the House of Representatives on December 10, 2009.

<sup>2</sup> Sections 2(d), 2(e), 2(g) and 2(h) of the CEA have been repealed.

<sup>3</sup> “Excluded commodities” are, generally, financial commodities with a virtually unlimited supply, such as currencies, securities, interest rates and securities indices. “Exempt commodities” are all commodities that are not excluded commodities or agricultural commodities and include energy and metals.

<sup>4</sup> ECPs are, generally, regulated entities, governmental bodies, entities that have more than \$10 million in total assets and certain sophisticated individuals.

exemptions provided for in section 2(c) of the CEA because many of those exempt transactions could fall within the broad definition of “swap” under the WSTAA. Section 2(c) of the CEA previously exempted, among others, contracts and transactions in foreign exchange (“FX”), government securities, security warrants and certain retail FX transactions (*e.g.*, OTC FX transactions in which one of the counterparties is not an ECP).

The WSTAA gives the SEC jurisdiction over SBS (swaps based on a single security or narrow-based security index) and adds SBS to the definition of “security” under the Securities Act of 1933 (the “Securities Act”) and the Securities Exchange Act of 1934 (the “Exchange Act”). The WSTAA will require registration of SBS under the Securities Act for transactions with non-ECPs and reporting of SBS under Sections 13 and 16 of the Exchange Act.

The WSTAA creates new registration categories for certain counterparties to swaps and SBS (*i.e.*, major swap participants (each an “MSP”), major SBS participants (each an “SBMSP”), swap dealers and SBS dealers) and authorizes the CFTC and SEC to impose capital and margin requirements on such counterparties. The WSTAA imposes aggregate position limits across all futures contracts and swaps contracts on the same underlying commodity that perform significant price discovery functions.

The WSTAA provides a framework to regulate the manner in which swap or SBS trading is conducted by requiring that the majority of swaps and SBS be cleared by a regulated clearing house and that swaps subject to the clearing requirement be traded on regulated trading venues (*i.e.*, CFTC designated contract markets or swap execution facilities -- a new type of trading facility -- for swaps, and SEC regulated exchanges or SBS execution facilities for SBS). It is expected that the majority of standardized swaps and SBS will be subject to the clearing requirement.

The WSTAA also requires reporting of all swaps and SBS to the appropriate regulator or a data repository (a new type of entity under the WSTAA) regulated by the SEC or CFTC, as appropriate. With respect to FX transactions, the WSTAA requires reporting of such contracts as prescribed by the CFTC even if the Secretary of the Treasury (the “Secretary”) acts to exclude them from the definition of “swap.”

### **Definition of “Swap” and SBS**

The WSTAA introduces an extremely broad definition of the term “swap” into the CEA. A “swap” pursuant to the WSTAA could be, generally, any transaction that is not immediately settled by delivery of the underlying commodity.

The definition of swap includes:

- options, such as puts, calls, caps, and floors on most reference assets;
- swaps, such as those on interest rates, broad-based securities indices and most other reference assets;

- credit default swaps (“CDS”)<sup>5</sup>;
- any other instrument “that is or becomes commonly known as a swap;”
- foreign exchange swaps and foreign exchange forward contracts; and
- an instrument that combines any of the above.

As noted above, the WSTAA specifically includes foreign exchange swaps (“FX Swaps”) and foreign exchange forwards (“FX Forwards”) in the definition of “swap.” The WSTAA gives the Secretary the ability to submit to Congress a written determination to exclude FX Swaps and FX Forwards from the definition of “swap.”

The definition of swap generally *excludes* futures contracts and forward contracts that are likely to be settled by physical delivery. This exclusion creates uncertainty as to what instruments would be “swaps” under the WSTAA because certain types of swaps could be viewed as two contracts of sale of a commodity for future delivery.

An SBS is also excluded from the definition of swap; that term is defined as a swap based on a single security or a narrow-based security index. SBS are separate and distinct under the WSTAA from swaps based on broad-based security indices (such “broad” security-based swap agreements, “SBSA”). SBSA are included in the definition of “swap” and are subject to CFTC jurisdiction.

### **Swap Dealers (and SBS Dealers) and MSPs (and SBMSPs)**

Counterparties to a swap will have to register with the CFTC if they fall within the definition of swap dealer or MSP, and with the SEC if they fall within the definition of SBS dealer or SBMSP. An entity deemed to be a dealer or major participant for both swaps and SBS will have to register with both the CFTC and the SEC. *There is no explicit exclusion from the registration requirement for investment vehicles such as hedge funds and registered investment companies.*

Swap dealer or SBS dealer, generally, means:

Any person who (i) holds itself out as a dealer in swaps or SBS; (ii) makes a market in swaps or SBS; (iii) regularly enters into swaps or SBS 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 swaps or SBS.

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<sup>5</sup> CDS on a broad group of securities presumably would be swaps. CDS on single names or a narrow group of securities presumably would be security-based swaps.

A person may be designated as a swap dealer or SBS dealer for a single type or single class or category of swap or SBS or activities and considered not to be a swap dealer or SBS dealer for other types, classes or categories of swaps or SBS or activities.

Swap dealer or SBS dealer excludes, respectively, a person that enters into swaps or SBS for such person's own account, either individually or in a fiduciary capacity, but not as part of a regular business.

The CFTC or SEC, as appropriate, must exempt from designation as a swap dealer or SBS dealer an entity that engages in a de minimis quantity of swap or SBS dealing in connection with transactions with or on behalf of its customers.<sup>6</sup>

Major Swap Participant or SBMSP, generally, means:

Any person that is not a swap dealer or SBS dealer, and (i) maintains a substantial position<sup>7</sup> in swaps or SBS for any of the major swap or SBS categories as determined by the CFTC or the SEC, excluding (I) positions held for hedging or mitigating commercial risk<sup>8</sup>; and (II) positions maintained by any employee benefit plan (or any contract held by such a plan) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan; (ii) whose outstanding swaps or SBS 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 swaps or SBS in any major swap or SBS category as determined by the CFTC or the SEC.

A person may be designated as an MSP or SBMSP for one or more categories of swaps or SBS without being classified as an MSP or SBMSP for all classes of swaps or SBS.

The definition of MSP excludes an entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90% or more of which arise from financing that facilitates the purchase or lease of products, 90% or more of which are manufactured by the parent company or another subsidiary of the parent company.

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<sup>6</sup> The agencies must promulgate regulations to establish factors with respect to what qualifies as de minimis activity.

<sup>7</sup> The CFTC is required to define "substantial position."

<sup>8</sup> The CFTC may adopt rules defining "commercial risk."

We note that a person who is an SBS dealer will not necessarily be a “dealer” within the meaning of Section 3(a)(5) of the Exchange Act. Although SBS is defined as a “security” under amended Section 3(a)(10) of the Exchange Act, and Section 3(a)(5) defines a dealer as a person who is engaged in the business of buying and selling securities for the person’s own account, amended Section 3(a)(5) excludes from the definition of dealer a person who buys and sells “security-based swaps, other than security-based swaps with or for persons that are not eligible contract participants.” Thus, a person who acts as an SBS dealer would need to register with the SEC as such, but would not necessarily be required to register as a dealer under Section 3(a)(5). Whether dealer registration is required will depend on (i) the types of SBS transactions in which the entity engages, and (ii) whether the entity is engaged in the business of buying and selling securities other than SBS for its own account.

The swap dealer and MSP registration requirements will apply to any U.S. person.<sup>9</sup> In addition, the WSTAA authorizes extraterritorial application of its measures regarding swaps when the activity taking place outside of the U.S. (i) has a direct and significant connection with activities in the U.S. or effect on U.S. commerce or (ii) contravenes any rules made to prevent evasion of the WSTAA. The measures regarding SBS would appear to apply extraterritorially only if the activity outside of the U.S. violates rules established to prevent evasion of the WSTAA.<sup>10</sup>

Thus, it appears that there is a greater basis for application of the WSTAA registration requirements to non-U.S. entities engaged in swap, rather than SBS, transactions outside of the U.S. Although the enforceability of any such attempt at extraterritorial application would need to be evaluated on a case-by-case basis, the CFTC and SEC will possess the ability to bar an entity domiciled outside of the U.S. from participating in any swap or SBS activities in the U.S. if one of the agencies determines, in consultation with the Secretary, that the regulation of swaps or SBS in the country in question undermines the stability of the U.S. financial system. Presumably, the ability to bar access to U.S. markets will serve as a basis for U.S. regulators to compel registration of foreign entities.

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<sup>9</sup> Generally, under the CEA, a U.S. person includes a collective investment vehicle with 10% or more U.S. ownership.

<sup>10</sup> For a discussion of a recent case on the application of U.S. securities laws in foreign markets, please see our memorandum “*Supreme Court Issues Landmark Decision on Extraterritorial Application of U.S. Securities Laws*,” dated June 28, 2010, which may be accessed at: [http://www.willkie.com/files/tbl\\_s29Publications/FileUpload5686/3396/Supreme%20Court%20Issues%20Landmark%20Decision.pdf](http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/3396/Supreme%20Court%20Issues%20Landmark%20Decision.pdf). Title IX of the Dodd-Frank Act, however, enables the SEC and Department of Justice, notwithstanding that Supreme Court decision, to pursue violations involving foreign investors trading foreign securities in foreign markets if there has been either conduct within the United States that constitutes significant steps in furtherance of the violation, or conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

## Margin Requirements

Swap dealers, SBS dealers, MSPs and SBMSPs will be subject to, among other requirements, minimum capital and margin requirements established by the CFTC, the SEC or a banking regulator.<sup>11</sup> The margin requirements (the amount of collateral parties post to secure their obligations to one another) will include requirements for initial margin (collateral posted on the first day of a trade) and variation margin (margin posted on a daily basis based on the market value of a trade or group of trades). In establishing margin requirements for swap dealers, SBS dealers, MSPs and SBMSPs, the banking regulator, CFTC and SEC are required to permit the use of non-cash collateral as the banking regulator, CFTC or SEC determines to be consistent with preserving the integrity of the markets trading swaps or SBS and preserving the stability of the U.S. financial system. In addition, as discussed below under “*Systemically Important Entities Under Title VIII*,” the agencies must consult with the Board of Governors of the Federal Reserve System (the “Federal Reserve”) in establishing margin and capital requirements for certain types of entities. The Federal Reserve may mandate stricter requirements. The method for determining minimum margin requirements for swaps and SBS has not yet been prescribed.

With respect to unregistered entities, the CFTC or SEC would have the authority to establish margin requirements only when a swap or SBS has been determined by the agency to be subject to the clearing requirement, but no clearing organization accepts the swap or SBS for clearing. The ability of the CFTC and SEC to establish margin requirements for swap dealers, SBS dealers, MSPs and SBMSPs, however, could also indirectly impose such requirements on unregistered entities (including end users) because these registered entities may contractually require reciprocal financial standards from their unregistered counterparties. Any swap or SBS cleared by any clearing house will be subject to the margin requirements established by that clearing house.

With respect to swaps or SBS entered into prior to the enactment of the WSTAA, however, there is currently a difference of opinion on whether such swaps or SBS will be exempt from margin requirements. There is some evidence that such a retroactive application was not intended. In a June 30, 2010 letter from Senators Dodd and Lincoln to Representatives Frank and Peterson (the “Dodd Letter”) the Senators noted that the capital and margin requirements in the WSTAA could have an impact on existing swaps. The Dodd Letter further stated that “[i]t is imperative that we provide certainty to these existing contracts for the sake of our economy and financial system.” The Dodd Letter indicated that this could be clarified during the rulemaking process.<sup>12</sup>

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<sup>11</sup> While various regulators will establish minimum capital and margin requirements under the WSTAA, nothing would preclude a counterparty, clearing house or trading facility from establishing higher requirements.

<sup>12</sup> Lawmakers, however, were apprised of the ambiguity and failed to remedy it. In a June 9, 2010 letter from the ABA Business Law Section (the “ABA Letter”) to Chairman Dodd and Chairman Frank, the ABA stated that the ambiguity in the current WSTAA could lead to unnecessary protracted litigation on whether it was intended to apply retroactively and would result in a disruption of the financial markets. The ABA Letter cited to testimony of Treasury Secretary Timothy Geithner that economic requirements should have only prospective application to swaps.

## “Clearing” Requirement

Clearing, in general, is the procedure by which an organization acts as an intermediary for transactions by assuming the role of buyer to every seller (and vice versa) *for the duration of the contract*. This process reconciles orders between transacting parties and, in theory, reduces counterparty risk and provides for a more efficient and secure market. The clearing mechanism in the futures markets operates in this fashion.

The WSTAA explicitly exempts swaps or SBS entered into prior to enactment from the clearing requirement, provided that such swaps or SBS are reported as discussed below. The WSTAA provides that, going forward, all swaps and SBS required to be cleared must be submitted to a derivatives clearing organization (“DCO”) registered with the CFTC or a clearing agency registered with the SEC, as applicable, unless the “end user” exemption applies. Thus, it appears that the clearing requirement applies only to those instruments that have completed the agency clearing approval process.<sup>13</sup> If the CFTC or SEC were to approve an instrument for clearing and no DCO or clearing agency were to make that instrument available for clearing, the CFTC or SEC could impose directly on the counterparties to such an instrument requirements the agency determines necessary (including margin and minimum capital standards).

The WSTAA exempts a swap and SBS from the clearing requirement if the counterparty is an “end user” that (i) employs swaps or SBS to hedge or mitigate commercial risk<sup>14</sup> and (ii) notifies the CFTC or SEC, in a manner set forth by the applicable agency, how it generally meets its financial obligations associated with entering into non-cleared swaps or SBS. This exemption is at the discretion of the end user counterparty and such person may elect to have the clearing requirement apply. A “financial entity” cannot be an end user. Financial entities include, among others, swap dealers, SBS dealers, MSPs, SBMSPs, certain private funds (*e.g.*, hedge funds) and commodity pools.

## “Transparency” or Execution Requirement

One of the goals of the WSTAA is to move as much trading in standardized swaps as possible to a regulated venue. Under the WSTAA, persons that are not ECPs will be able to trade swaps only on a designated contract market (“DCM”) and SBS only on a national securities exchange.

The WSTAA provides that all swaps and SBS that are subject to the clearing requirement must be traded either on a DCM, swap execution facility (“SEF”), securities exchange or SBS execution facility (as applicable) unless no such trading venue accepts the contract in question or the contract is not subject to the clearing requirement pursuant to the end user exception discussed above.

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<sup>13</sup> The CFTC or SEC, as applicable, will provide a minimum 30-day public comment period regarding trades it determines are required to be cleared. Any DCO may submit information regarding trades it plans to accept for clearing and the applicable agency will make a determination within 90 days.

<sup>14</sup> The CFTC may adopt rules defining “commercial risk.”

Thus, the WSTAA appears to exempt from the “transparency” requirement swaps and SBS between ECPs that are not available for trading on a DCM, SEF, securities exchange or SBS execution facility (as applicable), regardless of whether such instruments are subject to the clearing requirement.

### **SEF Registration**

Any trading venue that facilitates trading in cleared swaps or SBS (or that would like to facilitate trading in cleared swaps or SBS) would have to become a DCM, securities exchange, SEF or SBS execution facility regardless of how the trading is facilitated.

Swap execution facility means:

A trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that (A) facilitates the execution of swaps between persons and (B) is not a DCM.

SBS execution facility means:

A trading system or platform in which multiple participants have the ability to execute or trade SBS by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that (A) facilitates the execution of SBS between persons and (B) is not a national securities exchange.

Only swaps and SBS not readily susceptible to manipulation may be traded on a SEF or SBS execution facility.

Certain obligations are imposed on SEF and SBS execution facilities, including: monitoring and enforcing facility rules, monitoring and enforcing trading procedures, establishing information gathering and sharing capacities, establishing position limits, establishing and enforcing rules to ensure the financial integrity of the transactions, adopting rules for the exercise of emergency authority, publishing trading information in a timely manner, maintaining and reporting of records relating to the facility’s business activity, avoiding rules resulting in constraints on trade or anticompetitive burdens, establishing and enforcing rules regarding conflicts of interest, maintaining adequate financial resources, maintaining system safeguards, and designating a compliance officer.

## **Position Limits**

The CFTC is authorized to establish limits on the aggregate number or amount of positions (other than bona fide hedge positions) in swaps held by any trader (or group of traders). Position limits may be established with respect to contracts listed on DCMs, contracts on trading venues that are settled against a DCM contract settlement price, contracts listed on a foreign board of trade that permits U.S. persons to access an electronic system; and contracts that perform a significant price discovery function.

The SEC will establish position limits on the size of any SBS that may be held by any person (and may prescribe requirements for aggregating positions) for the stated purpose of preventing fraud and manipulation.

The CFTC or the SEC, as applicable, may generally exempt any person or class of persons, any swap or class of swaps, or any transaction or class of transactions from any position limit it may otherwise establish.

In addition to enforcing position limits set by the CFTC and SEC, exchanges, SEFs and SBS execution facilities will adopt position limits to reduce the potential threat of market manipulation and congestion, though such limits may be no higher than those set by the CFTC or SEC.

## **Reporting of Swaps**

The WSTAA requires reporting of all swaps. The WSTAA provides that all swaps entered into prior to enactment may retain their exemption from the clearing requirement only if they are reported to a swap or SBS data repository, the CFTC or the SEC (as applicable) as prescribed by the agencies.

Swaps not accepted for clearing by a registered clearing agency must be reported to a swap or SBS data repository or to the CFTC or the SEC as the applicable agency requires. The WSTAA also requires reporting of FX Swaps and FX Forwards even if a determination is made by the Secretary not to regulate them as swaps. Cleared swaps will be reported by the applicable DCO.

The method and format for delivering such reports have not yet been prescribed.

Swap and SBS data repositories are new regulatory categories created by the WSTAA for entities that collect and maintain the records of the terms and conditions of swaps or SBS entered into by third parties.

As with other provisions in Title VII, *there is no explicit exclusion from the reporting requirement for investment vehicles such as hedge funds and registered investment companies.*

### **Prohibition on Federal Assistance to Swaps Entities**

The WSTAA prohibits federal assistance to any swaps entity with respect to any swaps or SBS activity. Swaps entities prohibited from receiving federal assistance are also prohibited from accessing the Federal Reserve discount window and FDIC insurance.

Certain banking entities<sup>15</sup> can continue to engage in swaps or SBS activities if such activities are related to: (i) risk mitigation or hedging directly related to a banking entity's activities or (ii) acting as a swaps entity with respect to swaps that are permitted by relevant banking regulators, provided that, in the case of CDS or security-based CDS, such CDS must be cleared.<sup>16</sup>

Swaps entity means, in general, any swap dealer or major swap participant and effectively requires most banks to move swaps activities to a non-bank affiliate. Banks may establish separate swaps entity affiliates under their holding companies funded from the bank's capital.

This provision is not immediately effective. Banking entities have two years following enactment of the WSTAA to divest themselves of a swaps entity or to cease prohibited activities. Trades entered into prior to the end of the two-year transition period, however, will be permitted to remain within the banking entity.

### **Registration of SBS Under the Securities Act**

The WSTAA makes it unlawful for anyone to buy or sell or offer to buy or sell an SBS with a non-ECP counterparty unless there is an effective registration statement under the Securities Act with respect to that SBS.

### **Beneficial Ownership Under the Exchange Act**

The WSTAA amends the beneficial ownership reporting requirements of Sections 13 and 16 under the Exchange Act to require disclosure of certain SBS positions<sup>17</sup> if the SEC issues rules providing for such disclosure.<sup>18</sup>

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<sup>15</sup> The WSTAA refers to insured depository institutions.

<sup>16</sup> It appears that, in order for a banking entity to engage in such activities, the transactions in question might also have to satisfy one of the exceptions to the Section 619 prohibition on proprietary trading (discussed below).

<sup>17</sup> In addition to SBS, certain SBSAs will also be subject to Section 16 of the Exchange Act.

<sup>18</sup> The SEC will issue rules, after consultation with other regulators, based on its determination of whether a given SBS provides incidents of ownership comparable to direct ownership of the equity security.

## **Insider Trading**

The WSTAA adds SBS to the definition of “security” under both the Securities Act and the Exchange Act. SBS will, consequently, be subject to the same antifraud provisions and SEC enforcement mechanisms, including those concerning insider trading, as securities. However, given a recent district court decision finding that the SEC had antifraud enforcement authority over credit default swaps because those instruments fell within the previous definition of SBSA, the extent to which the inclusion of SBS in “security” will amount to an expansion of SEC insider trading oversight rather than a reiteration of its present authority is questionable.<sup>19</sup>

## **Timeline of Events Following Enactment of WSTAA**

Many of the rules and key definitions under the WSTAA are to be promulgated not later than one year after the date of enactment of the WSTAA. Following the date of enactment, the CFTC and SEC will: (i) promulgate rules, regulations or orders permitted or required, including with respect to registration requirements for swap dealers and MSPs; (ii) conduct studies; (iii) register persons under the provisions of the WSTAA; and (iv) exempt persons, agreements, contracts or transactions from provisions of the WSTAA.

CFTC and SEC rulemakings will include, among other things, (i) defining “substantial position,” (ii) establishing the factors that will exempt a person from the “swap dealer” category on the basis of de minimis trading on behalf of customers, and (iii) further defining swap, swap dealer, major swap participant and eligible contract participant.

Generally, the provisions of the WSTAA that require rulemaking become effective on the later of 360 days after the date of enactment or 60 days after publication of the final rule. The CFTC and SEC, however, must adopt the rules providing for the registration of MSPs, SBMSPs, swap dealers and SBS dealers within one year of the effective date. Provisions related to the reporting of swaps may become effective as early as 120 days after the effective date.

## **Title VI: Prohibitions on Certain Types of Proprietary Trading and Investments**

Title VI of the Dodd-Frank Act is the Bank and Savings Association Holding Company and Depository Institution Regulatory Improvements Act of 2010 (“Title VI”).

Section 619 (the “Volcker Rule”) of Title VI, applies to banking entities, their holding companies, and any of their subsidiaries including affiliated broker dealers and fund managers. Section 619 prohibits such entities from engaging in proprietary trading or investing in or sponsoring hedge funds or private equity funds (other than de minimis investments). Proprietary trading includes such things as engaging, as principal, in trading in stocks, bonds, options, commodities, derivatives and other financial instruments.

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<sup>19</sup> *SEC v. Rorech*, 2010 BL 144301 (S.D.N.Y. June 24, 2010).

Section 619, however, exempts certain activities from the proprietary trading prohibition, including (i) trading relating to market making, to the extent such activities do not exceed short term client needs, (ii) risk mitigating hedging activities designed to reduce specific risks of the banking entity, and (iii) certain activities outside of the United States.

Implementation of Section 619 is subject to a study by the Financial Stability Oversight Council and the issuance of final regulations by federal banking agencies, the SEC or the CFTC, as applicable.

### **Systemically Important Entities Under Title VIII**

The Payment, Clearing, and Settlement Supervision Act of 2010 is Title VIII of the Dodd-Frank Act (“Title VIII”). Pursuant to Title VIII, the Federal Reserve, the SEC and the CFTC will prescribe risk management standards for designated financial market utilities<sup>20</sup> and financial institutions<sup>21</sup> engaged in a payment, clearing or settlement activity that the Financial Stability Oversight Council (the “Council”)<sup>22</sup> has determined is systemically important.<sup>23</sup>

The scope of Title VIII could capture certain entities required to register with the SEC and CFTC under the WSTAA and impose stricter standards. The Federal Reserve, the SEC and the CFTC are required to consult each other on risk management standards whether or not the entity is already regulated under the WSTAA.

Risk management standards include, among other things, capital and margin requirements, participant default policies and ability to complete timely clearing and settlement of financial transactions. Excluded from the scope of Title VIII are the rights of the SEC or CFTC under the WSTAA to approve swaps or categories of swaps for clearing, whether any entities are exempt from mandatory clearing requirements and execution and trade reporting requirements.

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<sup>20</sup> Financial market utility means “any person that manages or operates a multilateral system for the purpose of transferring, clearing or settling payment, securities, or other financial transactions among financial institutions or between financial institutions and the person.” It excludes swap data repositories, swap execution facilities, brokers, dealers, futures commission merchants and commodity pool operators.

<sup>21</sup> Financial institutions means depository institutions, domestic branches of foreign banks, organizations operating under the Federal Reserve Act or Federal Credit Union Act, broker or dealers, certain investment companies and insurance companies as defined under the Investment Company Act of 1940, investment advisors, futures commission merchants, commodity trading advisors and commodity pool operators and any company engaged in activities that are financial in nature or incidental to a financial activity, as described in the Bank Holding Company Act.

<sup>22</sup> The Council is created by Title I of the Dodd-Frank Act and is given broad authority to, among other things, monitor the financial markets for potential threats and risks and recommend oversight and/or heightened regulation of entities determined to pose risks.

<sup>23</sup> The Council will review such factors as the money value of transactions processed by a particular financial market utility or financial institution, aggregate exposures of such entity and the effect that a failure or disruption of such entity would have on critical markets, financial institutions or the broader financial system.

Title VIII provides mechanics for resolving certain disputes such as where (i) a particular entity disagrees with its designation by the Council as systemically important or (ii) the Federal Reserve determines that certain standards set by the SEC or the CFTC for an entity are insufficient.

Title VIII also imposes additional reporting requirements, advance notice requirements prior to changing procedures or operations and annual reviews.

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