

Coalition for Derivatives **End-Users**

Derivatives Regulatory Reform: Legislative Overview and Outlook

Who We Are

- The Coalition for Derivatives End-Users is a broad-based group of trade associations and businesses representing diverse industries that use over-the-counter (OTC) derivatives to manage business risks including fluctuating currency exchange and interest rates and commodity prices.
- American Petroleum Institute
- Business Roundtable
- Financial Executives International
- National Association of Corporate Treasurers
- National Association of Manufacturers
- National Association of Real Estate Investment Trusts
- The Real Estate Roundtable
- U.S. Chamber of Commerce

Overview

- Obama Administration's Response to the Financial Crisis

- House Committee Action
 - Financial Services
 - Agriculture

Overview

- H.R. 4173, the Wall Street Reform and Consumer Protection Act
 - Title III: Over-the-Counter Derivatives Markets Act

- Next Step: Senate Banking and Agriculture Committee

Primary Components of Proposals

- Mandatory Reporting Requirement
 - Central Repository to hold trade data

- Swap Dealer Registration/Regulation
 - Capital and margin requirements, reporting requirements, business conduct standards

- Central Clearing/Exchange Trading Mandate for all Swap Dealers and Major Swap Participants

What are the key issues for end-users?

- Exemption from Central Clearing/Exchange Trading Requirement for End-Users

- Definition of Major Swap Participant (MSP)
 - Set a sufficiently high threshold to avoid encompassing end-users that do not pose a threat to financial stability, and that access OTC markets to hedge business risk.

What are the key issues for end-users?

- Margin Requirement
 - No new authority or legislative mandate for regulators to impose margin requirements on end-user transactions.

- Capital Requirements
 - Increase to capital charges should be based on actual risk of loss, rather than as a punitive regulatory mechanism to drive volume away from the OTC market.

What are the key issues for end-users?

- Prospective Application
 - Legislation should not threaten the legality or validity of existing contracts negotiated in compliance with laws and market practices currently in place.

House Overview: Key Provisions and Amendments

- H.R. 4173, the Wall Street Reform and Consumer Protection Act passed the House by a vote of 223-202 on December 11, 2009

- Mandatory Central Clearing Requirement
 - Swaps must be cleared if:
 - A clearinghouse will accept the swap for clearing
 - The CFTC or SEC has determined clearing is required

House Overview: Key Provisions and Amendments

- Clearing Exemption
 - If one of the counterparties to the swap:
 - 1.) Is not a swap dealer or major swap participant;
 - 2.) Is using swaps to hedge or mitigate commercial risk, including operating or balance sheet risk; and
 - 3.) Notifies the CFTC, in a manner set forth by the Commission, how it generally meets its financial obligations associated with non-cleared swaps.

House Overview: Key Provisions and Amendments

- Definition of Major Swap Participant (Murphy/McMahon/Kratovil Amendment – passed 304-124))
 - Any person who is not a swap dealer and:
 - 1.) Maintains a substantial net position in outstanding swaps, excluding positions held primarily for hedging, reducing or mitigating commercial risk; or
 - 2.) Whose outstanding swaps create net counterparty exposure that could have **serious adverse effects on the financial stability of the U.S. banking system or financial markets.**
 - Definition of “substantial net position” to be defined by the CFTC/SEC

House Overview: Key Provisions and Amendments

- ❑ Regulators are not granted authority to impose margin requirements on end-users
(Frank Amendment to grant authority defeated 240-182)
- ❑ Regulators directed to set capital standards to ensure the safety and soundness of dealers/MSP's and appropriate for the risk associated with non-cleared swaps held by the dealer/MSP.

Senate Overview

Chairman Dodd's Committee Print

- ▣ Mandatory Central Clearing Requirement
 - ▣ All swaps must be submitted to a clearinghouse (unless an exception applies), but the clearinghouse must obtain prior SEC/CFTC approval for any categories/types of swaps it seeks to accept for clearing.

Senate Overview

Chairman Dodd's Committee Print

- Clearing Exemption
 - If no derivatives clearing organization or clearing agency will accept the swap for clearing, or
 - CFTC/SEC may exempt a transaction if one of the counterparties
 - Is not a swap dealer or MSP, and
 - Does not meet the eligibility requirements of the clearinghouse.

Senate Overview

Chairman Dodd's Committee Print

- Definition of Major Swap Participant
 - A non-swap dealer whose outstanding swaps create net counterparty credit exposures (current or potential future exposures) to other market participants that would expose those other market participants to significant credit losses in the event of the person's default.

Senate Overview

Chairman Dodd's Committee Print

- Regulators (CFTC, SEC, FIRA) to jointly set initial and variation margin requirements for swap dealers and MSP's on non-cleared trades. Exemptions from margin requirements may be granted for effective hedges under GAAP if one of the counterparties is a non-financial firm and neither a swap dealer or MSP.
- Regulators required to set capital requirements that are "substantially higher" for non-cleared swaps than for those accepted for clearing.

Outlook for Senate Action

- ▣ Bipartisan Working Group led by Senator Jack Reed (RI) and Senator Judd Gregg (NH)
- ▣ Timing for Banking Committee Mark-up
- ▣ Senate Agriculture Committee Draft expected early February

Chairman Gensler's Swap Execution Facility (SEF) Proposal

- Chairman Gensler's proposal to increase transparency in the OTC market
- Proposal would require swaps that are exempt from central clearing to trade on a "Swap Execution Facility"
(e.g. electronic trading platform)

Key Questions for End-Users

- ❑ What would be the impact on competition and pricing?
- ❑ Would it produce meaningful transparency for end-users?

Next Steps

- Support the Bipartisan Process in the Senate Banking Committee
- The role of the Senate Agriculture Committee
- Coalition Legislative Recommendations

What Can You Do?

- ❑ Sign on to the Joint Letter to be circulated by the Coalition;
- ❑ Contact Key Members of the Senate Agriculture and Banking Committees;
- ❑ Travel to Washington in the next two months.

ANY QUESTIONS?

THANK YOU

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