

FINANCIAL INSTITUTIONS ALERT

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

Swap Push-Outs Under Dodd-Frank Part 2 of 2

September 28, 2010

On September __, 2010, we circulated [the first part](#) of this two-part alert regarding the swap push-out provision in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). In Part 1, we explored the definitions in the Act to determine the meaning of the Act's prohibition on "Federal assistance" to "swaps entities." In this second part, we discuss guidance that financial institutions can expect to receive from the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC"), and the swap push-out provision's anticipated impact on financial institutions.

Regulatory Guidance

As with many other sections of the Act, the SEC and the CFTC are tasked with promulgating a significant number of rules and regulations related to the swap push-out provision. First, the Act expressly directs the SEC and CFTC to define what it means for an entity to have a "substantial position" in swaps such that it is considered a "major swap participant." Second, the Act requires CFTC and the SEC, in consultation with the Board of Governors of the Federal Reserve System, to further define the terms "swap," "swap dealer," "major swap participant," "security-based swap," "security-based swap dealer," and "major security-based swap participant." Third, the SEC and CFTC will likely interpret the "hedging and other risk mitigation activities" in which insured depository institutions are allowed to engage. Fourth, the Act requires the SEC and CFTC to promulgate regulations to establish factors for determining whether a financial institution's swap activities are "*de minimis*" such that the institution is not deemed a swap dealer. Finally, the Act expressly permits the SEC and CFTC to further define other terms used in the Act. As this discussion demonstrates, much of the impact of the swap push-out provision will be determined by the scope of the regulatory rules and regulations.

Impact of Swap Push-Out Provision on Financial Institutions

If a financial institution is determined to be a swaps entity, it is not entitled to advances from the Federal Reserve or insurance from the FDIC. Financial institutions are effectively required to push-out their swaps business to affiliates to retain the federal benefits. In the near-term, this means that financial institutions must assess the nature and extent of their swaps business to determine whether they are subject to the push-out provision. If so, the institutions should begin divesting their swaps activities to affiliates and may want to consider commenting on the SEC and CFTC rulemaking processes. Divestiture of swap activities may require a financial institution to establish new corporate affiliates, depending on the financial institution's current corporate structure.

The push-out provision goes into effect on July 22, 2012, and the Act gives the appropriate bank regulators the authority to allow financial institutions up to 24 months to divest swaps entities or cease the activities that require registration as swaps entities. This transition period may be extended up to one additional year upon approval by the appropriate Federal banking agency in consultation with the SEC and CFTC, meaning financial institutions may have until as late as July 22, 2015 to comply with the push-out provision. Best practices, however, weigh strongly in favor of earlier compliance.

In the long-term, financial institutions can expect increased scrutiny on their swap agreements from both regulators and investors. In addition, depending on the precision with which the SEC and the CFTC define terms in the rulemaking process, the scope of permissible swap activities may be unclear. As a result, the outer bounds of permissible swap activities may prove to be fertile grounds for testing through regulatory proceedings and through litigation.

If you have any questions regarding the information in this alert, or with respect to other provisions for this legislation, please contact any of the attorneys in our business or litigation Financial Institutions Groups listed below.

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