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FINANCIAL INSTITUTIONS
ALERT

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

Swap Push-Outs Under Dodd-Frank
Part 1 of 2

September 21, 2010

The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") provides for broad new regulatory oversight of the market for over-the-counter ("OTC") derivatives. One of the provisions related to derivatives—the so-called "push-out" provision—generally prohibits "swaps entities" from receiving "Federal assistance."[1] In this first part of a two-part alert, we discuss the scope of prohibited activities based on definitions set out in the Act. Part two of this alert will address forthcoming regulatory guidance, and the impact of the swap push-out provision on financial institutions.

Federal Assistance

The Act defines "Federal assistance" as "the use of any advance from any Federal Reserve credit facility or discount window [except for certain emergency lending], Federal Deposit Insurance Corporation insurance or guarantees for the purpose of" any of the following:[2]

- Making loans to or purchasing any stock, equity interest, or debt obligation of any swaps entity;
- Purchasing the assets of any swaps entity;
- Guaranteeing any loan or debt issuance of any swaps entity; or
- Entering into any assistance arrangement (including tax breaks), loss sharing, or profit sharing with any swaps entity.

Swaps

The definition of "swaps" includes:

- Options contracts on reference assets;
- Swaps based on interest rates, options, currencies, equities, debt, credit, commodities, or other similar products that transfer future risk without conveying current or future ownership;
- Products that are currently known in the industry as "swaps" or become known to the industry as "swaps" in the future; or

[1] Dodd-Frank Act, 11th Cong. § 716 (2010).

[2] The prohibition on Federal assistance will only apply to swaps entered into after the Act's enactment.

- Products that are combinations or permutations of, or options on, any products specifically identified in the Act as swaps.

A "security-based swap" is a swap agreement that is based on a narrow-based security index, any single security or loan, or the occurrence, nonoccurrence, or extent of the occurrence of an event relating to the issuers of those securities.

Generally, the Act uses the term "swap" to refer to an agreement within the ambit of the Commodity Exchange Act and the Commodity Futures Trading Commission ("CFTC"). The Act uses the term "security-based swap" to refer to agreements within the ambit of the Securities Exchange Act of 1934 and the Securities and Exchange Commission ("SEC").[3]

Swaps Entities

The push-out provision only applies to "swaps entities," which the Act defines as "any swap dealer, security-based swap dealer, major swap participant, [or] major security-based swap participant . . . ."[4] Swap dealers and security-based swap dealers are persons or entities that:

- Hold themselves out as swap dealers;
- Make markets in swaps;
- Regularly enter into swaps with counterparties as an ordinary course of business for their own accounts; or
- Engage in any activity causing them to be commonly known in the industry as swap dealers or market makers.

If a person or entity is not a "swaps dealer," it may nonetheless be a "major swap participant" or "major security-based swap participant" subject to the swap push-out provision if it:

- Maintains "substantial positions" in swaps; or
- Possesses outstanding swaps that create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets.

Exceptions to Designations and Prohibitions

This section of the Act has become known as the "push-out" provision because it expressly allows insured depository institutions to have or establish affiliates that conduct swap activities.

The Act also carves out an exception from the definition of "swaps entity" for insured depository institutions that are major swap participants. As a result, insured depository institutions are only considered swaps entities if they are swap dealers.

Insured depository institutions are also permitted to engage in the following conduct without being considered swap dealers: (1) offering to enter swaps with customers in connection with

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[3] For example, the Act's definition of "swap" excludes "security-based swaps" and other contracts subject to the Securities Act of 1933 and the Securities Exchange Act of 1934, recognizing the different regulatory oversight.

[4] The Act also states that "swaps entity" only includes entities that are registered under the Commodity Exchange Act or the Securities Exchange Act of 1934. However, because Section 731 of the Act requires registration for swap dealers and major swap participants, this restriction does not limit the definition of "swaps entity."

originating loans for those customers; (2) engaging in "*de minimis*" swap dealing; (3) entering swap agreements for the purposes of "[h]edging and other similar risk mitigating activities directly related to the insured depository institution's activities;" and (4) acting as swaps entities for swap activities involving rates or reference assets that are permissible for investment by a national bank. Notwithstanding the various exceptions, credit default swaps will not be considered permissible activities unless the swaps clear through derivatives-clearing associations established pursuant to other provisions of the Act.

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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