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July Second Half Developments

Overview

It was two years ago that Dodd Frank was passed. Many of the important concepts underlying this law are still in dispute. Even today's New York Times had an editorial on the wisdom of regulating large banks and whether repealing Glass-Steagall was a mistake. Nonetheless, the process started by the enactment of the law continues albeit slowly. The CFTC continues to finalize its rules for swap clearing requirements and registrations for parties involved with swaps. The clearing requirements were the centerpiece of Dodd-Frank in the swaps area and now two years later we are getting close to seeing the clearing regime starting. The CFTC has published its final rules on the timetable for compliance with the clearing requirements. The extraterritorial reach of the swap rules was highlighted by the CFTC's publication of the registration requirements and reporting for non-US swap dealers and the CFTC's own estimates for the annual costs.

CFTC Notice on filing compliance plans for Cross-Border Swap Activities

On July 24, 2012, the CFTC published a notice regarding its information requests in its exemptive order regarding compliance with swap regulations. This requires action on the part of non-US swap dealers to obtain the exemption. First, any non-U.S. person that is required to register as an SD or MSP must apply to become registered. Second, within 60 days of applying for registration, the non-U.S. applicant would be required to submit to the National Futures Association a compliance plan addressing how it plans to comply, in good faith, with all applicable requirements. The Commission estimates that 60 to 125 entities (including 40 to 80 non-U.S. entities) will submit initial compliance plans. The Commission further estimates that, on average, between 60 and 125 entities will prepare and submit one amendment annually. The aggregate cost burden for all SDs and MSPs (both U.S. and non-U.S.) for both initial compliance plans and one amendment is estimated to be approximately \$3,243,760 to \$6,674,660. See the notice at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-24/html/2012-17919.htm>

Retail Foreign Exchange Transactions for Brokers

On July 16, 2012, the SEC published an extension of its interim final rule on retail FX transactions to next year. All the banking agencies have adopted similar rules, which were required by the Dodd-Frank Act. The final rule imposes requirements on other foreign currency transactions that are functionally or economically similar, including so-called "rolling spot" transactions that an individual enters into with a foreign currency dealer, usually through the Internet or other electronic platform, to transact in foreign currency. The regulations do not apply to traditional foreign currency forwards, spots, or swap transactions that an insured depository institution engages in with business customers to hedge foreign exchange risk. See the final rule at:

<http://www.gpo.gov/fdsys/pkg/FR-2011-07-15/html/2011-18009.htm>

The SEC's notice of extension is at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-16/html/2012-17261.htm>

Exemptions for Swaps of Cooperatives

On July 17, 2012, the CFTC published a proposed rule that would exempt certain swaps entered into by cooperatives from the clearing requirements. As amended by the Dodd-Frank Act, the commodities laws require a swap to be submitted for clearing through a derivatives clearing organization if the Commission has determined that the swap is required to be cleared, unless an exception to the clearing requirement applies. The fact that cooperatives act on behalf of members that are non-financial entities or small financial institutions justified an extension of the end-user exception to the cooperatives. Because a cooperative acts in place of its members when facing the larger financial markets on behalf of the members, the end-user exception that would be available to a cooperative's members should pass through to the cooperative. See the proposed rule at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-17/html/2012-17357.htm>

Exception to the Clearing Requirement for Swaps of End-Users

On July 19, 2012, the CFTC published its final rules to implement the end-user exception to the swaps clearing requirements. Congress promulgated the end-user exception to permit non-financial companies to continue using non-cleared swaps to hedge risks associated with their underlying businesses, such as manufacturing, energy exploration, farming, transportation, or other commercial activities. The new regulation effects this by: (1) establishing the criteria for determining whether a swap hedges or mitigates commercial risk; (2) specifying the information that counterparties must report to satisfy the notification requirement; and (3) establishing an exemption for small financial institutions. The rule also requires reporting of certain information that the Commission will use to monitor compliance with, and prevent abuse or evasion of, the end-user exception. The Commission is exempting small financial institutions, including small banks, savings associations, farm credit system institutions and credit unions, at the \$10 billion total asset level. The CFTC received approximately 2,000 comment letters on the proposal, which can be seen at:

<http://edocket.access.gpo.gov/2010/2010-31578.htm>

The final rule is found at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-19/html/2012-17291.htm>

Regulation of Consumer Reporting Entities

On July 20, 2012, the BCFP published its final rule regarding identifying the larger participants in the market for consumer reporting for purposes of regulation. The Bureau has the authority to supervise nonbank "larger participant[s]" of markets for other consumer financial products or services, as the Bureau defines by rule. The Bureau issues this final rule to define larger participants of a market for consumer reporting. The final rule thereby facilitates the supervision of nonbank covered persons active in that market. A nonbank covered person with more than \$7 million in annual receipts resulting from consumer reporting activities described in the Rule would be a larger participant of the consumer reporting market. The CFTC indicates that only 30 of the 410 firms in the industry meet this definition and only 6 consumer reporting companies have revenues in excess of \$100 million per year. See the final rule at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-20/html/2012-17603.htm>

The proposed rule may be viewed at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-02-17/html/2012-3775.htm>

SEC guidance on Mortgage and Small Business Securities

On July 23, 2012, the SEC published guidance on how to define creditworthiness for these securities until final rules are adopted. The Dodd-Frank Act removed the provisions of the definitions of these terms that referenced credit ratings. The SEC has not fully developed its standards for creditworthiness for these securities and thus is issuing this guidance until final rules are adopted. The Commission also is seeking comment on potential standards of creditworthiness that could be established to replace the use of NRSRO credit ratings in the definitions of the terms "mortgage related security" and "small business related security." See the final rule at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-23/html/2012-17763.htm>

FDIC rules on permissible investments in corporate debt by Savings Associations

On July 24, 2012, the FDIC published its final rule on investment securities investments by savings associations. This rule has been harmonized with the OCC's rules on the same subject. This final rule amends FDIC regulations to prohibit any insured savings association from acquiring or retaining a corporate debt security unless it determines, prior to acquiring such security and periodically thereafter, that the issuer has adequate capacity to meet all financial commitments under the security for the projected life of the investment. An issuer would satisfy this requirement if, based on the assessment of the savings association, the issuer presents a low risk of default and is likely to make full and timely repayment of principal and interest. See the

final rule at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-24/html/2012-17860.htm>

The FDIC's proposed rule may be found at:

<http://www.gpo.gov/fdsys/pkg/FR-2011-12-15/html/2011-31883.htm>

FDIC Guidance on due diligence on permissible investments in corporate debt

On July 24, 2012, the FDIC published its final guidance on due diligence that saving associations must conduct prior to investing in corporate debt. The final guidance document provides supervisory expectations for savings associations conducting due diligence to determine whether a corporate debt securities investment satisfies the creditworthiness requirements of the final rule--that is, whether the issuer has adequate capacity to satisfy all financial commitments under the security for the projected life of the security. See the final guidance at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-24/html/2012-17854.htm>

The proposed FDIC Guidance may be found at:

<http://www.gpo.gov/fdsys/pkg/FR-2011-12-15/html/2011-31884.htm>

Swaps Market Participants and Accounts Reporting

On July 26, 2012, the CFTC published a proposed rule to aid in identification of participants in the futures and swap markets. The proposed rules also collect ownership and control information, through a dedicated ownership and control report ("OCR"), for trading accounts active on reporting markets that are designated contract markets or swap execution facilities. These rules will assist the CFTC in its surveillance activities given the overwhelming volume of trading reports. As of last year, the CFTC received over 7 million trading records per day from the designated contract markets and over 600,000 position records per day.

See the proposed rule at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-26/html/2012-16180.htm>

Commodities and Swaps Accounts Ownership and Control

On July 26, 2012, the CFTC published a notice that it has withdrawn a proposal to collect information on the trading accounts of customers; the CFTC plans to obtain this information from another rulemaking discussed below. The original proposal was published at: 75 FR 41775 (July 19, 2010). See the withdrawal at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-26/html/2012-16178.htm>

Swaps Clearing Phase In

On July 30, 2012, the CFTC published a final rule to establish a schedule for a phase in of the requirements to clear swap transactions. Once the final rules are published, parties depending upon their sophistication will have between 90 and 270 days to comply with the clearing rules.

See the final rule at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-30/html/2012-18383.htm>

See the proposed rule at: <http://www.gpo.gov/fdsys/pkg/FR-2011-09-20/html/2011-24124.htm>

Credit Union Liquidity Plans

On July 30, 2012, the NCUA published a proposed rule that would require Credit Unions to have plans in place for insuring emergency liquidity and have contingency funding plans in place. Large CUs, over \$100 million in assets would need access to a federal liquidity source. The NCUA had published an advance notice of this proposed rule. See the proposed rule at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-30/html/2012-18565.htm>

Credit Unions in Troubled Condition

On July 31, 2012, the NCUA published a proposed rule that would allow the determination of whether a credit union was in troubled condition to be made by the NCUA or the credit union's state supervisor. Under current regulations, only the state supervisor may make this determination. See the proposed rule at:

<http://www.gpo.gov/fdsys/pkg/FR-2012-07-31/html/2012-18560.htm>

This advisory is a service of Connell & Andersen LLP for our clients and friends. It is not a full recitation of all developments. The descriptions are summaries of complex and detailed laws and regulations and may be incomplete or misleading. We invite any of our readers to contact us to discuss any items contained herein for further elaboration.