

Senate Passes Financial Reform Bill Incorporating More Stringent Regulation of Over-the-Counter Derivatives Markets


By Lisa Epifani and Tomás Carbonell

On May 20, 2010, after four weeks of floor debate, the Senate passed S.3217, “The Restoring American Financial Stability Act of 2010.” The vote of 59-39 largely followed party lines, with four Republicans ultimately voting in favor of the bill and two Democrats voting against. As predicted in our April 23, 2010 Issue Alert (<http://www.vnf.com/news-alerts-455.html>), the bill incorporates most of the derivatives reform language introduced by Chairman Blanche Lincoln (D-AR) and reported from the Senate Committee on Agriculture, Nutrition and Forestry on April 21, 2010.

The Lincoln bill, as incorporated into Title VII of S.3217, would dramatically alter federal regulation of commodity derivatives, including the largely unregulated derivatives market for customized “swaps” used by many industries to hedge commercial risks. Among other things, Title VII would require most swaps – except those used by non-financial companies to hedge commercial risk (known as “commercial end-users”) – to be “cleared” by clearinghouses registered with the Commodity Futures Trading Commission (CFTC); require swaps that are subject to clearing to trade on CFTC-registered exchanges; and direct the CFTC to establish aggregate position limits for swaps. In addition, the bill would require “major swap participants” and “swap dealers” to register with the CFTC and abide by new minimum capital requirements and margin requirements prescribed by the CFTC (or by federal banking regulatory agencies, in the case of banking institutions).

Another major element of the derivatives reform title of S.3217 is a provision that would prohibit federal assistance of any kind (including advances from any Federal Reserve credit facility or Federal Deposit Insurance Corporation insurance) from being provided to institutions that are market makers or major participants in derivatives markets. This provision would likely cause many financial institutions to divest themselves of their derivatives trading desks, and could cause derivatives brokering activities to migrate to independent investment houses or to overseas markets.

Although over 400 amendments to S.3217 were filed, only a fraction were debated and voted upon, and only two that related directly to the energy industry were ultimately approved. First, Senator Maria Cantwell (D-WA) introduced an amendment (S.Amdt. 3786), which passed by a voice vote, that modifies and expands the CFTC’s enforcement powers and anti-manipulation authority to more closely mirror those of the Securities and Exchange Commission (SEC). Second, Senator Jeff Bingaman (D-NM) introduced an amendment (S.Amdt. 3892), which also passed by a voice vote, that seeks to clarify the jurisdictional roles of the Federal Energy Regulatory Commission (FERC) and the CFTC. The Bingaman amendment reaffirms the authority of the



FERC to ensure just and reasonable rates for transactions within its jurisdiction. The Bingaman amendment would also allow the CFTC to grant a “public interest” exemption from the Commodity Exchange Act for any transactions entered into pursuant to a tariff approved by FERC or a state or municipal regulatory authority.

Conference negotiations to reconcile the Senate financial reform bill with the counterpart bill passed by the House of Representatives in December 2009 (H.R. 3217, “The Wall Street Reform and Consumer Protection Act of 2009”) are expected to begin soon. The Democratic leadership reportedly seeks to deliver a final bill to the President by July 4th. The derivatives title, and especially the provision prohibiting federal assistance for derivatives trading institutions, will be a key element of negotiations between the Senate and the House in conference.

FOR ADDITIONAL INFORMATION

Van Ness Feldman regularly counsels clients on regulation of energy transactions, and is actively engaged in the ongoing policy debates concerning reforms to the financial regulatory system as they relate to the energy sector. If you are interested in additional information regarding the Senate financial reform bill or other financial reform initiatives, please contact Curt Moffatt at (202) 298-1885, Lisa Epifani at (202) 298-1947, or John Buchovecky at (202) 298-1887.

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