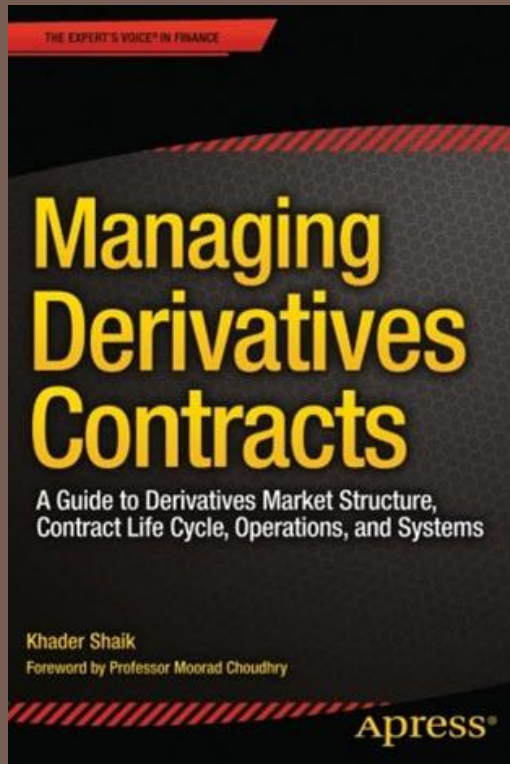


# THE DODD-FRANK ACT & DERIVATIVES MARKET

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*This presentation can be used as a supplement to Chapter 9 - “The Dodd-Frank Act”*

# Agenda

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- Introduction
- Major Tenets
- Derivatives Market Reform
- Derivatives Market Structure
- Product Classification
- Market Players
- Push-out Rule
- Volker Rule

# The Dodd-Frank Act

- The Dodd-Frank Wall Street Reform and Consumer Protection Act
- Introduced in 2010 in U.S.
- Avoid failures such as 2007-08 financial crisis
- Principal objectives
  - ▣ Promote financial stability by improving accountability and transparency throughout financial system
  - ▣ Control systemic risk
  - ▣ Avoid the need for government bailout
  - ▣ Protect consumers from abusive market practices

# Major Tenets

- Financial Stability Reform
- Regulatory Agency Reform
- Securitization Reform
- Derivatives Business Reform (*focus of this presentation*)
- Investor Protection Reform
- Credit Rating Agency Reform
- Volker Rule Provisions
- Compensation and Corporate Governance
- Capital Requirements

# Derivatives Market Reform

- Introduced through Title VII of the Dodd-Frank Act
- Also known as – *The Wall Street Transparency and Accountability Act of 2010*
- Imposes many regulatory rules on derivatives business and market participant

# Major Elements of Derivatives Reform

- Enhanced regulatory framework of overall derivatives market (SEC, CFTC and banking regulators)
- Overall derivatives market standardization – standard products, participant categorization, trading, clearing and reporting
- Mandatory electronic trading of standard products
- Central Clearing of standard products
- Reporting of trading
- Enhanced collateral and margin requirements for all products
- Restrictions and limitations on participation
- Various exceptions to allow required scenarios

# New Market Structure

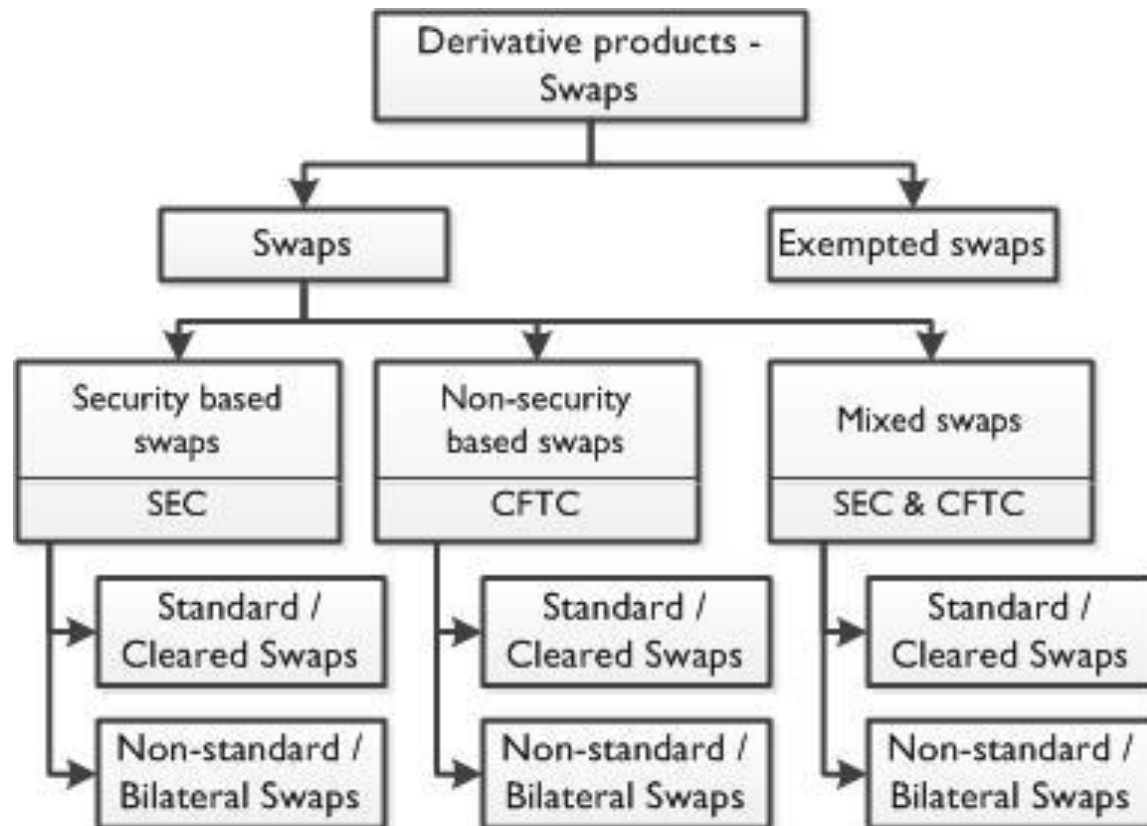
- Enhanced OTC market structure introducing following roles and changes
  - OTC products – *cleared and bilateral*
  - Enhanced role of regulatory agencies – SEC and CFTC
  - Electronic trading venues – SEF
  - Central clearing counterparties (CCP) (clearinghouse)
  - Trade repositories to record trading activities
  - Classification of all market participants

# Product Classification

- All OTC derivatives are known as SWAPS in general
- Categories
  - ▣ Security-based swaps (SEC)
  - ▣ Non-security-based swaps (CFTC)
  - ▣ Mixed Swaps (SEC and CFTC)
- Two types
  - ▣ Cleared by CCP (standard/cleared swaps)
  - ▣ Bilateral (non-cleared OTC)
- Some swaps are excluded under new rules (as they are already regulated, eg: listed contracts)



# Product Classification

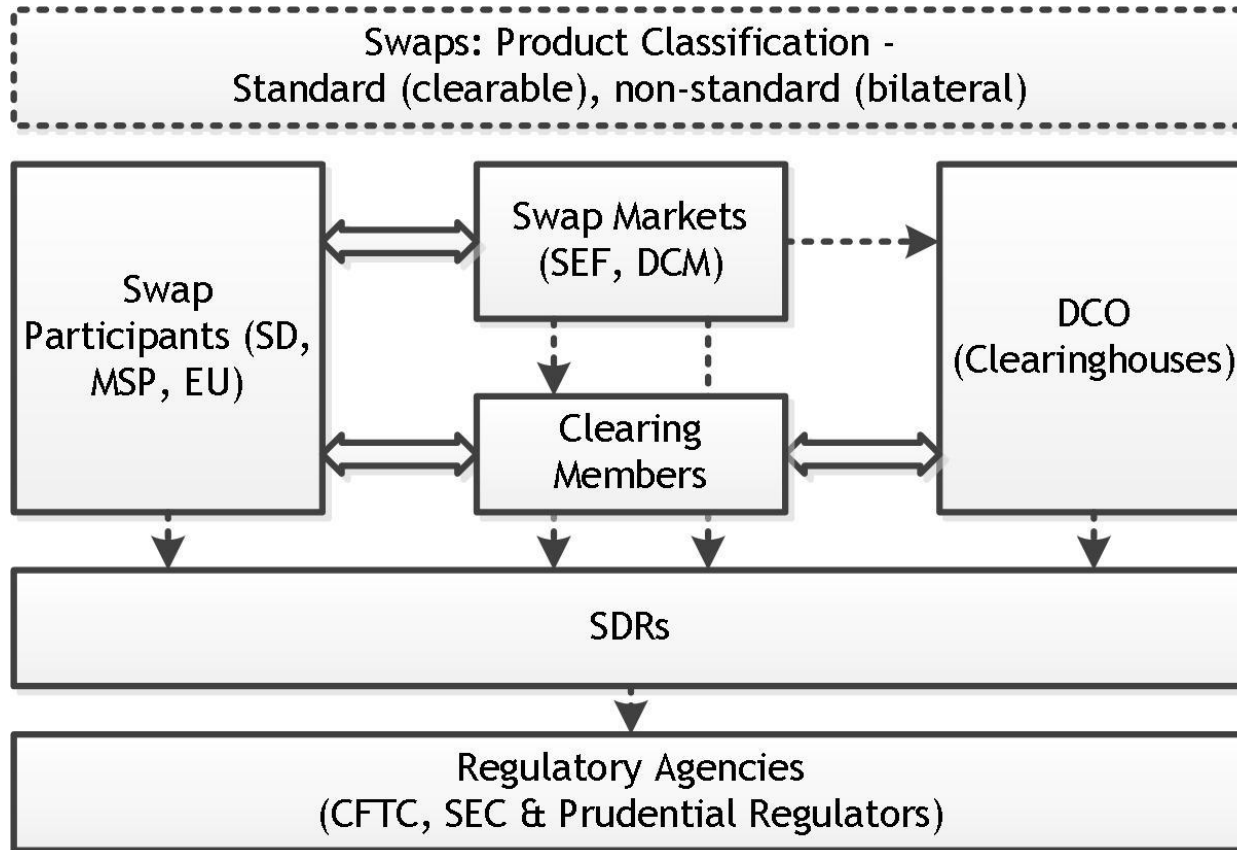


**Classification of derivative products**

# Market Participants

- All market participants must register
- Known as *Eligible Swap Participants (ESP)*
- Categorized as
  - ▣ Swap Dealers (SD) – various brokerage firms
  - ▣ Major Swap Participants (MSP) – large players
  - ▣ End Users (EU) – all other users (smaller institutions)
- End Users
  - ▣ Financial end users – various types of financial institutions
  - ▣ Non-financial end users – non-financial corporations

# Market Structure



# Trading Venues

- Standard swaps are mandated to trade on registered electronic trading platforms
- Known as *Designated Contract Markets (DCM)*
- Trading venues are licensed by regulatory agencies
- DCM are two categories
  - ▣ Large derivatives exchanges
  - ▣ *Swap Execution Facility (SEF) or Organized Trading Platform (OTF)*

# Mandatory Clearing

- All standard contracts must be cleared by *Designated Clearing Organization (DCO)*
- DCP are also known as CCP
- Licensed clearinghouse
- CCP acts as a counterparty for all cleared contracts

# Trade Repository

- All market activity is recorded in a central repository
- Known as *Trade Repository (TR) of Swap Trade Repository (SDR)*
- SDR collects data from market
- Provides reports to regulatory agencies as required

# Push-out Rule

- Applies to Banking institutions with access to Federal government assistance
- These institutions are not allowed to engage in derivatives trading activities with certain exemptions
- Push-out rule is also known as Lincoln Rule

# Global Reforms

- G20 countries are committed to reform their markets to stay in line with the Dodd-Frank Act
- Financial Stability Board (FSB) providing guidelines and monitoring implementation
- Popular similar acts – EMIR and MiFID II in E.U



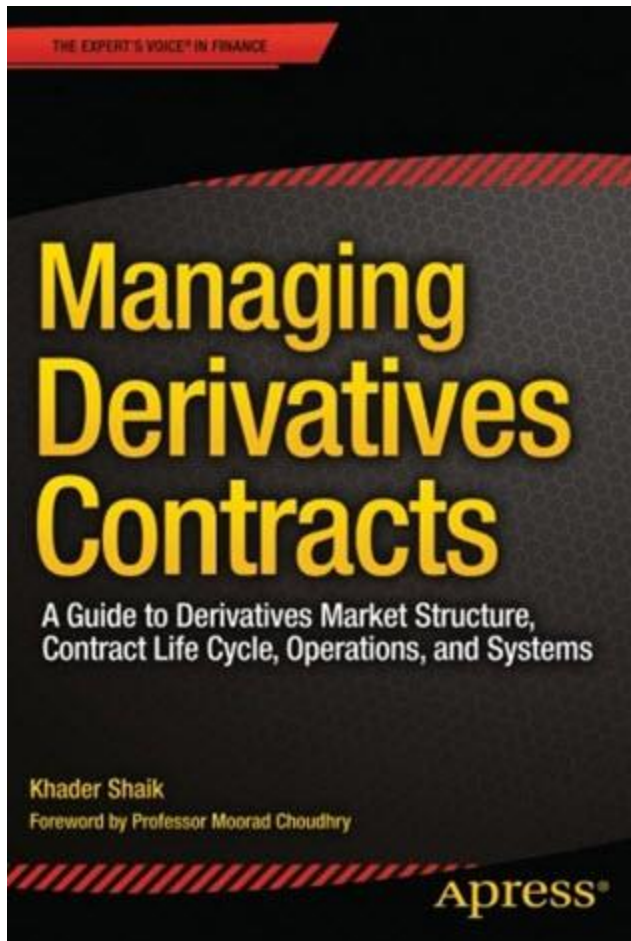
# Volker rules

- Applies to banking entities
- Prohibits and limits certain derivatives activities
- Prohibits from engaging proprietary trading
- Limits the involvement in sponsoring and investing private equity and hedge funds
- Certain exemptions are included
- Defines *Systemically Important Financial Institution (SIFI)* designation

# References

- Full text -  
<http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>
- **CFTC -**  
<http://www.cftc.gov/LawRegulation/DoddFrankAct/Dodd-FrankFinalRules/index.htm>
- **SEC -** <http://www.sec.gov/spotlight/dodd-frank/derivatives.shtml>
- **FSOC -**  
<http://www.treasury.gov/initiatives/fsoc/Pages/home.aspx>
- **OFR -**  
<http://www.treasury.gov/initiatives/ofr/Pages/default.aspx>

# The End



To learn more about new landscape of derivatives market as a result of the Dodd-Frank act, and other derivatives topics, please refer to ***Managing Derivatives Contracts***.

On Amazon - <http://www.amzn.com/1430262745>

Thank you

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