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Rollback of Swap "Push-Out" Rule: Expansion of Permissible Swap Activities for Banks

After much-publicized legislative debates, the scope of the so-called swap "push-out" rule was significantly reduced in the appropriations bill signed into law on December 16, 2014. Under the new law, US banks (and US branches of non-US banks) will be permitted to deal in all swaps except certain structured finance swaps. This legislation is the first substantive amendment to the statutory language of the Dodd-Frank Act since its 2010 enactment.

Background – Original Push-Out Rule

As originally enacted, the swap "push-out" provisions of the Dodd-Frank Act prevented any swap dealer (including a security-based swap dealer) from gaining access to the Federal Reserve discount window or other assistance provided by the government to banks. (These provisions are referred to as the "push-out" rule because they would have effectively required banks to "push out" swap dealing activities to non-bank affiliates.) However, the original push-out rule included an exemption for (a) the hedging activities of insured depository institutions (i.e., US banks and FDIC-insured branches of non-US banks); and (b) dealing activities of insured depository institutions involving rates or reference assets eligible for investment by US banks, e.g., interest rates, foreign exchange, US government securities, and investment grade corporate debt securities. This exemption, by its terms, did not apply to dealing in uncleared credit default swaps ("Uncleared CDS"). As a result, under the original push-out rule, a US bank would have had to cease its dealing activities in equity swaps, certain commodity swaps, Uncleared CDS and certain other swaps. The exemptions in the original push-out rule did not explicitly apply to US branches and agencies of foreign banks that did not have US deposit insurance.

New Legislation

The new legislation expands the push-out rule exemptions and allows uninsured US branches and agencies of foreign banks to benefit by the exemptions.

- **Expansion of Exemption**: The new legislation exempts from the push-out rule any swap dealing activity except for dealing in structured finance swaps, which are defined as swaps based on an asset-backed security or index or group of asset-backed securities. In addition, the exemption applies to dealing in structured finance swaps if (a) the structured finance swaps are undertaken for hedging or risk management purposes, or (b) each underlying asset-backed security is of a credit quality and type specified by the prudential regulators (under rules to be adopted). The legislation deletes the prohibition on dealing in Uncleared CDS. As a result, the push-out rule now only applies to dealing in structured finance swaps that are not being used for hedging or risk management purposes, and even this limited push-out requirement could be further narrowed by regulatory action.
- **US branches of Foreign Banks:** The new legislation provides that all the exemptions will apply to the dealing activities of all US branches and agencies of non-US banks irrespective of whether they are insured or not.

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