

## Financial Reforms and Regulation of REC Markets

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# Agenda

**Dodd-Frank Background**

**Regulation of Swaps, Swap Dealers and Major Swap Participants**

**Dodd-Frank Impacts on End-Users, Markets, Liquidity and Credit**

**Questions**

# Reasons for Dodd-Frank

**Housing Bubble**

**Failure of Parties to Meet their Obligations**

**Lack of Available Credit**

**Bailouts of Financial Firms**

**Perceived Lack of Regulation**



# Dodd-Frank

## Goals

- Reduce Risk of Default
- Reduce the Systemic Impact of Default (end “Too Big to Fail”)
- Promote Market Integrity
- Increase Transparency

## New Jurisdiction

- CFTC, SEC, and Treasury Regulation of “Swaps,” “Swap Dealers” and “Major Swap Participants”



# Swaps Definition

**Contracts in which payments are exchanged based upon the occurrence of financial or commercial events**

- Ex. Derivative based upon sunny days in Nevada to hedge solar PPA
- Ex. Exchange of fixed vs. floating interest rates (“vanilla swap”)

**Options on commodities**

- Ex. REC option agreement

**Financially settled commodities contract which does not also convey an ownership interest in an asset**

- Ex. “Contract for Differences”



## Swaps Definition Continued

Other contracts that become known as swaps in the future.

- Ex. Transactions parties describe as swaps.



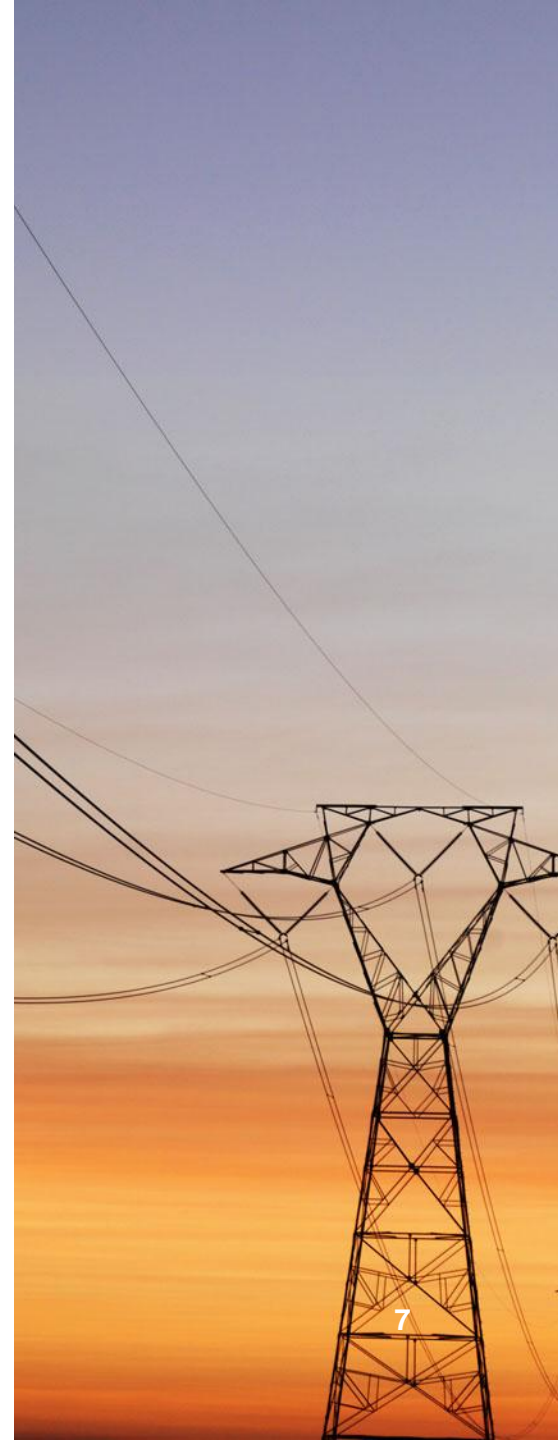
# Swaps Definition—Exceptions

Options embedded in forward contracts

Transactions the CFTC chooses to exempt

**Forward Contracts Intended to Physically Settle**

- Sale of *non-financial* commodities,
- for deferred shipment,
- transaction is “intended” to be *physically* settled.



# Are RECs, Carbon Offsets, and Allowances Swaps?

Section 750 Study

Definitions of “physically settled” and “non-financial”

Federal Preemption



# Regulation of Swaps

Standardized swap trades must be cleared, unless exempted by CFTC

Margin posting requirements

Reporting of swap trades to Swap Data Repositories or the CFTC

Recordkeeping requirements



# Regulation of Swap Dealers and Major Swap Participants

Net capital requirements

Position limits

Registration requirements for firms and individuals

Reporting requirements

Business conduct rules

Appoint a Chief Compliance Officer



# Dodd-Frank Impacts to End-Users

**Even if you're not a swap dealer, Dodd-Frank imposes-  
Intensive data keeping and reporting requirements**

**Position limits**

**Internal governance burdens**

**Practical limits on OTC transaction frequency**

**New documentation standards**

**Credit management complications**

**CFTC-claimed jurisdiction over most of the economy**

**Contract enforceability risk due to lack of safe harbors**

**Markets with substantially impaired liquidity  
Business planning in an economy with substantial systemic  
de-levering**



# Some Dodd-Frank Impacts on Markets and Liquidity

**Substantial systemic de-levering**

**OCC Study and JP Morgan comment letter admit trillions of dollars will be required for *initial margin among largest dealers***

**Capital Costs of collateral thresholds and exchange margin  
Increased dealer and counterparty funding and compliance costs passed through  
e.g. cost of right to require segregation of posted initial margin**

**Expanded basis risk  
exchange products favored over custom products and therefore more liquid**

**Costs and risks of key vendors and customers not hedging**

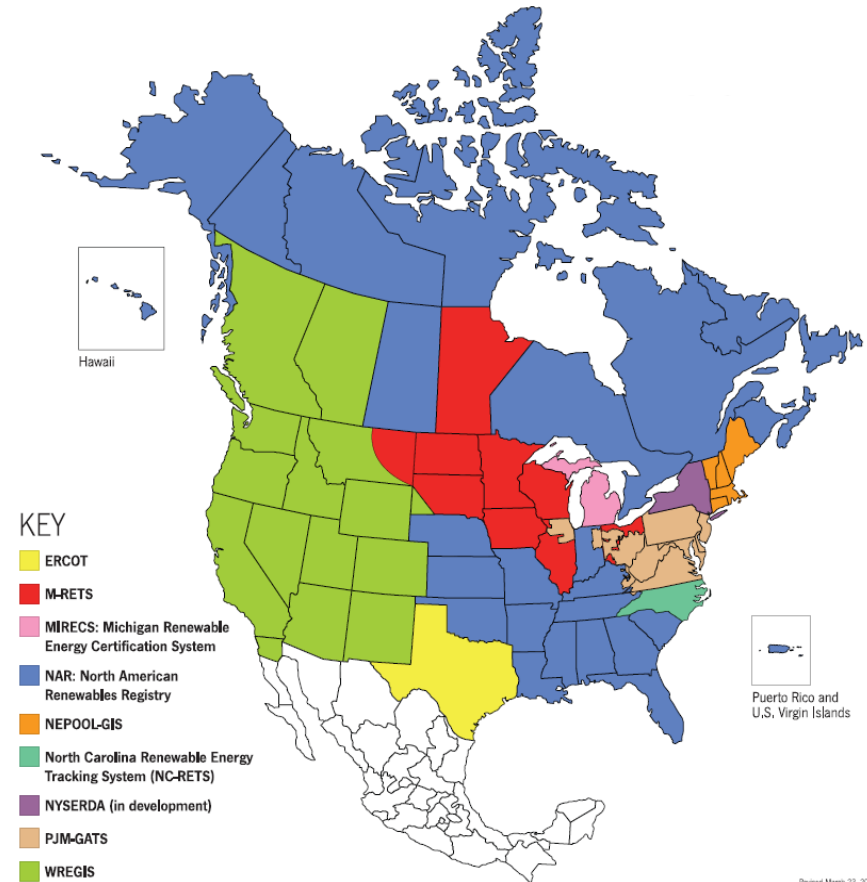
**Credit and Collateral Requirements**



# RECs as Collateral

## *Security Interests in REC Transactions with a Focus on Tracking Agency Issues*

- Scope of collateral security
  - Buy/sell contracts
  - REC certificates
  - Tracking agency account
- Creation of a REC security interest
  - security agreement
  - a description of the collateral that reasonably identifies what is described
- Perfection of a REC security interest
  - What should a UCC cover?
  - Understand third party liens in collateral
- Enforcing a REC security interest
  - Post-default rights
  - Best practices for analogous collateral types
- Tracking agency issues
  - How to transfer RECs to secured party's account
  - What if counterparty and tracking agency do not cooperate?
  - Workarounds



# Appendix: Swap Dealer Definition

## Swap Dealer definition

- Holds itself out as a dealer of swaps
- Makes a market in swaps; or
- Enters into swaps in the ordinary course of business

## Exceptions to Swap Dealer Definition

- Person who enters into swaps for own account, not as a part of regular business; or
- De Minimus
  - < \$100,000,000 Notional value in swaps transactions over previous 12 months;
  - < 15 swap counterparties over previous 12 months; and
  - < 20 swap transactions over previous 12 months.



# Appendix: Major Swap Participant Definition

## Major Swap Participant Definition

- Not a Swaps Dealer and
- Maintains a “substantial position” in outstanding swaps

## A Substantial Position for Commodity Swaps =

- > \$1,000,000,000 daily average aggregate uncollateralized exposure
- Minus hedging transactions



# Appendix: End User Exception

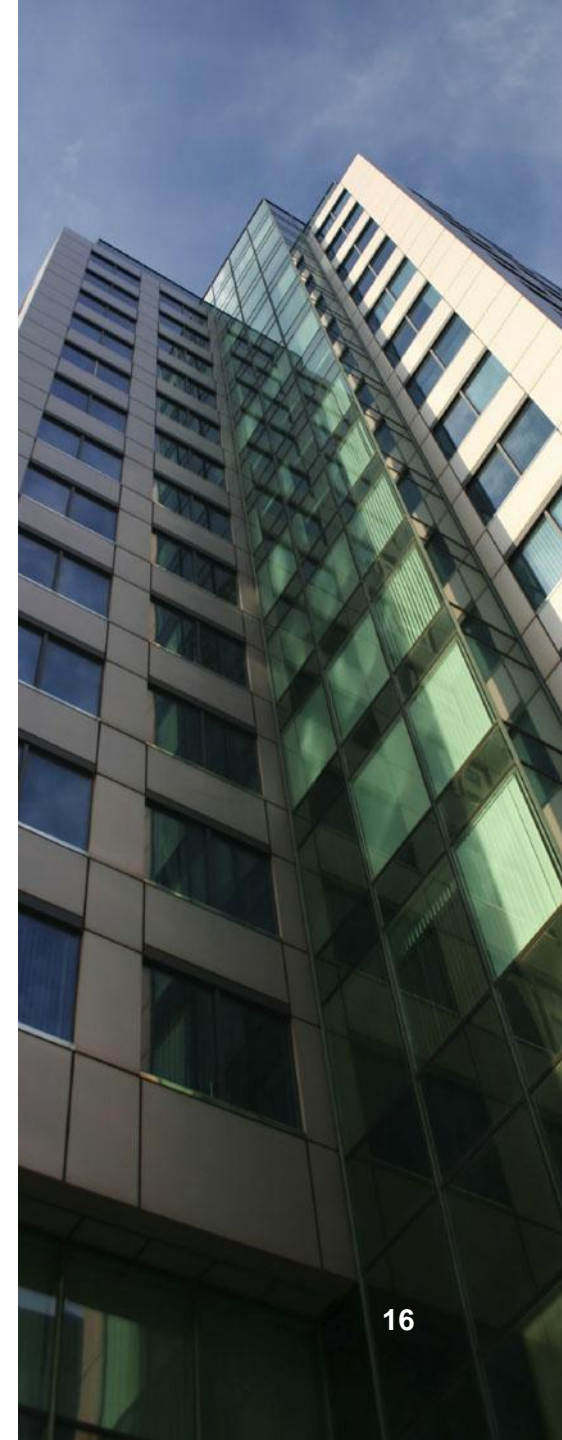
## “End Users” Are Not Subject to Mandatory Swap Clearing Requirements

### Who are End Users?

- Any counterparty who is not a “Financial Entity”

### Financial Entity Definition:

- Swap Dealer;
- Major Swap Participant;
- Commodity Pool;
- Private Fund; or
- Banker



# Appendix: End User Exception

## What types of transactions qualify?

- Swap purpose must be hedging preexisting commercial risk;
- Swap is not used to for speculation, investing or trading;
- Swap is not used to hedge a swap; and
- Swap is reported to Swap Data Repository or CFTC

