

White Collar Defense Alert: Criminal Provisions in the Wall Street Reform Act

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Today, the Senate passed, by a 60-39 vote, new financial reform legislation that includes a number of new criminal provisions that impact the derivatives market, secondary swaps and commodity swaps, ratings agencies, municipal advisors, margin lenders, lenders in general, and traders in general. In some instances, the bill creates brand new criminal provisions or makes activities involving those subject to it applicable to existing criminal laws. Furthermore, this bill allows unelected officials to enact new, broad regulations for the financial sector, many of which will be directly tied to criminal enforcement provisions, and thus will be criminally punishable. Perhaps most troubling, the overwhelming majority of the criminal offenses contained in this bill lack adequate *mens rea*, or criminal intent, requirements and, consequently, will fail to protect innocent or inadvertent actors from being criminally prosecuted or punished.

While the government must prove willful violations of many of these statutes, many also carry a qualifier allowing some to avoid a custodial prison term if they can prove that they had no knowledge of such rule or regulation. This bill also leaves an extraordinary number of matters to be addressed through rulemaking and other regulatory action, giving the regulators significant discretion in many areas. These rules and regulations will take time to write, take effect, and be enforced.

These new criminal provisions include the following:

Disclosures: Criminalizes Disclosures of Treasury Determinations or the pendency of court proceedings (Petitions of Orderly Liquidations).(section 202).

- **Indexing of Swap transactions:** Makes it a criminal offense for any person, other than an eligible contract participant, to enter into a swap unless the swap is entered into on, or subject to the rules of, a board of trade designated as a contract market under section 5.” [Pg. 809-810]; (Sections 723, 724, 728, 730, 731, 733, and 741).

Swaps, Segregations and Bankruptcy Treatment: Criminalizes accepting any money, securities, property or extending credit in lieu of money securities or property from, for, or on behalf of, a swaps customer to margin, guarantee, or secure a swap cleared by or through a derivatives clearing organization (including money, securities, or property accruing to the customer as the result of such a swap), unless the person shall have registered under this Act with the Commission as a futures commission merchant, and the registration shall not have expired nor been suspended nor revoked.” [Pg. 830-831]; This provision also prohibits any person, including any derivatives clearing organization and any depository institution, that has received any money, securities, or property for deposit in a separate account or accounts as provided in paragraph (2) to hold, dispose of, or use any such money, securities, or property as belonging to

the depositing futures commission merchant or any person other than the swaps customer of the futures commission merchant.” [Pg. 830, 834].

Registration Requirement for Swap Data Repositories: Creates a Registration Requirement in order to use the mails or any means or instrumentality of interstate commerce for swap data repositories without registering with the SEC. Criminal penalties apply for willful failure to do so.

Reporting Requirement for Large Swap Traders: Criminalizes the failure to report swap transactions that the SEC finds to perform a significant price discovery function with respect to registered entities if the trader enters a pre-designated amount into the swap in any one day (to be determined by the SEC) and the person obtains an amount in the swap in excess of an amount to be designated by the SEC. Such conduct will not be criminal if the person files reports regarding the transaction with the SEC (to be designated by SEC Rule or Regulation) and the person maintains records of all such swaps and transactions in any related commodity.

Registration Requirement for Swap Dealers and Major Swap Participants: Criminalizes the act of acting as a swap dealer or major swap participant while failing to have registered with the SEC.

Registration Requirement for Swap Execution Facilities: Prohibits the operation of a facility for the trading or processing of swaps unless the facility is registered as a swap execution facility or as a designated contract market under this section.

Fraud and False Statements: Criminalizes Fraud or Deceit in the use of the mails or means or instrumentality of interstate commerce in order to make any contract of sale of any commodity for future delivery (or option on such a contract), or any swap, on a group or index of securities (or any interest therein or based on the value thereof). This includes making any untrue statement of a material fact or failing to include a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

Broadens Insider Trading Ban and Adds New Categories to those Covered by the Statute: Expands and criminalizes the conduct of *federal employees* and the prohibitions on their use of insider information. Expands coverage of the statute to *any person* who receives and uses insider information obtained from a federal employee. Makes it a criminal offense for “any person” to obtain insider information held by the federal government that may affect or tend to affect the price of any commodity in interstate commerce, or for future delivery, or any swap, where that person knew or should have known that such information has not been disseminated by a department of the federal government **and** uses such information, or imparts such information with the intent to assist another person, directly or indirectly, in using such information to enter into, or offer to enter into—(i) a contract of sale of a commodity for future delivery (or option on such a contract); (ii) an option (other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)); or (iii) a swap.

Antidisruptive Practices Provision: Criminalizes willful acts of disruption during transactional negotiating or the closing period including acts which demonstrate an intentional or reckless disregard for the orderly execution of transactions during the closing period. The statute particularly targets the practice known as in the trade as ‘spoofing’ (bidding or offering with the intent to cancel the bid or offer before execution). It also criminalizes the use of swaps to defraud including knowing or acting in reckless disregard of the fact, that its counterparty will use the swap as part of a device, scheme, or artifice to defraud any third party. (Sections 747)

Securities Registration Requirement: Requires registration of all persons participating in securities based swaps and criminalizes the failure to register with the SEC. It also places the burden on securities based swap dealers and major securities based swap participants to not become associated with such unregistered persons in securities based swap transactions under criminal penalty for doing so.

Criminalizes Use of Mails or Interstate Commerce in Transactions with Ineligible Participants: Makes it a criminal offense to willfully use interstate commerce or the mails to trade in securities based swap transactions with any person not an eligible contract participant (as defined in section 1a(18) of the Commodity Exchange Act (7 U.S.C. § 1a(18)).” [Pg. 1155-1157] unless a registration statement has been filed.

Criminalizes Margin Lending: Bars any member of a national securities exchange or any broker or dealer, directly or indirectly, from extending or maintaining credit or arranging for the extension or maintenance of credit to or for any customer on any security(with few exceptions) without collateral or on any collateral other than securities. It also prohibits any member of a national securities exchange or any broker or dealer from extending or maintaining credit in cases where the extension or maintenance of credit is not for the purpose of purchasing or carrying securities or of evading or circumventing this provisions. Thus creating two separate criminal violations where only one previously existed.

Violations Reporting Requirement for Rating Agencies: Requires each nationally recognized statistical rating organization shall refer to the appropriate law enforcement or regulatory authorities any information that the nationally recognized statistical rating organization receives from a third party and finds credible that alleges that an issuer of securities rated by the nationally recognized statistical rating organization has committed or is committing a material violation of law that has not been adjudicated by a Federal or State court. With no requirement that the nationally recognized statistical rating organization warranty the accuracy of the information.

Regulation of Municipal Advisors: Makes it a criminal offense for a municipal advisor to provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, or to undertake a solicitation of a municipal entity or obligated person, unless the municipal advisor is registered in accordance with this subsection.

Municipal Advisor Fraud by Mail or Interstate Commerce: Criminalizes use of the mails or any means or instrumentality of interstate commerce to provide advice to or on behalf of a

municipal entity or obligated person with respect to municipal financial products, the issuance of municipal securities, or to undertake a solicitation of a municipal entity or obligated person, in connection with which such municipal advisor engages in any fraudulent, deceptive, or manipulative act or practice by municipal advisors.”

Bureau of Consumer Financial Protection(BCFP): Unlawful Acts: Makes it a criminal offense for any covered person or service provider covered under the BCFP to offer or provide to a consumer any financial product or service not in conformity with Federal consumer financial law, or otherwise commit any act or omission in violation of a Federal consumer financial law; or to engage in any unfair, deceptive, or abusive act or practice. It also criminalizes the refusal or failure of any covered person or service provider who fails or refuses required to permit access to or copying of records; to establish or maintain records; or to make reports or provide information to the Bureau when required by federal consumer financial law, or any rule or order issued by the Bureau thereunder. Additionally it criminalized providing substantial assistance to a covered person or service provider in violating these provisions.

Endnotes

¹ S. 3217 introduced by Senator Dodd (D-CT)
H.R. 4173 introduced by Barney Frank (D-MASS)
(all references herein are to the bill as presented in the Dodd-Frank Conference Report [H.R. 4173])

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