Is Our Economy Safe?  
A Proposal for Assessing the Success of Swaps Regulation under the Dodd-Frank Act

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The Dodd-Frank Act mandates that all standardized derivatives products be regulated in most instances by requiring that these trades be fully transparent and backed by adequate capital. How will we know whether these regulatory measures are protecting financial markets from a further destabilizing systemic breakdown?

Background: The Economic Meltdown as Failure of Regulation

Although many factors contributed to the financial meltdown of 2007 and 2008, principal among them was the collapse of the market in over-the-counter (“OTC”) derivatives. The OTC market in credit default swaps provided the trigger that launched the mortgage crisis, credit crisis, and systemic financial crisis that threatened to implode the global financial system, were it not for a trillion dollar U.S. taxpayer intervention. At the time of the crisis, this market was estimated to have a notional value of $596 trillion, including approximately $58 trillion in credit default swaps (“CDSs”), yet federal regulators (and most state regulators) were barred by a federal statute from ensuring stability in these transactions.

Swaps and the Economic Meltdown

CDSs were the last step in a subprime securitization process that came to undermine the economy. A counterparty investing in a CDS paid a “premium” for another counterparty to “guarantee” that another financial instrument, a collateralized debt obligation (“CDO”), would not fail. Thus, a CDS can be seen as a form of insurance for the success of a CDO. CDOs, in turn, involved the “pulling together and dissection into ‘tranches’ of huge numbers of [mortgage-backed securities (“MBSs”)],” based for their part on mortgage loans and, in the years before the crisis, subprime mortgages in particular.

Importantly, by “reframing the form of risk (e.g., from subprime mortgages to MBSs to CDOs),” investors, including those providing the guarantees through CDSs, thought that their investments were safe. This problem was compounded by “misleadingly high evaluations” by credit rating agencies and, of course, the insurance provided by CDSs. In addition, issuers of

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CDSs depended on an assumption that housing prices would never go down, so that they would never have to pay the guarantees they were providing.\(^4\)

Because CDSs were widely understood to be risk-free, financial institutions began writing “naked” CDSs to investors who had no direct investment in CDOs or MBSs. That is, for a small premium, investors bet that the mortgage-based instruments would fail, and they would receive a payment if they did. Estimates suggest that before the crisis, there were as many “naked” CDSs as those based on actual risk. In another surreal step, some financial institutions also created “synthetic” CDOs, where investors “bet” on the value of a CDO in which they had no financial interest. Both of these investments were bets that mortgages would not be paid.\(^5\)

All of this came to a head when housing prices began to plummet. Homeowners began to default on loans, leading to the failure of CDOs and triggering obligations of CDS issuers. Synthetic CDOs and naked CDSs added exponentially to the obligations owed. But because they believed that the guarantees would never be needed, issuers had not set aside sufficient capital to pay them off and therefore could not. In addition, because the investments were not reported to regulators, both the government and the financial community were surprised by the size of the market, which led to uncertainty and a tightening of credit. All of this resulted in the downward cycle of the economic meltdown, exacerbated by the fact that CDOs and CDSs existed not just in the subprime mortgage market, but in most credit markets.\(^6\)

**Failure of Regulation**

As of 2008, no state or federal agency regulated the swaps market. Although the Commodity Exchange Act (“CEA”) required that futures contracts be traded on publicly transparent and fully regulated exchanges, the Commodity Futures Modernization Act of 2000 “removed OTC derivative transactions…from all requirements of exchange trading and clearing.”\(^7\) Federal law also preempted state gaming and anti-bucket shop laws, which might have brought naked CDSs and synthetic CDOs under state regulation. Finally, CDSs were not regulated as insurance, in part because those engaged in them avoided calling them such, and so they were not subject to state insurance regulations.\(^8\)

Were swaps regulated under the CEA, they would have been subject to several key requirements: (1) public and transparent pricing; (2) disclosure of the real trading parties in interest to the federal government; (3) regulation of intermediaries, i.e. brokers and their employers, including stringent rules as to capital adequacy and customer protection; (4) self regulation by exchanges directly supervised by the Commodity Futures Trading Commission (“CFTC”) to detect unlawful trading activity; (5) prohibitions against fraud, market manipulation and excessive speculation; and (6) enforcement of all these requirements by the CFTC, state governments, and private rights of action.\(^9\)

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\(^4\) See Greenberger, *supra* note 3, at 100.

\(^5\) Id. at 101.

\(^6\) Id. at 102.

\(^7\) Id. at 99.


Dodd-Frank’s Solutions for Regulating Swaps

On July 21, 2010, President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) into law.\(^{10}\) The Dodd-Frank Act transforms the regulation of OTC derivatives by requiring that swaps be subject to clearing and exchange trading as well as capital and margin requirements.

The Act first requires that all “swap dealers” and “major swap participants” register with the banking regulators, CFTC, and/or Securities and Exchange Commission (“SEC”).\(^ {11}\) A swap dealer is an entity that (1) holds itself out as such, (2) makes a market in swaps, (3) regularly enters into swaps for its own account in the ordinary course of business, or (4) engages in activity generally recognized in the trade as dealing in swaps.\(^ {12}\) Major swap participants are entities that are not swap dealers and (1) maintain a substantial position in swaps, excluding transactions used to hedge commercial risk, (2) create substantial counterparty exposure that could undermine the banking system or financial markets, or (3) are highly leveraged, not subject to capital requirements, and maintain a substantial position in swaps.\(^ {13}\)

Registered swap dealers and major swap participants must disclose any material risks of swaps and any material incentives or conflicts of interests.\(^ {14}\) In addition, they must meet capital and margin requirements and conform to business conduct rules, including those related to fraud and market manipulation, that are set by the agencies (clearing organizations and exchanges can supplement those requirements).\(^ {15}\) They must also conform to position limits on their trading volume in commodity swaps, which are set by exchanges within standards set by the agencies.\(^ {16}\) The Dodd-Frank Act also requires that swaps transactions be publicly reported.\(^ {17}\)

The Dodd-Frank Act also imposes clearing and exchange trading requirements on standardized swap transactions. Both are central features of CEA regulation of futures. Under a clearing system, a clearing facility stands between the buyer and seller of a contract to guarantee each against failure of the other party. Clearing facilities have a strong incentive to establish and enforce the capital adequacy of traders, including through the collection of margins, i.e., deposits on the amount at risk in a trade.\(^ {18}\) Under the Dodd-Frank Act, the regulatory agencies decide whether specific types of swaps must be cleared, and designated clearing organizations (“DCOs”) must inform their regulatory agencies which types of swaps they plan to clear.\(^ {19}\) DCOs must allow “non-discriminatory” access to clearing.\(^ {20}\) Swaps that are required to be cleared must also be traded on a designated contract market, securities exchange, or swap

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\(^{11}\) Dodd Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 731.

\(^{12}\) § 721(a).

\(^{13}\) § 721(a).

\(^{14}\) §§ 731, 764.

\(^{15}\) Id.

\(^{16}\) Dodd Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§737, 763(h).

\(^{17}\) § 727.

\(^{18}\) See Greenberger, *supra* note 3, at 99.

\(^{19}\) Dodd Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 723, 763.

\(^{20}\) § 732(a)(2).
execution facility ("SEF"). Important, however, swaps do not have to be cleared or exchange traded if no existing entity will list a particular swap product.

The Dodd-Frank Act contains a narrow “end-user” exception designed to ease the burden on businesses using swaps to mitigate risk associated with their activities. For example, airlines buying fuel may use swaps to hedge against price increases. The exception applies to parties that are not financial entities, are using swaps to hedge or mitigate commercial risk, and have notified the CFTC and/or SEC as to how they meet financial obligations of non-cleared swaps. It does not cover swaps in which both parties are major swap participants, swap dealers, or other financial entities.

Despite this exception, the Dodd-Frank Act imposes its reporting and margin requirements for all swaps, whether or not they are cleared. The swaps must be reported to a registered swap data repository, the CFTC or the SEC and must occur as soon as technologically possible after execution. Margin requirements technically apply to all swaps, although the Act’s sponsors have stated that they are not intended to apply to end-users.

One of the more controversial provisions in the Dodd-Frank Act is the Lincoln or “Push-Out” Rule, which prohibits federal assistance to any bank operating as a swap dealer. Federal assistance is defined broadly to include, *inter alia*, federal deposit insurance or access to the Federal Reserve’s discount window. Although the Push-Out Rule does not take effect for two years, its logical consequence will be to encourage banks to “push out” or divest their swap divisions, so that they can maintain access to federal banking resources.

Similarly, the Volcker Rule generally prohibits banks from engaging in proprietary trading (that is, trading that is on its own behalf and not a customer’s) or acquiring or retaining an interest in a hedge fund or private equity fund. While the Volcker Rule will not be implemented for at least two years, the consequence is that these activities will also move from banks to other smaller and less systemically risky entities.

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21 §§ 723, 763.
22 § 763.
23 §§ 723(a)(3), 763(a).
25 §§ 731, 764; Clearly Gottlieb, Dodd-Frank Wall Street Reform and Consumer Protection Act Poised to Usher in Sweeping Reform of U.S. Financial Services Regulation, July 9, 2010, at 25, available at http://www.cgsh.com/files/News/8a4361fa-131b-46b9-a3ad-779430daceda6/Presentation/NewsAttachment/7e9d121a-cc44-4a85-9677-7af127fda46b/CGSH%20Summary%20of%20the%20Dodd-Frank%20Act.pdf (“Recent correspondence between Senators Dodd and Lincoln states that the margin requirements are not intended to be interpreted to require end user counterparties to post margin to a swap dealer or major swap participant . . . . [R]egulators and commentators will need to consider what weight, if any, to give this legislative history.”).
27 § 619.
28 Id. The Financial Stability Oversight Council will first conduct a six-month study, after which regulators will have nine months to write regulations; the provisions will take effect the earlier of 12 months after the agencies issue regulations or two years after enactment of Dodd-Frank, but banks will have a two-year transition period that can be extended up to three years. Id.
How Will We Know If the Dodd-Frank Act Is Working?

Dodd-Frank has been hailed as important and comprehensive financial reform. But like many reforms before it, proof of its success lies not in the text of the law, but in how it changes the status quo. Imagine a world five years from now: How will we know if the Act has successfully changed the landscape of the U.S. financial system? How will we know if we, as consumers, are better protected against another economic meltdown?

1) 90% of standardized over-the-counter derivatives will be cleared and exchange traded, and just 10% will be exempt based on the end-user exclusion.

The basic rule of the Dodd-Frank Act is that swaps must be cleared and exchange traded. One of the few exceptions is for end users. As CFTC Chairman Gary Gensler has said, the “exception should be narrowly defined to include only nonfinancial entities that use swaps as an incident part of their business to hedge actual commercial risks. Even though individual transactions with a financial counterparty may seem insignificant, in aggregate, they can affect the health of the entire system.”

To achieve this end, regulators should carefully consider how they define hedging for commercial risk. A model for doing so may come from proposed regulations from January 2010, which would have imposed potential speculative position limits on futures contracts for certain energy commodities. Suggesting an exemption for bona fide hedging, the CFTC relied on a definition from regulation 1.3(z), under which bona fide hedging includes “transactions or positions [that] normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise.” Further, the CFTC emphasized that “[u]nder the proposed regulations, traders holding positions pursuant to a bona fide hedge exemption would generally be prohibited from also trading speculatively. This definition limits the end-user exemption to those whose intent is, ultimately, to purchase or sell a physical commodity, rather than a bank.” Such an approach would be sufficiently narrow to limit the ability of entities to circumvent regulation.

29 See, e.g., Dennis, supra note 10 (“President Obama launched a new era in the relationship between Washington and the financial world when he placed his signature Wednesday on a massive bill to rewrite the nation’s financial rules.”).
32 Id. at 4,159.
2) Swap dealers or major swap participants will have no more than 20% ownership of any derivative clearing organization (“DCO”), board of trade (“BOT”), or swap execution facility (“SEF”).

One of the main principals shaping derivatives regulation under the Dodd-Frank Act is to provide free and open access to clearing and exchange trading by financial institutions. Simply put, clearing and exchange trading are designed to reduce risk by providing price transparency, requiring that investors set aside adequate capital in case of default, and producing public information on who is involved in trading and to what extent. But if large numbers of trading institutions are excluded from clearing organizations or exchanges, the protections otherwise contributed by these protections will be undermined.

Already, large swap dealers and banks are working to limit access and competition from smaller entities by creating ways to exert control over DCOs, BOTs, and SEFs. According to the Office of the Comptroller of the Currency, just five U.S. banks represent 98% of the total amount invested by banks in swaps. In many cases, clearinghouses and exchanges are owned by banks, including those that are the five dominant swaps investors. In an apparent attempt to discourage competition, the banks, in their roles as owners, have imposed unnecessarily high capital requirements or other thresholds, far in excess of that needed for conservative risk management, as minimums for satisfying the clearinghouse membership eligibility, in order to keep smaller, but highly credit worthy institutions out of the clearing process.

While several proposals have been raised, a simple solution to this problem is to curtail the influence and control of large banks over clearing and exchange institutions by capping their ownership at a maximum of 20%. The 20% ownership restriction is similar to an amendment proposed in 2009 by Representative Stephen Lynch and included in the House version of the Dodd Frank bill. This amendment would have restricted the beneficial ownership interest to an aggregate of 20% of all swap dealers and major swap participants, as well as those associated with them. Although the Lynch amendment was stripped from Dodd Frank by the Conference

33 See, e.g., S. Rep. 111-176, at 32–35 (2010) (noting that draft provisions concerning OTC derivatives were designed to minimize non-cleared, off-exchange trades); Public Roundtable on Governance and Conflicts of Interest in the Clearing and Listing of Swaps: Commodity Futures Trading Commission and Securities and Exchange Commission, at 33 (Aug. 20, 2010) (statement of Randy Kroszner, University of Chicago, Booth School of Business) (“And the law is clear: Open access is the fundamental principle.”) [hereinafter CFTC/SEC Roundtable].
34 S. Rep. 111-176, supra note 33, at 29–35 (“The combination of these new regulatory tools will provide market participants and investors with more confidence during times of crisis, taxpayers with protection against the need to pay for mistakes made by companies, derivatives users with more price transparency and liquidity, and regulators with more information about the risks in the system.”).
36 E.g., CFTC/SEC Roundtable, supra note 31, at 112 (statement of Michael Greenberger) (stating that one exchange’s ownership structure includes nine banks taking 50% of profits).
37 E.g., CFTC/SEC Roundtable, supra note 31, at 25–26, 39 (statements of Jason Kastner, Vice Chairman, Swaps and Derivatives Market Association) (stating that banks have been “really clever about keeping people out of the system” and providing example that one clearinghouse has set high capital requirements and large amounts of previously cleared swaps for institutions to join).
Committee before final passage, the Dodd-Frank Act requires the CFTC and SEC to adopt rules eliminating conflicts of interest arising from the control of clearing and exchange institutions where a swap dealer or major swap participant has “a material debt or material equity investment.” In carrying out the duties expressly delegated by the Act, the CFTC and SEC have complete and unfettered discretion to create restrictions on ownership—including numerical caps. These restrictions would be effective and clear tools for ensuring that large banks could not employ control tactics such as anti-competitive policies over clearing and exchange institutions in a manner that would exclude smaller participants.

Some observers have argued that requiring an independent board of governors—that is, one that is not comprised of banks, but outside experts or other members—would effectively avoid the problem of overly concentrated power. However, a recent example shows the futility of relying on that approach alone: In 2009, ICE Trust acquired the Clearing Corp., a clearinghouse owned by nine of the largest swap trading banks. Although ICE Trust claims to be managed by an independent board, the acquisition involved a profit-sharing scheme in which these banks not only have an equity ownership in ICE Trust, but, in addition, they will receive collectively in their own names 50% of the profits. In addition, the founding banks will be subject to a pricing structure distinct from that applied to other banks.

3) All large financial institutions that deal in or buy swaps would be subject to strict capital requirements and rigorous business conduct rules.

As noted above, swap dealers and major swap participants must conform to capital requirements and business conduct rules set by the agencies. As they define the terms “swap dealers” and “major swap participants,” agencies should aim to capture the top 200 or so entities dealing in derivatives. As Chairman Gensler recently stated, “initial estimates are that there could be in excess of 200 entities that will seek to register as swap dealers [under the Dodd-Frank Act],” including “[209] global and regional banks currently known to offer swaps” as

39 Dodd Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 726, 765. See also (Cong. Record, June 30, 2010, H5217) (in a colloquy with Rep. Lynch, House Financial Services Chair Barney Frank agreeing that Sections 726 and 765 of the Dodd-Frank Act require the SEC and CFTC to adopt rules eliminating the conflicts of interest arising from the control of clearing and trading facilities by entities such as swap dealers, security-based swap dealers, and major swap and security-based swap participants).
41 See, e.g., CFTC/SEC Roundtable, supra note 31, at 120–21 (statement of Lynn Martin, NYSE Life) (stating that board independence is a more effective way to handle conflicts of interest than mandating ownership restrictions, because it ensures broad representation of constituency interests).
“Primary Members” of the International Swaps and Derivatives Association (“ISDA”).43 These entities should be encompassed by the definitions adopted by the CFTC.

To achieve this number, agencies should consider how they define several terms. First, the CFTC and SEC should adopt a definition used by ISDA for deciding which institutions should be registered. The ISDA definition includes all business organizations and entities that deal in derivatives except those who do so “solely for the purposes of risk hedging or asset or liability management.”44 In adopting this definition, the agencies should also clarify that it does not exclude entities that claim to use derivatives for risk hedging or asset or liability management but for whom the transactions could materially affect their financial condition based on the significant revenue generated by the swaps.

Another key issue will be how to determine whether a firm enters into swaps in the course of “regular business,” because swap dealers do not include persons who enter into swaps for their own account, as long as they do not do so as part of their regular business.45 To ensure that regulation will cover the largest dealers, agencies should define regular business based on an institution’s annual average trading revenue from all swaps activities, as a percentage of total trading revenue. This percentage provides insight as to the nature of an institution’s business, and agencies should use it to compare the relative positions of various institutions as well as the importance of swaps to a particular firm. However, because trading revenue from swaps activities is currently unavailable to the public or regulators, in order to allow regulators to assess this percentage, the agencies should require all entities that have annual trading revenue over one billion dollars to provide the CFTC with audited financial statements reporting gross and net trading revenue from all swap activities. The percentage triggering regulation should be two percent, and the percentage should be adjusted accordingly based on the reported data going forward.

The term “major swap participant” encompasses three broad categories: entities that maintain a substantial position in “major swaps categories,” those that pose substantial risk to counterparties, and those that are highly leveraged.

Here, “major swaps categories” should be broken down to reflect relatively specific commodity products, so that entities that are heavily involved in a commodity—and thus can influence prices—do not escape regulation by “hiding” within a larger category. For example, the categories should be defined not just as “energy” or even “crude oil,” but should be broken down to a precise commodity product, i.e., “light sweet crude oil.” In addition, “substantial position” should be measured by the notional value of an entity’s swap positions, as a proportion of the notional value of all swaps positions held by all entities. This can paint of picture of how concentrated risk is, and regulators can use it to ensure that the firms with the most risk are covered by regulation.

Entities creating substantial counterparty exposure can be determined by looking at two factors: (1) how much is currently at risk in case of default, measured by the market value of contracts, and (2) how much could potentially be at risk in the future, over the life of the contract. To assess both, agencies should consider how many counterparties are at risk through swaps transactions with a given entity—a measure of interconnectedness, or the extent to which an institution’s failure would have a ripple effect into the overall economy. In addition, agencies should consider the financial stability of counterparties, to capture transactions that involve one or very few counterparties but may still create substantial risk.

Highly leveraged entities can be identified based on entities’ current credit risk relative to their capital. Where agencies find that entities have taken on too much risk, they should restrict them from additional swaps activities and/or require an increase in available capital. This will prevent an excessively leveraged firm from triggering significant market dysfunction.

4) Proprietary trading, hedge and equity funds, and credit default swaps would be moved from large banks to smaller structures with smaller potential impacts on the overall financial system.

As noted earlier, the Dodd-Frank Act includes both the “Volker Rule,” which prohibits banks from engaging in proprietary trading or ownership of hedge or equity funds, and the “Lincoln” or “Push-Out Rule,” which requires bank holding companies to establish separate affiliated corporations for swaps dealings in unregulated CDSs in order to benefit from federal assistance. Although both provisions have long lead times before implementation, they are already having their intended effects.

In anticipation of the Volcker Rule, for example, a private equity division at Bank of America left in the fall of 2010 to form a new hedge fund. Even before the final bill was passed, Citigroup sold a private equity fund, and it is considering moving at least one of its proprietary trading units into a separate hedge fund. At Goldman Sachs, which will also disband its proprietary trading units, proprietary traders are reportedly leaving to join new or existing hedge funds. JP Morgan recently announced it will shut down its proprietary trading in commodities as a first step in closing down all proprietary trading. All of these firms, and

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47 See OCC Report, supra note 35, at 4 (stating that net current credit exposure is “the primary metric used by the OCC to evaluate credit risk in bank derivatives activities”).
51 Kopecki & Chanjaroen, supra note 49.
This movement is healthy—a sign that the Volcker Rule will have a powerful impact. The transactions covered by the Rule will move from banks that are too big to fail (“TBTF”) to more diverse and less systemically risky parts of the market, including non-TBTF institutions such as hedge funds. As the Senate Committee on Banking suggested, this provision “will reduce the scale, complexity, and interconnectedness of those banks that are now actively engaged in proprietary trading, or have hedge fund or private equity exposure. [It] will reduce the possibility that banks will be too big or too complex to resolve in an orderly manner should they fail.”53 In addition, investment banks will not be able to create risky financial products and sell them to investors, while holding on to the other side of the bets to make profit at customers’ expense—an act that Goldman Sachs was accused of by the SEC.54

The Lincoln or Push-Out Rule is also already driving risky trades into more diverse structures. JP Morgan, for example, is spinning off its high-risk derivatives into a unit that will be separate from its other investments.55 This movement is healthy, because speculation in derivatives such as swaps has contributed significantly to price volatility in commodities and commodity index funds, an effect that has increased with the influx of more speculation, including “the rapid growth of index investment,” in commodity futures markets.56 To the extent that smaller and more diverse entities engage in such speculation, they will have a lessened impact on commodity index fund prices, simply because they have less weight to throw around. Moreover, where commodity index funds do have swaps, they will be regulated.

5) **Energy and food prices would be explained by market fundamentals rather than unknowns that may be attributable to excessive speculation.**

The Dodd-Frank Act requires the CFTC and SEC to set position limits on the amount of swaps trading that entities can conduct, with the goal of limiting speculation and subsequent volatility in commodities.57 Speculation can unmoor prices from market fundamentals such as supply and demand. In essence, prices are usually determined by a healthy tension between commercial users, who want low prices, and producers, who want high ones. Speculators, however, are unconcerned about what a fair price for a commodity might be, but rather want

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prices to move dramatically in the direction of their bets. Position limits can minimize the role of speculation by limiting both its volume and impact, allowing market fundamentals to be the primary driver of prices.

The impact of speculation on oil pricing was evident between 2007 and 2009, when prices rose from $65 per barrel in June 2007, to $145 in July 2008, to the $30s in winter 2008-09, shifting to the $60s and $70s in 2009. More recently, oil has been trading at $70-82. Economists have ascribed volatility to speculation in oil during this period. In fact, in 2006, a Senate committee found that if fundamentals alone explained prices, it would trade at about $50/barrel, rather than the $75 that it did at the time. At the current level, economists can explain relatively small changes based on market fundamentals. Position limits would help maintain such market rationality.

6) Even swaps that do not clear and exchange trade should be subject to appropriate capital and transparency requirements.

As noted above, the Dodd-Frank Act affords the CFTC and SEC the authority to require that uncleared swaps, even those not subject to clearing and exchange-trading requirements, adhere to “real-time reporting” and, if necessary, margin requirements established by regulation. In particular, those swaps that are not accepted for clearing at a derivatives clearing organization must be reported to a registered swap data repository or, if no swap data repository will accept the report, to regulators in a manner that does not disclose the business transactions and market positions of any person. The Act defines “real-time reporting” as public dissemination of data relating to a transaction, including price and volume, as soon as technologically practicable after the time at which the swap transaction has been executed.

Also, the Act authorizes the CFTC and SEC to make swap transaction and pricing data available to the public in such forms and at such times as are deemed appropriate to enhance

59 See U.S. Energy Information Administration, Cushing, OK WTI Spot Price FOB (Dollars per Barrel), http://www.eia.doe.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RWTC&f=D.
63 §§727, 729, 763, 764.
64 See §727.
price discovery. In light of this, Chairman Gensler has recently stated that “[the CFTC] anticipate[s] rules in [the data reporting] area to require swap data repositories to perform their core function of collecting and maintaining swaps data and making it directly and electronically available to regulators. . . . It will be important that swaps data be collected not only when the transaction occurs, but also for each lifecycle event and valuation over its duration.”

Under these reporting requirements, prudential and market regulators will receive all relevant and necessary data in a timely manner. As such, the reporting requirements are significant because they are one of the only ways that regulators and other observers can assess whether derivatives are significant enough to pose risk to the market through their size or the interconnectedness of counterparties. Indeed, the lack of reporting and transparency was a main cause of regulators’ inability to anticipate the effect of swaps on the financial markets in 2007 and 2008.

Conclusion

The true test of the Dodd-Frank Act is simple but profound: Has it made the economy any safer from the threat of another economic meltdown? If so, we expect to see each of the following achievements:

- 90% of standardized OTC derivatives are cleared and exchange traded, with just 10% exempt based on the end-user exemption.
- Swap dealers or major swap participants have no more than 20% ownership of any derivative clearing organization, board of trade, or swap execution facility.
- All large swap dealers and major swap participants are registered with the agencies and subject to strict capital requirements and rigorous business conduct rules.
- Proprietary trading, hedge and equity funds, and swaps trading are moved from large banks to smaller structures with smaller potential impacts on the overall financial system.
- Energy and food prices are explained by market fundamentals rather than unknowns that may be attributable to excessive speculation.
- Even swaps that are not cleared or exchange traded are subject to real-time reporting and margin requirements.

The Act has the potential to meet these standards, if regulators make the most of the tools available to them.

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65 Id.
66 Gensler, supra note 43.