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Swap Regs Still A Work In Progress As Dodd-Frank Turns 10

By **Tom Zanki**

Law360 (July 21, 2020, 7:45 PM EDT) -- Ten years since the Dodd-Frank Act sought to reform the opaque swaps market, experts say regulators have improved transparency and enacted safeguards against speculation that were nonexistent a decade ago, but it's no time to declare victory.

Congress' push to rein in this corner of the financial markets followed the economic crisis of 2008 that was partly blamed on a lack of oversight over swaps, the derivative contracts traded between large institutions in order to manage risk. The massive swap market was historically traded through bilateral agreements out of public view, involving everything from plain vanilla interest-rate swaps to more exotic instruments.

Congress in 2010 laid out a comprehensive — some would argue overly complex — framework for governing swaps more transparently through Title VII of the Dodd-Frank Act. The U.S. Commodity Futures Trading Commission embraced the brunt of the work, while the U.S. Securities and Exchange Commission was given a smaller role. Both agencies are still hashing out the details.

"Clearly, we've made great progress," said James Angel, an associate professor at Georgetown University's McDonough School of Business. "The swaps regulation in Dodd-Frank was badly needed. Should we declare mission accomplished and go home? No."

Congress granted the most authority over governing swaps to the CFTC, which is responsible for regulating derivatives. The CFTC responded aggressively in proposing rules in the years after Dodd-Frank's passage under then-Chairman Gary Gensler, who was appointed by former President Barack Obama to run the once-sleepy agency with a mandate to prevent another financial crisis.

The SEC took a slower approach from day one and is now finalizing its regime for security-based swaps, a more narrow segment of swaps based on a single security or loan.

"The idea, at least for the SEC, was to spend more time and be more deliberate about it, whereas the CFTC seemed to want a first-mover advantage, and would revisit its rules to make improvements or fix problems later," Davis Polk & Wardwell LLP partner Gabriel Rosenberg said.

The CFTC enacted three pillars of Dodd Frank's Title VII mandate, including requiring the central clearing of swaps, meant to reduce financial risk to the economy; establishing trading platforms known as swap execution facilities, or SEFs; and creating repositories to record swaps data so regulators can track market activity, designed to enhance visibility.

The CFTC hasn't shied away from using its powers to enforce data reporting rules. The agency recently reached a $10 million accord with Deutsche Bank to settle two cases, including a 2016 suit the CFTC filed against the financial giant alleging that it failed to file tens of thousands of swap messages in violation of a prior settlement over similar failures. Deutsche Bank agreed to the fine without admitting to or denying the CFTC's allegations.

While the agency has met key goals mandated by Dodd-Frank's Title VII mandate, not everyone is convinced markets are better off.

"The No. 1 goal is transparency of an opaque market," said Covington & Burling LLP counsel Anne Termine, a former chief trial attorney in the CFTC's enforcement division. "I think that has been a success. The problem is: Has it created almost too strict of a structure?"

Former CFTC commissioner Chris Giancarlo — a Republican who served on the agency from 2014 to 2019, including two years as chairman — has argued that the swaps regime enacted after Dodd-Frank, while needed, is often too complex and expensive for market participants. He pressed for reforms during his tenure, though the agency stopped short of drastic rollbacks.

The current CFTC is continuing the deregulatory approach that began under Giancarlo, easing elements of the swaps regime such as the data reporting requirements.

Under Giancarlo's successor Heath Tarbert, also a Republican, the CFTC in February pitched rules aimed at relieving market participants from reporting obligations considered duplicative. These efforts show the CFTC is still trying to get its approach to swaps right after a decade of learning.

"The rulemakings generally achieved the objectives," Eversheds Sutherland counsel Ray Ramirez said. "But they definitely can be refined and I think they are trying to do that now."

Republican CFTC Commissioner Dawn Stump stressed that point in a recent speech in which she said swap data reporting has come at a "high cost" without fully delivering on its intended benefits.

"As regulators, we must refine our current regulations based on our years of experience collecting and working with this data," Stump told a Women in Housing & Finance Inc. conference July 9. "We should only require the reporting of swap data elements that have a proven use-case or demonstrated utility to justify their inclusion, and we at the CFTC are currently performing such a review."

But one watchdog group is skeptical of the CFTC's deregulatory bent. Better Markets senior derivatives consultant and special counsel Joseph Cisewski said Dodd-Frank went a long way toward creating a swaps market that has more competition and less systemic risk. He warned that the CFTC's push to revisit rules could undo years of progress.

"Nevertheless, the CFTC apparently seeks to snatch defeat from the jaws of victory, giving into short-sighted industry requests for exemptions, exclusions, exceptions and various carve-outs by other names," Cisewski said. "Almost no Dodd-Frank stone has been left unturned in the CFTC's recent deregulatory zeal."

Cisewski added that CFTC leadership has "set the stage for the adoption of a series of hastily considered but consequential regulations, most of which appear to be driven by political considerations and most of which provide a road map to evade the Dodd-Frank Act's reforms."

Tarbert, the current chairman, described the agency's efforts differently in a television interview Tuesday. He said the CFTC is looking to close the book on Dodd-Frank rulemaking and provide a more certain environment for the financial industry.

"Most importantly, what we've heard from the business community for the last decade is, 'We need certainty,'" Tarbert told Bloomberg.

One area where the CFTC says it wants to provide more certainty involves cross-border regulation. This was also a sticking point for Giancarlo, who argued the CFTC took an "overly expansive, unduly complex" approach after the financial crisis and failed to show deference to non-U.S. regulators.

The CFTC tackled this matter in December, when it proposed rules on when its regulations should apply to swaps booked abroad, such as through a foreign-based subsidiary of a U.S. bank. The proposal also refrained from imposing CFTC regulations in foreign venues that have comparable rules to the U.S. The matter is up for vote Thursday.

The cross-border rule is part of a busy week for the CFTC, which on Wednesday will also vote on a long-awaited rule to set capital requirements for swap dealers and major swap participants.

The SEC's plate is not nearly as full as its sister agency's, but it still has sizable jobs to finish. The agency agreed in September to establish record-keeping and reporting requirements for security-based swap dealers and major security-based swap participants.

The SEC also in December approved a rules package involving security-based swaps and set an Oct. 6, 2021, compliance date for security-based swap entities to register with the SEC.

Attorneys said the SEC's slower, more deliberate approach is consistent with past practice, and noted that the agency is trying to align its regime with the CFTC's system to ensure coherence for market participants. How that plays out in the coming years remains to be seen.

Angel, the Georgetown finance professor, worries that a "fuzzy demarcation of responsibilities" between the agencies prevents regulators from nimbly responding to potential crises. He cautioned that central clearinghouses have become far more "systemically important" since Dodd-Frank, potentially creating new risks to stability.

Angel said he would prefer that Congress merge the CFTC and SEC for simplicity's sake, an idea that has been bandied about for years but hasn't gained traction. In any event, the job of enacting safeguards to prevent another crisis while letting markets breathe should keep regulators busy.

"Clearly, the work of Dodd-Frank is not finished," Angel said. "Dodd-Frank did a lot of things that were absolutely necessary, like providing some kind of regulatory framework for swaps. But there is a lot that is unfinished. And Congress really needs to start the discussion as to how we can improve our unwieldy regulatory structure."

--Editing by Kelly Duncan and Alanna Weissman.