IV. Curtailing "Financial Weapons of Mass Destruction": The Boundaries of Derivative Regulation under Title VII of the Dodd-Frank Act

In the wake of the financial crisis, Congress enacted Title VII ("Title VII") of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") to address gaps in the regulation of derivatives.[1] The Act produced a new regulatory framework for swap derivatives designed to promote stability in U.S. financial markets by improving transparency, limiting counterparty risk and encouraging market integrity.[2] Although Title VII contains a variety of provisions intended to further these goals, its most stringent restrictions are reserved for systemically important entities known as "swap dealers" and "major swap participants."[3] While Congress provided initial guidance on these terms, it left regulators to decide upon the terms' precise application,[4] a task that requires a careful balancing of conflicting policy concerns.[5] On one hand, Title

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[1] *See generally* Wall Street Transparency and Accountability Act of 2010, Pub. L. No. 111-203, tit. VII, 124 Stat. 1376, 1641-1802 (2010) (to be codified in scattered sections of the U.S. Code).

[2] Michael Sackheim & Elizabeth M. Schubert, *Dodd-Frank Act Has Its First Birthday But Derivatives End-users Have Little Cause for Celebration*, 2 HARV. BUS. L. REV. ONLINE 1, 1 (2011), http://www.hblr.org/wp-content/uploads/2011/07/Schubert-Derivatives_End_User.pdf (identifying the legislative goals of Title VII).

[3] *See* discussion *infra* Part B. For an additional account, see SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP, TITLE VII OF THE DODD-FRANK ACT ONE YEAR LATER: PIECING TOGETHER THE DODD-FRANK 'MOSAIC' FOR DERIVATIVES REGULATION 5-10 (July 21, 2011), *available at* http://www.skadden.com/newsletters/title_vii_of_the_dodd-frank_act_one_year_later.pdf.

[4] *See* 15 U.S.C.A. § 8302(d)(1)-(2) (West 2011) (calling for the Commodity Futures Trading Commission and the Securities and Exchange Commission, in consultation with the Board of Governors of the Federal Reserve to "further define the terms 'swap', 'security-based swap', 'swap dealer', 'security-based swap dealer', 'major swap participant', [and] 'major security-based swap participant'" in a manner consistent with the statute).

[5] *Compare* Vice President Joe Biden, Remarks by the Vice President at the Brookings Institute's Hamilton Project Forum (Apr. 20, 2010), *available at* http://www.whitehouse.gov/the-press-office/remarks-vice-president-brookings-institutions-hamilton-project-forum (stating that derivatives regulations must be strong enough to "bring the light of day into that

VII fills an essential need by providing for regulatory oversight over the swap trading operations of certain financial institutions that played a major role in the global financial crisis of 2007-2011.[6] Conversely, an overly broad application could adversely affect U.S. financial markets by discouraging commercial businesses from using derivatives for legitimate hedging purposes.[7] This article will discuss how lawmakers have grappled with these considerations in determining which entities to classify as "swap dealers" or "major swap participants."

A. The Need For Regulation

Prior to Dodd-Frank, over-the-counter ("OTC") swaps between large institutional traders were principally exempt from regulatory supervision under the Commodity Futures Modernization Act of 2000 ("CFMA").[8] In the absence of oversight, several highly leveraged financial entities built up massive credit-default swap exposures while holding insufficient capital to cover potential margin

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shadowy risky market"), *with* Letter from Sen. Christopher Dodd & Sen. Blanche Lincoln to Rep. Barney Frank & Rep. Colin Peterson (June 30, 2010), *available at* http://online.wsj.com/public/resources/documents/dodd-lincoln-letter070110.pdf (arguing that regulators must not interpret the definition so expansively that it becomes "prohibitively expensive for end users to manage their risk").

[6] *See* discussion *infra* Part A; *see also* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES xxiv-xxv (2011) [hereinafter FCIC Report] (concluding that unregulated over-the-counter derivative markets "contributed significantly" to the financial crisis); MARK JICKLING & KATHLEEN ANN RUANE, CONG. RESEARCH SERV., R41398, THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT: TITLE VII, DERIVATIVES SUMMARY (2010), *available at* http://www.llsdc.org/attachments/files/239/CRS-R41398.pdf ("The financial crisis implicated the unregulated over-the-counter (OTC) derivatives market as a major source of systemic risk.").

[7] *See* discussion *infra* Part C.

[8] Sackheim & Schubert, *supra* note 2, at 1-2 ("The CFMA opened the door for institutional traders having total assets exceeding $10 million . . . to enter into privately negotiated OTC derivatives for both hedging and speculative purposes, with credit terms tailored to the needs of the parties, free from burdensome government regulation . . . [and] in most instances without being required to tie up capital as collateral.").

calls if the value of the underlying securities (or their own credit rating) deteriorated.[9] As a result, when these speculative positions generated enormous losses in 2007 and the resulting margin calls nearly pushed these firms into bankruptcy, the damage threatened to cascade through the financial system, spreading from the firms to their creditors and trading partners.[10] To make matters worse, because swaps were formed bilaterally and were not subject to reporting requirements, both the market and its regulators were unaware how much swap exposure was systemically embedded within the financial system.[11] When American taxpayers were eventually forced to cover the losses under the Troubled Asset Relief

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[9] The most well-known example is the American International Group ("AIG"), which had accumulated $440 billion in credit-default swap exposure by the time of its collapse in 2008. *See* Gretchen Morgenson, *A.I.G., Where Taxpayer's Dollars Go to Die*, N.Y. TIMES, Mar. 7, 2009, http://www.nytimes.com/2009/03/08/business/08gret.
html. The problem extended far beyond AIG, though, as more than $58.2 trillion in assets were backed by credit-default swaps in 2007. FCIC Report, *supra* note 6, at 50.

[10] *See* Jickling & Ruane, *supra* note 6 ("Failure of a dealer would have resulted in the nullification of trillions of dollars worth of contracts and would have exposed derivatives counterparties to sudden risk and loss, exacerbating the cycle of deleveraging and withholding of credit that characterized the crisis."); *see also* FCIC Report, *supra* note 6, at xxv (attributing the A.I.G. bailout to concerns that its collapse "would trigger cascading losses throughout the global financial system"). *But see* Peter J. Wallison, *Credit-Default Swaps Are Not to Blame*, AMERICAN ENTERPRISE INSTITUTE (June 1, 2009), http://www.aei.org/article/economics/financial-services/credit-default-swaps-are-not-to-blame/ (arguing that "there is very little evidence that the failed financial institutions were the victims of their participation in credit-default swaps, or that their failure jeopardized their swap counterparties").

[11] *See* Neal S. Wolin, Deputy Sec'y, U.S. Treasury, Remarks at the International Swaps and Derivatives Association 25th Annual Meeting (Apr. 22, 2010), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg656.aspx ("Because derivatives like credit default swaps . . . were traded on a bilateral basis, few understood the magnitude of aggregate derivatives exposures in the system. Risks embedded in AIG's $400 billion exposure to CDS, which brought that global institution to its knees and threatened to bring the financial system down with it, went unseen by the market and by regulators alike.").

Program,[12] Congress responded to the resulting taxpayer frustration by enacting Title VII.[13] The Act imposes a number of restrictions on swap transactions, including a mandate that all nonexempt, standardized swaps be centrally-cleared and traded on exchanges or other platforms termed "swap execution facilities."[14] It also contains more focused provisions that will apply exclusively to entities classified as "swap dealers" or "major swap participants."[15]

B. The Effects of Being Branded a Swap Dealer or Major Swap Participant

While Title VII provides oversight of all swaps, swap dealers ("SDs") and major swap participants ("MSPs"), these "swap entities" will be subject to particularly stringent regulatory burdens that will increase their compliance costs and significantly impact their business operations.[16] Swap entities must register with and report all swaps to either the SEC or the CFTC.[17] Likewise, swap entities must make heightened counterparty disclosures under elevated business conduct rules.[18] Each entity must also designate a chief compliance officer to report annually to its federal regulator, certifying Title VII compliance.[19] The Act also disadvantages swap entities when they

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[12] The first group of companies to receive funds under the Troubled Asset Relief Program included nearly every large derivative dealer. Jickling & Ruane, *supra* note 6.

[13] One provision of Title VII, which has been dubbed the "Swaps Push-Out Rule," expressly prohibits "federal assistance" from being provided to "swaps entities" in the future. 15 U.S.C.A § 8305 (West 2011).

[14] 7 U.S.C.A § 2(h) (West 2011); 15 U.S.C.A. § 78c-3.

[15] *See, e.g.*, *id.* § 731 (imposing registration requirements on swap dealers and major swap participants).

[16] In dividing regulatory jurisdiction between the SEC and the CFTC, Title VII differentiates between SDs or MSPs that are security-based, and those that are not. *See* 7 U.S.C.A. § 6s; 15 U.S.C.A. § 78o-10. Title VII gives the SEC jurisdiction over security-based swap dealers and major security-based swap participants, while granting the CFTC jurisdiction over all other swap dealers or major swap participants. *See* 7 U.S.C.A. § 6s; 15 U.S.C.A. § 78o-10. In many cases, however, these distinctions are immaterial as Title VII requires that the agencies establish and maintain comparable requirements to the maximum extent practicable. *See* 15 U.S.C.A. § 8302.

[17] 7 U.S.C.A. § 6s(a)(1)-(2); 15 U.S.C.A. § 78o-10(a)(1)-(2).

[18] 7 U.S.C.A. § 6s(h); 15 U.S.C.A. § 78o-10(h).

[19] 7 U.S.C.A. § 6s(k); 15 U.S.C.A. § 78o-10(k).

enter into swaps with counterparties that are not SDs or MSPs. For example, when a swap entity enters such a swap, the Act grants the counterparty sole authority to select the derivatives clearing organization at which the swap will be cleared.[20] And if the swap is exempt from the clearing requirement, the counterparty may still require its clearance despite the exemption.[21]

Most important, swap entities will be subject to new minimum capital standards and will be required to post and maintain margin on all uncleared swaps.[22] The margin requirement on uncleared swaps will be higher than those typically imposed by clearing agencies to discourage swap entities from customizing their swaps solely to circumvent the clearing requirement.[23] If a swap entity is a bank, the applicable standards are those set by its prudential regulator.[24] Meanwhile, if the entity is not already subject to prudential regulation, it must comply with the standards established by the CFTC or the SEC.[25] These requirements will generate significant compliance costs that will alter the way that swap entities conduct business.[26]

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[20] 7 U.S.C.A. § 2(h)(7)(E)(i); 15 U.S.C.A. 78c-3(g)(5)(A).

[21] 7 U.S.C.A. § 2(h)(7)(E)(ii); 15 U.S.C.A. 78c-3(g)(5)(B).

[22] 7 U.S.C.A. § 6s(e)(1)(A); 15 U.S.C.A. § 78o-10(e)(1)(A).

[23] *See* Wolin, *supra* note 11 (acknowledging that derivative customization should be allowed where "there is a legitimate and valuable" need to cover a particular risk but identifying higher capital and margin requirements on customized OTC derivatives as a method of limiting customization by providing incentives to move derivatives onto exchanges).

[24] For a list of the proposed standards, see Margin and Capital Requirements for Covered Swap Entities**,** 76 Fed. Reg. 27,564, 27,587-96 (proposed May 11, 2011).

[25] 7 U.S.C.A. § 6s(e)(1)(A); 15 U.S.C.A. § 78o-10(e)(1)(A). For a list of the CFTC's proposed standards, see Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, see 76 Fed. Reg. 23,732, 23743-48 (proposed Apr. 28, 2011); Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27,802, 27,823-39 (proposed May 12, 2011).

[26] *The Impact of CFTC Proposed Rules to Implement Title VII of Dodd-Frank on Energy Market End-Users: Where Are We Now?*, CLIENT ALERT: CAPITAL MARKETS/DERIVATIVES (White & Case LLP, New York, N.Y.), Mar. 2011, at 2, *available at* http://www.whitecase.com/files/Publication/0ad28c40-7929-4ec1-9a8b-76cab2d8165e/Presentation/PublicationAttachment/c1e23979-d303-4a94-bd78-b68f037ff9f/Alert_The_Impact_of_CFTC_Proposed_Rules_to_Implement_Title_VII_of_Dodd-Frank_on_Energy.pdf ("The consequences of an entity's designation as an

C. The Costs of Overregulating Commercial End-Users

While these elevated requirements are aimed at the financial entities whose swap exposure contributed to the crisis, their application to certain parties, particularly to nonfinancial end-users seeking to hedge commercial risk, would also impose great costs on the U.S. economy with little added benefit.[27] Despite their abuse by financial entities, swaps help commercial end-users manage risks that arise in the course of business.[28] Commercial end-users are nonfinancial companies that use commodities "to produce, manufacture, process, or merchandise goods."[29] Swaps allow these companies to reduce risk by locking in prices for key commodities, interest rates, and currency exchange rates.[30] As a result, classifying commercial end-users as SDs or MSPs for their swap activities would increase the cost of hedging for these businesses, effectively discouraging them from managing risk.[31] Therefore, an overly broad application would be counterproductive to Dodd-Frank's overarching goal of risk reduction.[32]

SD or MSP are substantial and will undoubtedly raise the cost of doing business.").

[27] *See* Jason Gold & Anne Kim, *The Risks of Over-Regulating End-User Derivatives*, PROGRESSIVE POL'Y INST. POL'Y BRIEF (Progressive Pol'y Inst., Washington, D.C.), July 2011, at 1-6, *available at* http://progressivefix.com/wp-content/uploads/2011/07/07.2011-Gold-Kim_Risk-of-Over-Regulating-End-User-Derivatives.pdf (discussing how imposing swap entity restrictions on commercial end-users would negatively impact the economy).

[28] *See* Wolin, *supra* note 11 (recognizing that swaps serve the important purpose of allowing businesses to hedge against operational risks).

[29] Scott D. O'Malia, Former Comm'r, CFTC, *Not All End-Users are Created Equal, Remarks at the Reval Annual Client Conference* (May 11, 2011), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opaomalia-6.

[30] *Id.* (delineating the various ways that commercial end-users use swaps to mitigate risk).

[31] Two of Dodd-Frank's chief architects, Senators Christopher Dodd and Blanche Lincoln, echoed these concerns in an explanatory letter less than a month before the bill was signed into law. *See* Sen. Dodd & Sen. Lincoln, *supra* note 5 ("Regulators . . . must not make hedging so costly it becomes prohibitively expensive for end users to manage their risk.").

[32] *See id.* ("If regulators raise the cost of end user transactions, they may create more risk.").

Meanwhile, even if commercial end-users continued to hedge despite the increased cost of doing so, margin requirements and capital segregation requirements would tie up their capital from more productive uses, thereby hindering productivity and impeding job growth. [33] These expenses would likely be passed on to consumers in the form of higher prices.[34] Of course, applying the regulations to large financial entities could impose similar economic efficiency costs, but these costs are more easily justified where the regulated entity is systemically important.[35] Commercial end-user swap trading, however, represents a small fraction of the total derivatives market, and therefore poses significantly less systemic risk to the U.S. economy than the trading operations of financial entities.[36] Consequently, it is important for regulators to limit the scope of the swap entity categories.

D. Who Will Qualify as a Swap Dealer?

Despite initial concerns that regulators would interpret "swap dealer" broadly, application under the proposed definitions will focus primarily on liquidity providers who operate on the sell-side of the transaction in swap markets.[37] To determine if an entity is a "swap dealer," regulators will look subjectively at its swap trading

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[33] *See* Gold & Kim, *supra* note 27 ("[I]n the case of end-user companies that use derivatives just to manage risk, margin requirements would unnecessarily tie up billions of dollars that could otherwise go toward growth and investment.").

[34] *See id.* at 6 (explaining the potential adverse effects on consumers if commercial companies are subject to increased regulatory burdens under Title VII).

[35] *See id.* at 4 (contrasting the interconnected nature of banks and insurance companies with commercial end-users).

[36] In fact, less than 10 percent of all derivative trading involves nonfinancial users. *See id. But see* Chris Baltimore, *Are Commodity Merchants "Swap Dealers" By Another Name?*, REUTERS (Feb. 21, 2012), http://www.reuters.com/article/2012/02/21/us-usa-regulation-swaps-idUSTRE81K1SI 20120221 (drawing attention to large energy companies and commodity merchants with side market making operations that should arguably fall within the regulatory scope).

[37] *See* SKADDEN, *supra* note 3, at 5 (clarifying that the dealer definition focuses on liquidity providers).

activities.[38] Under Title VII, an entity will qualify as a swap dealer if it: (a) holds itself out as a dealer in swaps; (b) makes a market in swaps; (c) regularly enters into swaps for its own account; or (d) engages in activities causing it to be commonly known as a dealer or market maker in swaps.[39] The Act excludes entities that enter into swaps on their own account "either individually or in a fiduciary capacity, but not as a part of [its] regular business."[40] It also exempts entities that have engaged only in a "*de minimis* quantity" of swap dealing over the preceding twelve months.[41]

Regulators have adopted a functional approach to defining "swap dealer" that will likely exclude end-users that do not engage in large market making operations.[42] Regulators have identified swap dealers as entities that have a general tendency and availability to accommodate the demand for swaps, and that regularly enter into swaps in response to other parties' interest as a part of their "regular business."[43] In response to concerns that this narrow definition might still capture commercial end-users which engage in side market-making operations, the CFTC has announced that it will raise the *de minimis* ceiling on annual swap dealing to $3 billion, up from the $100 million initially proposed.[44] This elevated ceiling may still capture very large energy companies like Shell and BP, forcing them either to succumb to the regulations or to give up their side operations.[45] These companies have fervently contested the

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[38] 7 U.S.C.A. § 1a(49)(A) (West 2011); 15 U.S.C.A. § 78c(a)(71)(A) (West 2011).

[39] 7 U.S.C.A. § 1a(49)(A); 15 U.S.C.A. § 78c(a)(71)(A).

[40] 7 U.S.C.A. § 1a(49)(C); 15 U.S.C.A. § 78c(a)(71)(C).

[41] 7 U.S.C.A. § 1a(49)(D); 15 U.S.C.A. § 78c(a)(71)(D).

[42] Sackheim & Schubert, *supra* note 2, at 2 ("The majority of end users will not qualify as swap dealers . . . If the proposed rules on these definitions are adopted without major change, few end users will clear this high bar.").

[43] *See* Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant," 75 Fed. Reg. 80,174, 80,177 (proposed Dec. 21, 2010).

[44] Christopher Doering, *Exclusive: CFTC Poised to Raise Swap Dealer Threshold*, REUTERS (Mar. 2, 2012), http://www.reuters.com/article/2012/03/02/us-financial-regulation-cftc-idUSTRE8211QL2012 0302?feedType=RSS&feedName=everything&virtualBrandChannel=11563 (reporting that agency officials are considering the increased threshold).

[45] *See* Baltimore, *supra* note 36 (stating that the fair market value of BP's derivative holdings exceeded 7.2 billion at the end of 2010).

regulations, arguing that they are being punished for the sins of others.[46] Others have responded that the result remains justified given that their market making operations often compete directly with banks that will be subject to the new regulations.[47] Despite these limited exceptions, however, the proposed definition of "swap dealer" will likely exclude the bulk of swap trading conducted by end-users.[48]

E. Who Will Qualify as a Major Swap Participant?

In contrast to the subjective tests used to classify "swap dealers," regulators will identify systemically important buy-side users—deemed "market swap participants"—by objective criteria.[49] Non-swap dealer entities will be classified as MSPs if they "maintain a substantial position in any of the major swap categories, excluding positions held for hedging or mitigating commercial risk,"[50] or if their swap activities create "substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets."[51] Additionally, if an entity is highly leveraged and not otherwise subject to prudential banking regulation, it will be deemed a MSP for maintaining "a substantial position in any major swap category even if its positions are held for hedging or mitigating commercial risk."[52]

Within this statutory framework, regulators have focused on identifying users whose "swap activities do not cause them to be dealers, but nonetheless could pose a high degree of risk to the U.S.

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[46] *Id.* (explaining energy companies' objections toward being regulated as swap entities despite their lack of involvement in the financial crisis).
[47] For example, Professor John Parsons, an expert in energy policy at the Massachusetts Institute of Technology Sloane School of Management, has argued that "[i]f Shell is dealing in derivatives in direct competition with Goldman Sachs, they shouldn't be held to a different standard than Goldman Sachs." *Id.*
[48] *See* Sackheim & Schubert, *supra* note 42.
[49] *See* Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant," 75 Fed. Reg. 80,174, 80,212-17 (proposed Dec. 21, 2010).
[50] 7 U.S.C.A. § 1a(33)(A)(i) (West 2011); 15 U.S.C.A. § 78c(a)(67)(A) (West 2011).
[51] 7 U.S.C.A. § 1a(33)(A)(ii); 15 U.S.C.A. § 78c(a)(67)(A).
[52] 7 U.S.C.A. § 1a(33)(A)(iii); 15 U.S.C.A. § 78c(a)(67)(A).

financial system generally."[53] Under current proposals, an entity would hold a "substantial position" in any of six proposed swap categories, if either its current uncollateralized exposure or its current uncollateralized exposure plus its potential future exposure exceeds the thresholds that regulators have deemed "prudent" for that category.[54] For rate swaps, regulators have proposed thresholds of $3 billion for uncollateralized exposure and $6 billion for combined uncollateralized plus potential future exposure.[55] For all other swaps, the thresholds would be daily averages of $1 billion and $2 billion, respectively.[56] While commercial end-users' total swap exposure might exceed these thresholds, the definition remains unlikely to capture most commercial end-users because the inquiry excludes "positions held for hedging or mitigating commercial risk."[57]

To determine whether an entity has "substantial counterparty exposure," regulators would also consider an entity's current uncollateralized exposure and potential future exposure.[58] In this case, however, regulators would inquire as to the entity's cumulative exposure across all swap categories.[59] Since this second prong contains no statutory carve-out for hedging or employee benefit plan positions, regulators have decided to include these positions in their calculations.[60] For swaps within the CFTC's jurisdiction, the proposed thresholds are $5 billion for uncollateralized exposure and $8 billion for combined current and potential future exposure.[61] For security-based swaps, the SEC has proposed thresholds of $2 billion and $4 billion, respectively.[62] While the "substantial counterparty exposure" definition contains no statutory carve-out, its thresholds are significantly higher than the thresholds for "substantial position," so the definition would still only capture very high volume end-users.[63]

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[53] 75 Fed. Reg. at 80,185.
[54] *Id.* at 80,187-89.
[55] *Id.* at 80,213.
[56] *Id.*
[57] *See* Sackheim & Schubert, *supra* note 2, at 3 ("In all likelihood these thresholds will capture only the very largest of high volume end-users.").
[58] 75 Fed. Reg. at 80,197-98.
[59] *Id.* at 80,197.
[60] *Id.*
[61] *Id.* at 80,215.
[62] *Id.* at 80,217.
[63] *Id.* at 80,215-17.

Meanwhile, the final prong focuses on highly leveraged, unregulated financial entities, such as hedge funds.[64] Although the term "financial entity" is broad, capturing banks, private investment funds, and commodity pools,[65] the final prong is significantly narrowed by its exclusion of entities that are already subject to prudential regulation.[66] Regulators have not yet decided what leverage ratio will constitute "highly leveraged," but they are currently considering alternative proposals of 8 to 1 or 15 to 1.[67] The ratios refer to an entity's total liabilities to its total equity as measured by GAAP at the close of business on the last business day of the applicable fiscal quarter.[68] Since the final prong explicitly includes hedging and risk-mitigating positions, the definition could encompass financial entities that hold substantial swap positions exclusively for hedging purposes, provided that their leverage ratios exceed the thresholds.[69]

F. Looking Ahead

Since Congress enacted Title VII, regulators have worked to resolve its ambiguities by weighing the costs of overregulation in swap markets against the risk of under inclusiveness. Even today, however, as regulators stall in finalizing the definitions, many market participants remain uncertain about whether they will be deemed a "swap dealer" or "major swap participant."[70] As Title VII does not

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[64] 7 U.S.C.A. § 1a(33)(A)(iii) (West 2011); 15 U.S.C.A. § 78c(a)(67)(A) (West 2011).

[65] 75 Fed. Reg. at 80,215; Sackheim & Schubert, *supra* note 2, at 3 ("[T]he definition of financial entity is broad and captures private investment funds.").

[66] *Id.* at 80,198.

[67] *Id.* at 80,199.

[68] *Id.*

[69] 7 U.S.C.A. § 1a(32); 15 U.S.C.A. § 78c(a)(66).

[70] The CFTC and SEC have repeatedly delayed votes to finalize the definitions. *See, e.g.*, Christopher Doering, *CFTC to Delay Vote on Swap Dealer Definition*, REUTERS (Feb. 21, 2011), http://www.reuters.com/article/2012/02/21/us-financial-regulation-swaps-idUSTRE81K1PO20120221 (announcing postponement of the February 21st vote); *see also* Silla Brush, *CFTC Said to Delay March 9 Vote on Swap Dealer Definitions Rule*, BLOOMBERG (Feb. 29, 2012), http://www.bloomberg.com/news/2012-02-29/cftc-said-to-delay-march-9-vote-on-swap-dealer-definitions-rule.html (announcing further delays).

explicitly exempt commercial end-users from either category, regulators remain free to apply the Act's most stringent restrictions to nonfinancial companies using swaps to hedge commercial risk.[71] In light of these concerns, members of the U.S. House of Representatives have introduced a bipartisan bill to exempt transactions that involve a commercial end-user from the margin requirements.[72] Under the bill, swaps would be exempt from margin requirements if they satisfy the requirements for the Title VII's end-user clearing exemption, which is available to any end-user that is not a "financial entity" and that is using swaps to "hedge or mitigate commercial risks."[73] In this way, the bill would lighten the regulatory burden on commercial end-users that fall within the defined swap entity categories.[74] These users, however, would remain subject to the remaining requirements, including those pertaining to minimum capital and business conduct.[75] As a result, regulators must remain cautious about including commercial end-users within their regulatory scope.

Andrew J. O'Loughlin[76]

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[71] *See* Brian C. Harms & John J. Leonti, *Proposed Legislation Codifies the End-User Exception from Margin Requirements*, TROUTMAN SANDERS LLP (Aug. 24, 2011), http://www.troutmansanders.com/proposed-legislation-codifies-the-end-user-exemption-from-margin-requirements-08-24-2011/ (explaining that the current law contains no exemption for commercial end-users).

[72] *See* The Business Risk Mitigation and Price Stabilization Act of 2011, H.R. 2682, 112th Cong. (1st Sess. 2011).

[73] *See* Harms & Leonti, *supra* note 71 (clarifying the scope of the exemption).

[74] *See* Press Release, Rep. Michael G. Grimm, Rep. Grimm's Derivatives End User Exemption Bill Passes Another Key House Committee with Unanimous Support (Jan. 25, 2011), http://grimm.house.gov/press-release/rep-grimm%E2%80%99s-derivatives-end-user-exemption-bill-passes-another-key-house-committee (arguing that exempting true end-users from the margin requirements would free up their capital for more productive uses).

[75] *See* discussion *supra* Part B.

[76] Student, Boston University School of Law (J.D. 2013).