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SMART REGULATION: IS IT POSSIBLE?

INTRODUCTION

It has been 16 months since Lehman Brothers filed for Chapter 11 bankruptcy. The largest casualty of the entire financial crisis led to a freeze in the credit markets and forced the U.S. government to step in and provide immediate funding. In addition to this funding, the Federal Reserve created multiple liquidity-providing programs. These decisions were difficult but necessary, and the history books should one day consider them an essential part of the stabilization of the global economy. While the debate as to what caused the crisis will continue forever, the one obvious issue was the lack of proper regulatory authority regarding over-the-counter (OTC) securities. The conventional wisdom of regulators and legislators was that the financial markets could regulate themselves. This idea was foolhardy because greed will always trump integrity when there's money to be made.

As a result, new regulatory structure has become the number one priority of all in the financial markets. The number-one mission has been to create a more transparent OTC marketplace, with processing and central clearing as the centerpiece. Progress has been made with the establishment of multiple clearinghouse options and almost 100% of all credit deals now being processed at the market depository. The marketplace must improve data management; it is the only way regulators can truly see what is happening in a effective way.

On the legislative front, the House of Representatives has already passed the Wall Street Reform and Consumer Protection Act by a vote of 223/202, while the Senate has provided the market a discussion draft for financial reforms. The process has been disrupted by the recent retirement announcement of the chairman of the U.S Senate Committee on Banking, Housing and Urban Affairs Chris Dodd, Democrat of Connecticut.

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The most recent major development had been President Obama's proposal to impose limits on banks' activities. Although details of the proposal are not yet available, the overall goal of the proposal would be to prevent commercial banks and institutions that own banks from owning and investing in hedge funds and private equity firms, and limit the trading they do for their own accounts.

The timing of the announcement — which came on the same week that Massachusetts Republican candidate Scott Brown defeated the Democratic candidate — is cause for concern. Is the Obama administration trying to change the negative momentum, attempting to make regulatory changes an election issue in November 2010? If so, politicizing the process before making major changes to the regulatory landscape will cause unintended consequences.

The debate on how to provide the most efficient regulatory environment without destroying the financial service industry will continue in the United States. The reality is that the U. S. economy is a service-based one, and that financial engineering and management is the country's number-one business. This makes the upcoming legislative decisions ever so important — the future of the country's economy hangs in the balance.

SENATE HOLDS THE KEYS

The legislative process is now in the hands of the U.S. Senate, and the responsibility to create and pass a regulatory overhaul bill in the hands of the Senate Committee on Banking, Housing and Urban Affairs. Although recent a proposal by President Obama has complicated the process, new amendments will now need to be added to the House bill. The reality is that the Senate can address new proposals and add them to the bill. That is easier said than done, as the stakes rise, and Congress tries to avoid a full-fledged partisan brawl.

The key components of the legislation are as follows:

- **Ending "Too Big to Fail":** The goal is to create a resolution mechanism to break up firms that are deemed a systemic risk to the marketplace.
- **Creation of a council of regulators:** The council would be a collection of the head of the major regulatory agencies and two independent representatives nominated by the sitting U.S. President. Their job would be to identify and address systemic risk by large, complex companies and products before they become a threat to the stability of the financial system.
- **Addressing risks posed by OTC derivatives:** The goal is to close the regulatory gap of the OTC market, mandating that standardized OTC products be processed and clear via a depository and clearinghouse.
- **Consumer Financial Protection Agency:** The goal of creating an independent watchdog agency would be to ensure American consumers get clear and accurate information when they shop for mortgages, credit cards, and financial products.
- **Creation of a single federal bank regulator:** This would require the merging the office of the Comptroller of the Currency and the Office of Thrift Savings, along with the state bank supervisory functions of the Federal Deposit Insurance Corporation (FDIC) and the bank holding company supervision authority from the Federal Reserve.
- **Hedge fund registration:** Requires that hedge funds worth more than US$100 million disclose financial data and register

with the Securities and Exchange Commission (SEC) as investment advisors.

- **Credit rating agency regulation:** Establishes a new office of credit rating agency at the SEC to strengthen regulation.
- **Executive compensation:** Gives shareholders a say on executive pay and proxy access. Requires public companies to set claw-back policies to take back executive compensation based on inaccurate financial statements.

RESOLUTION MECHANISM

Resolution mechanism, more commonly known as "Too Big to Fail," will be the most likely part of legislation to pass. Regulators and politicians concede that a law is needed that will allow for an orderly breakdown of a systemically important financial firms prior to bankruptcy. A new resolution regime for non-banks, analogous to the regime currently used by the FDIC to liquidate banks, would be created to permit the government to wind down a failing systemically important firm. The process would impose losses on the shareholders and creditors of the firm, and any resolution costs incurred by the government would be paid through an assessment on the financial industry rather than by taxpayers.

Some Congressional members prefer the idea of a prepaid fund as opposed to the industry (financial firms with US$10 billion in assets or more) paying a penalty after a firm is broken-up. The Obama administration is in favor of the after-the-fact payment as they know that any capital that is required would be taken out of an already-fragile economy.

Small banks and credit unions are pushing for an exemption from having to pay fees into the new fund. The original US$10 billion dollar-figure is now most likely to be increased to is as high as US$75 billion. Having any absolute figure will lead to problems; many financial firms will try to avoid being classified and paying any fee.

SYSTEMIC RISK REGULATOR

The creation of a systemic regulator is another major part of the new legislation. The initial reaction of legislators was to assign the additional responsibility to the Federal Reserve. Based on experience and market knowledge, the Fed would be in the best position to uncover potential risk to the financial system. Despite this, the reality is that the Federal Reserve has other major issues to deal with, including the eventual massive unwinding of their portfolio and the very difficult decision on when to remove their accommodative zero interest rate policy. The weak-dollar policy that the Obama administration and the Fed are pursuing contain massive risks as the U.S. currency is at risk of losing its role as the global reserve currency.

There seems to be bipartisan agreement that the Fed needs to concentrate on monetary policy, and the most likely outcome is that the systemic regulator will be a new council of regulators. The Senate has proposed a group of nine members that would include the financial regulators and two independent members. It would be governed by an independent chairperson, who would be appointed by the U.S. President and confirmed by the Senate. The proposed agency would not be responsible for direct supervision, but would be able to write rules and assign regulators to firms identified as posing systemic risk.

The most controversial aspect of the role of the council would be giving the authority to break up a large, complex company. Possible legislation would empower federal regulators to rein-in and dismantle financial firms that are so large, interconnected, or risky that their collapse would put the entire American economic system at risk, even if those firms currently appear to be well-capitalized and healthy. The legislation would transfer such mitigatory action from the Federal Reserve to the Financial Services Oversight Council, and establish objective standards for the council to effectively evaluate companies, determining whether they are systemically risky. Additionally, the legislation provides clear checks and balances by requiring the council to consult with the U.S. President before taking extraordinary mitigatory actions. Financial companies also have the right to appeal any actions.

OVER-THE-COUNTER DERIVATIVES MARKETS ACT OF 2010

The three proposals that are public included the Obama administration/Treasury, House Financial Services Committee and the House Committee on Agriculture. As with all legislation in Washington, D.C., the Senate controls the final direction; in this case, the lack of any concrete vision from the committees involved has put a cloud over the final legislation. Table A compares the public proposals.

TABLE A: COMPARISON OF PROPOSALS

Subject	Treasury Proposal	House Financial	Agricultural
Definition of swap	Excludes foreign exchange swaps and forwards and exempts them from bill's provision.	Same as Treasury	Includes foreign exchange swaps and forwards.
Definition of swap dealer	Person/firm engaged in business of buying and selling swaps for own account.	Same as Treasury	Person/firm whose business is making markets and buying and selling swaps.
Definition of major swap participant	Non-swap dealer who maintains a substantial net position other than a hedge	Non-swap dealer who maintains a substantial net position other than a hedge; regulators define substantial net position.	Non-swap dealer who maintains a substantial net position of non-cleared swaps; regulators define substantial net position of entities, which are systemically important.
Rulemaking	Joint rulemaking between CFTC and SEC for almost all rules concerning swaps.	Same as Treasury	CFTC and SEC consult with Prudential Regulator.
Rulemaking disputes	Treasury writes rules if CFTC/SEC cannot jointly agree to rules.	Same as Treasury	Either CFTC or SEC can initiate challenges in U.S. Court of Appeals.
Clearing requirement for swaps	Yes, Derivatives Clearing Organizations (DCO) and CFTC/SEC determine which swaps must be cleared.	Yes, CFTC/SEC determine which swaps must be cleared.	Yes, Derivatives Clearing Organization determines which swaps are cleared.

Source: Aite Group/Agriculture Committee

TABLE A: COMPARISON OF PROPOSALS

Subject	Treasury Proposal	House Financial	Agricultural
Clearing requirement determination	Standardized swaps are required to be cleared. Agencies can designate a swap to be standardized.	Agencies makes determination whether a swap must be cleared.	Only swaps that will be accepted by DCO are required to be cleared. Agencies will review DCOs for soundness and anti-competitive practices.
Clearing exceptions	DCO will not accept swap, or one of the counterparties is not a swap dealer or a major swap participant and does not meet the eligibility requirements of the DCO.	DCO will not accept swap, or one of the counterparties is not a swap dealer or a major swap participant.	One of the counterparties is not a swap dealer or a major swap participant, or can demonstrate appropriate risk management practices for non-cleared swaps. None of the counterparties is a tier-one financial holding company.
Trading requirement	Yes, swaps determined to be cleared must be traded on regulated exchange or alternative swap execution.	No trading requirement	Same as Treasury
Trading exceptions	None	N/A	Trading not required if no regulated exchange or trading facility will list the swap. Voice brokerage still permitted as long as swap is processed through a regulated exchange or a execution facility.
Capital requirements for swap dealers or major participant that is also a bank	Established by Prudential Regulator. Requirements will be higher for swaps that are not cleared.	Same as Treasury	Same as Treasury, except the respective regulator will base requirement on the risk associated of non-cleared swap.
Capital requirements for swap dealers or major non-bank participants.	Established by CFTC/ SEC. Requirement must be same or higher than a bank.	Same as Treasury.	Same as Treasury, except the respective regulator will base requirement on the risk associated of non-cleared swap.

Source: Aite Group/Agriculture Committee

TABLE A: COMPARISON OF PROPOSALS

Subject	Treasury Proposal	House Financial	Agricultural
Margin requirements for non-cleared swaps for swap dealer or participant that is also a bank.	Prudential regulators impose initial and variation margin requirements on all swaps. Prudential regulator may exempt requirements for swaps where one counterparty is not a swap dealer or major participant or using the swap as hedge or predominantly engaged in activities that are not financial in nature.	Prudential regulators impose initial and variation margin requirements on all swaps. Prudential regulator may exempt requirements for swaps where one counterparty is not a swap dealer or major participant.	Prudential regulators impose initial and variation margin requirements on all swaps under their jurisdiction.
Margin requirements for non-cleared swaps for swap dealer or participant that is not a bank	CFTC/SEC impose initial and variation margin requirements. Requirement must be same of higher as for a swap dealer or major participant that is a bank.	Same as Treasury, plus requirements must provide for use of non-case collateral.	CFTC/SEC impose initial and variation margin requirements on all swaps under their jurisdiction.
Position limits for swaps	CFTC/SC may impose position limits on swaps that perform a significant price discovery function. CFTC/SEC may require aggregate limits across markets.	CFTC may impose position limits on swaps that preform a significant price discovery function and require aggregate limits across markets. SEC may impose position limits on security based swaps as necessary in the public interest to prevent fraud and manipulation.	Same as House Financial.
Position limits on Alternative Swap Execution Facilities (ASEF)	ASEFs shall adopt position limits where necessary and appropriate.	No position limits for ASEFs.	Same as Treasury.
Addressing excessive speculation on regulated markets	No provision	No provision	CFTC to set position limits on futures contracts for physically delivered commodities on regulated markets. Redefines who is eligible for hedge exemption and can exceed position limits.
Foreign board of trade	Allows CFTC to require registration by foreign boards of trade.	Same as Treasury.	No explicit registration applied to foreign board of trade.

Source: Aite Group/Agriculture Committee

CENTRAL CLEARING

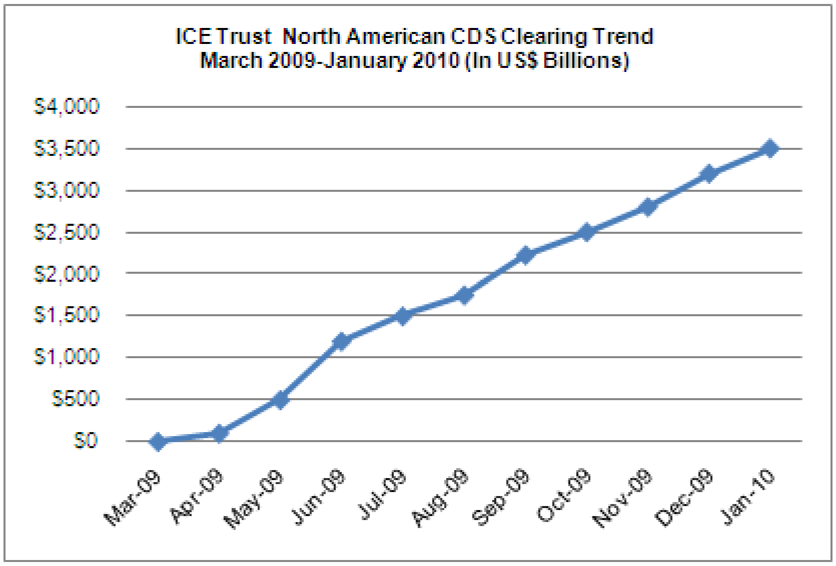
The centerpiece of the entire derivatives legislation revolves around the concept of centralized clearing. Two main processes are carried out by central counterparty clearinghouses (CCPs): clearing and settlement of market transactions. Clearing relates to identifying the obligations of both parties on either side of a transaction. Settlement occurs when the final transfer of securities and funds occur. As opposed to a typical bilateral single counterparty transaction, in which credit risk is borne by single buyer and single seller, the credit risk is spread among the members of the clearinghouse. This model is very successful within the futures industry. Margin requirements and daily price settlements are part of the traditional model in futures, but transferring this same model toward OTC derivatives is not that simple (reliable pricing of less-liquid products may be an issue). Another issue is that the legislation will most likely give the regulator of the product the job of deciding what the margin requirement would be. This role has always belonged to the respective clearinghouse and should remain so, as expanding the role of the regulators beyond their expertise is not prudent. Other issues being debated include the following: Who will decide which OTC swap is eligible for clearing (the regulator or the clearinghouse)? Should there be a limit on the percentage amount of ownership of a clearinghouse by a single entity? Aite Group believes that the clearinghouse should decide which transaction is eligible and having legislation defining corporate ownership structure is not necessary.

The credit derivatives market has already started to migrate to the clearinghouse model. ICE Trust has already cleared many North American credit default swaps (CDSs). CME Group and Eurex Credit Clear have also started to clear CDS in 2009.

ICE TRUST

ICE Trust is a dedicated CDS clearinghouse based in the United States. Its application to become a member of the Federal Reserve System was approved in March 2009. In its first nine months of operation, ICE Trust cleared more than US$3.5 trillion notional in North American CDS contracts. The trend of cleared CDS is shown in Figure 1 on page 11.

FIGURE 1: ICE TRUST NORTH AMERICAN CDS CLEARING TREND, US$ BILLIONS



Source: ICE Trust

The clearinghouse segregates cleared CDS positions and its risk pool from other markets. Membership is open to all qualifying buy-side and sell-side institutions that meet financial and eligibility standards, as set in the rules of the clearinghouse. ICE Trust currently has 14 clearing members. Table B lists the current members.

TABLE B: ICE TRUST CLEARING MEMBERS

	Banks	
Bank of America	Barclays	BNP Paribas
Citi	Credit Suisse	Deutsche Bank
Goldman Sachs	HSBC	J.P. Morgan
Merrill Lynch	Morgan Stanley	Royal Bank of Scotland
UBS	Nomura	

Source: ICE

The Federal Reserve and the New York State Banking Department have primary oversight responsibility for ICE Trust. The clearinghouse is also subject to oversight by the SEC due to an exempt order to clearing CDS. This may change, however, as it is likely the Commodity Futures Trading Commission (CFTC) will take over at least partial responsibility for clearinghouse regulation.

The clearinghouse recently announced that they will provide trade date clearing. Trade date clearing enables positions to be cleared on the same day the trade occurred, which significantly reduces the time that a buy-side firm has counterparty exposure to a clearing member. This will simplify operational processes and overhead associated with CDS trading. Trade date clearing eliminates the need for International Swap Dealers Association (ISDA) documentation between buy-side firms and executing dealers. Instead, a buy-side firm may trade with any executing dealer that is a clearing member, and may clear the trade at ICE through their designated derivative clearing member (DCM). This process consolidates the buy-side firm's counterparty risk to designated DCMs.

CME GROUP

CME Group started to clear credit default swaps on December 15, 2009, and has cleared US$52 million notional of CDS indexes. Sell-side members of the clearinghouse are listed in Table C, and buy-side members are listed in Table D.

TABLE C: CME GROUP SELL-SIDE CDS CLEARING MEMBERS

Sell-Side Members		
Barclays Capital	Citi	Credit Suisse
Deutsche Bank	Goldman Sachs	J.P. Morgan
Morgan Stanley	UBS	Bank America Merrill Lynch
Nomura		

Source: CME Group

TABLE D: CME GROUP BUY-SIDE CDS CLEARING MEMBERS

Buy-Side Members		
Alliance Bernstein	Blackrock	BlueMountain
Citadel	D.E. Shaw	PIMCO

Source: CME Group

EUREX CREDIT CLEAR

Eurex Credit Clear started clearing OTC credit default swaps in July 2009. The clearinghouse offers the European product suite of iTraxx indexes and 17 single names from the utilities sector. To date, ECC has cleared 85 million euros ($119 million) in iTraxx indices and 10 million euros ($14 million) in single names.

CONSUMER PROTECTION AGENCY

Originally a major part of the Senate's plan, the new consumer protection agency would be created to ensure American consumers receive clear and accurate information when they shop for mortgages, credit cards, and other financial products. Momentum for this agency has recently reversed, however; even chairman Dodd has admitted that the creation of a new agency would hurt the chances of a bill being passed as there is no Republican support. A new division would now be more likely to be created within the existing agencies.

This issue promises to be a major political battle — the overall subject of financial market reform is a winner for the Democratic party and a loser for the Republican side. Due to the inability to pass health care reform and the prospect of cap-and-trade being pushed back to 2011, the only game in town will soon be financial reform.

Financial literacy is one of the main goals of a consumer protection agency. Borrowing more than one can afford, understanding and reading the fine print on credit card and mortgage applications should be required in the U.S. educational system. While creating a government bureaucracy may not be the way to go about this education, it is crucial that this issue be resolved as part of the regulatory overhaul.

A SINGLE BANK REGULATOR

Consolidating the bank regulatory structure is one subject that has garnered little publicity. The U.S. Senate has introduced the idea of a new single regulator, called the Financial Institutions Regulatory Administration. The agency would be headed by an independent chairperson, appointed by the U.S. President and confirmed by the Senate. A vice chairperson with state banking experience would also be part, as would a board (including the chairs of the FDIC and Federal Reserve and two other independent members). The current four banking agencies (Comptroller of Currency, Office of Thrift Savings, FDIC state banking and Federal Reserve bank holding company authority) would be folded together. The state banking system that governs the nation community banks would stay intact, but a new, separate division to regulate community banks would be created. The goal of the consolidation would be two-fold:

- **Increased efficiency:** the goal is to eliminate coordinated rulemaking and reduce red tape, inconsistent enforcement, and cost to the institutions and their customers.
- **Streamline Responsibilities:** Allow the FDIC to focus on its job as deposit insurer and resolver of failed institutions, and the Federal Reserve to focus on monetary policy.

The Federal Reserve has publicly come out against this proposal, but their leverage is limited as the re-nomination of Fed chair Ben Bernanke has been delayed.

HEDGE FUND REGISTRATION

One of the guarantees of a new regulatory structure is requiring hedge funds to register with the Securities and Exchange Commission (SEC). Although most large hedge funds are already registered with the CFTC, the 2009 Madoff scandal brought the opaque industry to light. The threshold amount of customer funds under management to require registration will most likely be US$100 million and will require the funds to register as investment advisors. The hedge fund will be required to provide information about their trades and portfolios. This information will remain private, given that the trading strategies of any fund will need to remain the intellectual property of the fund's managers. State supervision will also be affected, as the threshold for federal regulation of investment advisors is expected to increase from US$25 million to US$100 million.

CREDIT AGENCIES

The new regulatory structure will include a new Office of Credit Rating Agencies within the SEC. The office will have its own staff and will be given the authority to fine agencies for poor performance. The credit agencies will have new requirements, listed below:

- **Disclosure:** Rating agencies will need to disclose their methodologies, their use of third parties, and their track record.
- **Independent information:** Requires agencies to consider credible information that comes from outside sources.
- **Conflicts of interest:** Prohibits compliance officers from working on ratings, methodologies, or sales.
- **Liability:** Allows investors to bring rights of action against ratings agencies for knowing or reckless failure to investigate or obtain analysis from an independent source.
- **Right to deregister:** Gives the SEC the authority to deregister an agency for providing inaccurate ratings over time.
- **Education:** Requires ratings analysts to pass qualifying exams and seek continuing education.

EXECUTIVE COMPENSATION

Another area that will be definitely included in a new regulatory structure is changes to executive compensation of public companies. This may be the only issue that all agree on; the incentives created by short-term gains without any long-term financial repercussions for has long been problematic. Some companies may try to privatize themselves to avoid additional scrutiny, but those who do not will need to provide shareholder rights in the following ways listed below.

- **Vote on pay and golden parachutes:** Gives shareholders a say on pay with the right to a non-binding vote on pay and golden parachutes linked to corporate takeovers. This is largely symbolic since the vote is non-binding, but at least shareholders will have the opportunity to publicly disapprove to the amount of compensation provided to executives.
- **Nominating directors:** Gives shareholders proxy access to nominate directors.

- **Clawbacks:** Requires that public companies set policies to take back executive compensation based on inaccurate financial statements that did not comply with accounting standards.

- **SEC review:** Directs the SEC to clarify disclosures relating to compensation, including requiring companies to provide charts that compare their executive compensation with stock performance over a five-year period.

SMART REGULATION

Leaving politics aside, the key component of all the discussion is how regulators can use technology to prevent another crisis. The first step is to increase transparency in the OTC markets. Mandating processing, clearing, and eventually electronic trading of most OTC products will be needed to create an electronic audit trail of a firm's activity. There cannot be any exemptions from this model. End-users of OTC derivatives who would like to be exempted for having to have their trades cleared due to the increase costs. Of course these costs will be passed onto the consumers, but the marketplace cannot have it both ways. Additional regulation will be a detriment to economic growth, but the boom-and-bust economy of the last decade cannot continue without anarchy. The answer to providing smarter regulation is in the data: how to manage it, consolidate it, understand it and to react to it. Data collection is no longer a technology issue, but a business issue that firms need to address.

The good news is that there is already an organization dedicated to addressing it. The Enterprise Data Management (EDM) Council is an industry consortium that focuses on data management. The goal of the organization is to help ensure that the critical data required for supervision and regulation of financial institutions and markets are collected, normalized, and made available to all agencies, legislators, and governmental authorities that need them to fulfill their oversight mandate.

Data for Systemic Risk Monitoring

The four components that should be captured by regulators are as follows:

- Forward-looking risk sensitivities;
- Leverage and capital adequacy for individual accounts and firms;
- Inter connectedness of investors, firms, and contracts within the system; and
- Concentrations of exposures relative to a market's liquidity.

The idea is to create a centralized depository from which systemic risk can be monitored. The EDM has proposed a three-step effort.

- **Create a National Institute of Finance:** Comprised of a central national data depository and a research and analytics center, the institute would support the council of systemic regulator;

- **Implement standards:** Create precise identifiers of all financial instruments; and

- **Manage the information:** Coordinate and validate data collection.

Providing the regulatory community with database access to all firms' networks of information is the only way to address potential systemic risk.

HARMONIZATION OF SEC AND CFTC

Since the merging of the major regulatory agencies will not occur due to the lack of necessary political will, the SEC and the Commodity Futures Trading Commission (CFTC) will be required to harmonize their rules. Product jurisdiction will also need to be decided, as the threat of regulatory gaps will still exist, albeit with a bifurcated structure. The agencies released a joint report on regulatory harmonization on October 16, 2009. The major areas of discussion are shown in Table E.

Table E: Reviewed Issues in CFTC/SEC Report

Important Items
Product listing and approval
Exchange/clearinghouse rule changes
Risk-based portfolio margining and bankruptcy/insolvency regimes
Linked national market and common clearing vs. separate markets and exchange-directed clearing
Price manipulation and insider trading
Customer protection standards applicable to financial advisers
Regulatory compliance by dual registrants
Cross-border regulatory matters

Source: SEC/CFTC Report

RULE CHANGES

The SEC has already made recommendations to eliminate unfiltered access to the equity markets, and is now reviewing dark pools and high-frequency trading. The listed markets have performed extremely well during and post-crisis, and the proposed changes to market structure seem to be politically motivated. Now that the upward trend in equity prices has been cracked, it will not take long for the cry to implement a new short-sale ban. For individual names, a 10% circuit breaker followed by a bid test is the most likely outcome.

On the commodity side, position limits in the energy futures are being proposed by regulators. While there has been little, if any, evidence to show that speculation led to higher energy prices, the CFTC felt that position limits should be implemented.

Passive longs held by large exchange-traded funds (ETFs) were the main culprit, but the ETF fund managers have already responded by recreating the same position in the OTC market. This is part of the problem —position limits need to be implemented in the OTC markets as well as the listed markets to be effective. Legislative changes to the Commodity Exchange Act will be needed to allow the CFTC to regulate the OTC commodity market.

CONCLUSION

- Regulatory overhaul is likely to become an election issue for 2010, as the Obama administration looks to change the negative momentum after the Senate election in Massachusetts in which a relative unknown Republican candidate Scott Brown won the senate seat vacated by the death of Democratic Senator Ted Kennedy.
- The Republican party would be foolish to fight the changes being proposed. It is clear that changes are necessary, a point that will be used against any candidate involved.
- The Federal Reserve will play a key role in the Council of Regulators. The council is the likely choice to become the systemic regulator, and the Fed will lose some power on the banking side. Its number-one issue will be how to execute the unwinding of quantitative easing and how to handle the much-needed increase in short-term interest rates.
- Processing and clearing of standardized OTC products will be mandatory. There should be zero exemptions for end-users, as all participates must play on a level field.
- Improving and creating standards in data management will allow the regulatory community to have tools at their disposal as they try to prevent the next crisis.
- Rule changes regarding short sales, unfiltered access, dark pools, position limits and high-frequency trading have been proposed or are under review. Making changes to market structure for listed markets that have performed well during- and post-crisis is a risk. Market liquidity and quality will be closely monitored in 2010.

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Equity Options: The Future of the Industry in the Regulators' Hands, June 2009.

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