

U. S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

November 3, 2009

The Honorable Mary L. Schapiro
Chairman

U.S. Securities and Exchange Commission
100 F Street, NE
Room 10700
Washington, DC 20549

The Honorable Gary Gensler
Chairman

Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Dear Madam Chairman and Mr. Chairman:

I have been hearing concerns from several quarters about the bill the Committee passed to regulate derivatives as we prepare that legislation for a floor debate that will probably take place next month. It is my intention to fashion amendments to deal with two aspects of these fears. First, we will clarify exactly who can claim the exception from the clearing and trading requirement and, second, we will place the responsibility of deciding what swaps must be cleared solely with the regulators. I write to seek the help of your agency in crafting amendments to carry these changes out.

I know that there is a disagreement as to whether or not all swaps that can be cleared should be, or whether there should be some exceptions for end-users hedging legitimate business risks. But in addition to that question, there is concern expressed by some that the bill as structured could be subject to manipulation by those who are not entitled to the exception—as the bill defines it—to avoid the clearing and trading requirement. This is why we need to further clarify the exception. I realize that this will not fully alleviate disagreement about the scope of transactions that should be forced to go through clearinghouses, but I believe that in the minds of some, the fact that an exception might be exploited by inadequate regulatory toughness is part of the general concern.

Part of this can be done by tightening the instructions the bill gives to the SEC and the CFTC with regard to the exception. As you know, the legislation provides for your agencies to decide whether or not the exception is appropriate. That is, there is no self-certification. Those who fear that clever financial firms will somehow scheme to get themselves under an exception to which they are not entitled can be reassured that the vigilance of the regulators will prevent this. Some have suggested, however, that we could more carefully limit the exception from the clearing and trading requirement. This is an approach which we are considering.

There is another concern expressed by some, including, for example, the *New York Times*, regarding the provision in the bill that allows a clearinghouse to decide in the first instance whether or not a trade can be cleared – and thus be required to trade on an exchange. Fears have been expressed that the clearinghouses, especially those in which some financial entities have an interest, might use that power to assert that swaps are not clearable. If they were to do that as the bill is now written, it would vitiate the clearing and trading requirement even for transactions that clearly do not qualify for any exemption. That provision – that it be the clearing houses and not the SEC or the CFTC that

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make the initial decision as to whether or not a trade is clearable – resulted, as I understand it, from Chairman Gensler’s view that it would be too burdensome for the CFTC to take on that task, and that it was best delegated to the clearinghouses. The concerns expressed by some, however, persuade me that there may be a problem here and so I propose to amend the bill so that the decision as to whether or not a trade is clearable should be made by the regulators.

We have tried to deal with that to some extent in our legislation through an amendment by my colleague Stephen Lynch of Massachusetts, which the Committee adopted, which would restrict the ownership in a clearing house by financial firms to twenty percent. But we are encountering resistance to that on the part of many, including my colleagues in the Agriculture Committee, and we have been told by some that if that requirement remains, there could be an insufficient number of clearinghouses at least in the near term. As I still believe it is important to reduce the stake in the clearinghouses of these firms to avoid any potential conflicts of interest, I continue to support Congressman Lynch’s amendment, although for technical reasons we are going to have to reinsert it into the bill on the floor. I believe that the case for having the SEC and the CFTC make the decision about what is clearable is a strong one. It is also important that we structure any exceptions from the clearing and trading requirement tight enough to prevent speculators from masquerading as end-users.

I look forward to hearing from you and have asked the Financial Services Committee staff to work with you so that we can strengthen this legislation on the floor in the near future.


BARNEY FRANK
Chairman