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Harkin legislation to regulate OTC swaps & derivatives

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In this year's first step to regulate financial derivatives trading that many observers list as a major factor in the current global recession, Senate Agriculture Committee Chair Tom Harkin (D-IA) introduced the "Derivatives Trading Integrity Act" on Thursday.

Harkin's bill would require that all over-the-counter financial transactions currently traded without federal regulation instead be traded on regulated exchanges, with full tracking and oversight. The "stop swaps" bill is aimed at restoring confidence in the financial system.

Over the years, the Commodity Futures Trading Commission (CFTC) and laws enacted by Congress have allowed instruments that are essentially futures contracts to be privately negotiated without the safeguards provided through exchange trading. Yet the total face value of swaps reached a high of some \$531 trillion at the middle of last year, eight and a half times the world GDP of \$62 trillion, according to the latest figures available. Investor Warren Buffett has called derivatives "financial weapons of mass destruction" if they are not properly understood and managed.

"In this economic downturn, we can no longer just sit back and let the markets work. Instead, we need to take a hard look at the contributing factors of this sagging economy," said Harkin. "By restoring reasonable safeguards and regulation of swaps, including credit default swaps, along with all futures contracts, this legislation will go a long way toward ensuring confidence in the markets and reestablishing soundness and integrity that the financial system needs. It will bring these transactions out into the sunlight where they can be monitored and appropriately regulated."

The bill would amend the Commodity Exchange Act to eliminate the distinction between "excluded" and "exempt" commodities and transactions versus commodities and transactions traded or conducted on regulated exchanges. All commodities and transactions of the same nature would be treated the same.

In addition, the bill would eliminate the statutory exclusion of swap transactions, and end the CFTC's authority to exempt such transactions from the general requirement that a contract for the purchase or sale of a commodity for future delivery can only trade on a regulated board of trade. In effect, this would mean that all futures contracts must trade on a designated contract market or a derivatives transaction execution facility. Virtually all contracts now commonly referred to as swaps fall under the definition of futures contracts and function basically in the same manner as futures contracts.

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