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House Ag Committee plans derivatives bill mark-up next week

By Jon H. Harsch

After five hours of testimony Wednesday from 15 commodity market experts following Tuesday's four hours of testimony from eight witnesses, there was agreement on a single point: the experts don't trust Congress to get it right and, as House Ag Committee Chair Collin Peterson (D-MN) told the trading industry witnesses, "Within the Congress, nobody trusts you guys."

Despite this mutual distrust and sharp disagreement among the expert witnesses over key parts of draft legislation to tighten regulation of derivatives trading, Peterson ended Wednesday's House Agriculture Committee hearing by announcing he plans to have his "Derivatives Markets Transparency and Accountability Act of 2009" ready for committee mark-up next week. He also warned industry spokesmen not pleased with some key provisions of the committee's draft bill that if they don't work with the Agriculture Committee on drafting a good compromise, they risk ending up having legislation written by other congressional committees which don't understand commodities.

Peterson has explained that he's determined to move quickly on the derivatives bill "to make sure that some of these problems don't happen again and that we get some confidence back into this marketplace."

The most contentious issue is the legislation's provision which would ban "naked" credit default swap (CDS) transactions. In a naked CDS, one party buys protection against a debt default without that party having any exposure to the specified risk. Section 16 of the proposed bill states that "It shall be unlawful for any person to enter into a credit default swap unless the person would experience financial loss if an event that is the subject of the credit default swap occurs."

In both Tuesday's and Wednesday's hearings, some witnesses pinned at least partial blame for the current global financial meltdown on "excessive speculation" and unregulated CDS transactions which led major corporations such as AIG to take on far more risk than they realized – and therefore far more risk than they could make good on without emergency bailout funds from the federal government. Other witnesses dismissed that contention. Blaming the sub-prime mortgage market, they argued that the CDS market has been an important stabilizing force which has provided and continues to provide more credit than available otherwise. These critics charged that banning naked CDS swaps in the U.S. would drive the swaps business overseas. One result, they said, would be that U.S. companies would find credit less accessible and more expensive, giving foreign companies a competitive advantage.

Rep. Jim Marshall (D-GA) charged that the witnesses defending CDS swaps were "stonewalling." He called on the industry spokesmen to "start considering compromises" and to "propose something that works for your industry, not stonewalling." Also calling for industry cooperation, Rep. Leonard Bosell (D-IA) told the witnesses that "We have got to have transparency and oversight like we've never had before. We've got to make this work, we need your help. . . We can't continue business as we've been doing it."

One after another, industry witnesses such as Johnathan Short, Vice President and General Counsel of IntercontinentalExchange; Robert Pickel, CEO of the International Swaps & Derivatives Association; and Stuart Kaswell, General Counsel of the Managed Funds Association voiced strong support for greater transparency and oversight, as proposed in the committee draft legislation. But most witnesses wanted greater leeway for exempting non-standard CDS trade from clearing and opposed a ban on naked swaps. Mark Brickell, CEO of Blackbird Holdings said the solution will be the wrong solution if the committee thinks the cause of current problem is the CDS market instead of the true cause: $1 trillion in mortgage loans "that never should have been made." He said the swaps industry needs to be protected, not decimated because "swaps make it easier and less expansive to create risk management." Explaining that each company's risk management needs are unique, Brickell and other witnesses said there will continue to be a need for custom-tailored CDS trades that could not be standardized, and therefore should not be subjected to mandatory clearing on regulated exchanges.

To read the witness testimony from the Tuesday and Wednesday hearings, go to: http://agriculture.house.gov/hearings/statements.html

To read the outline and text of the draft 38-page "Derivatives Markets Transparency and Accountability Act of 2009," go to: http://agriculture.house.gov/inside/legislation.html.

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