



02-12-09

House Agriculture Committee approves tough derivatives bill

By Jon H. Harsch

© Copyright Agri-Pulse Communications, Inc.

In a markup session Thursday, the House Agriculture Committee approved an amended version of the Derivatives Markets Transparency and Accountability Act of 2009, a bill sponsored by Committee Chair Collin Peterson (D-MN). The amended version drops the ban on naked credit default swaps that had been the most contentious issue in committee hearings last week.

The legislation, H.R. 977, is intended to increase transparency and oversight for futures markets and over-the-counter (OTC) derivatives trading. It toughens position limits on futures contracts for physically-deliverable commodities as a way to prevent potential price distortions caused by excessive speculative trading. The bill also imposes a clearing requirement on OTC derivatives contracts.

Peterson explained that the revised bill no longer outlaws naked credit default swaps in which one party buys protection against a debt default without that party having any exposure to the specified risk. Instead, he said, the bill give the Commodity Futures Trading Commission (CFTC) “the authority to suspend CDS trading temporarily, with the President’s consent.” He added that “In addition, this bill empowers the CFTC to criminally prosecute people who violate the commodities legislation. Currently, the Department of Justice has the sole power to initiate criminal proceedings against an alleged violator and apparently about a third of these criminal activities are not being prosecuted.”

“This bill broadens and improves on last year’s bipartisan derivatives legislation that passed the House by a wide margin,” Peterson said, noting that “the collapse of some of America’s largest financial institutions, entities that were heavily involved in the trading of off-exchange credit derivatives like swaps contracts. . . put the American taxpayer on the hook, so just sitting back and doing nothing is not an option.”

During the markup, Republican members asked for less restrictive position limit rules and more time to consider the legislation. New member Cynthia Lummis (R-WY) who dealt with derivatives trading when she was Wyoming state treasurer noted that delay might make sense because the issues are complex and “there are certain senior members of this committee who, when I consulted them about some of the questions I have regarding this bill, were themselves at a loss to explain them.”

Peterson's response was that "There are a lot of forces out there that would like us to delay for a lot of different reasons. It just, in my opinion, it's time to move. . . This is not the end of the day. This is the first step in a very long process, and we could get into an all-out war before we're done here." The long process could include turf battles with other congressional committees regarding jurisdiction over derivatives trading and whether the CFTC should have oversight or whether derivatives should be handled by the Securities and Exchange Commission or the Federal Reserve Board.

Provisions included in the Derivatives Markets Transparency and Accountability Act as sent to the House floor would:

- Require all prospective over-the-counter transactions to be settled and cleared through a CFTC-regulated designated clearing organization, unless exempted by the CFTC in accordance with specified criteria. In some cases, the clearing requirement can be met through a Securities and Exchange Commission (SEC) regulated clearing agency or a properly regulated foreign clearinghouse.
- Give CFTC the authority, with the President's consent, to suspend naked credit default swap trading whenever a SEC short selling suspension order is in effect.
- Close the so-called "London Loophole" by requiring foreign boards of trade to share trading data and adopt speculative position limits on contracts that trade U.S. commodities similar to U.S.-regulated exchanges.
- Require CFTC to set trading limits for physically-deliverable commodities, in order to prevent excessive speculation.
- Empower the CFTC to criminally prosecute people who violate commodities legislation.
- Limit eligibility for hedge exemptions to bona-fide hedgers.
- Improve transparency by requiring that CFTC disaggregate and separately report the trading activity of index funds and swap dealers in agriculture and energy markets.
- Call for new, full-time CFTC employees to enforce manipulation and prevent fraud.
- Authorize CFTC to take corrective action if it finds disruption in over-the-counter markets for energy and gas.

During the markup session, members approved several amendments from Democrats by voice votes and rejected every amendment offered by Republican members, some by voice vote and others by party-line 27-16 roll call votes.

The most significant amendment came from Leonard Boswell (D-IA) who successfully replaced the draft bill's option of either clearing or reporting over-the-counter derivatives transactions with required OTC derivative clearing unless exempted by the CFTC. "I believe that the reporting alternative included in H.R. 977 might have provided too much of an incentive to avoid clearing," Boswell said. "The clearing provisions in the draft circulated last week were strong reforms, and I am pleased the committee wanted them back in the bill."

For an Agri-Pulse report on the final Feb. 4th House Agriculture Committee hearing on the derivatives bill, click on: <http://www.agri-pulse.com/uploaded/20090204H.pdf>