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# Treasury Sec. Geithner reassures Rep. Lucas on derivatives

**By Jon H. Harsch**



In a House hearing Wednesday on financial regulatory reform, Rep. Frank Lucas (R-OK) questioned Treasury Secretary Timothy Geithner about concerns that proposed new rules could hurt smaller financial institutions and businesses which rely on the derivatives market for hedging their risks.

House Financial Services Committee member Lucas, the Ranking Republican on the House Agriculture Committee, explained that his constituents rely on derivatives for price stability. He warned that if financial reform includes the administration's proposal to raise capitol and margin requirements, derivatives users will be "driven to the biggest financial institutions because they'll have to have someone who can afford to not only engage in the contract with them, but who can finance all these other options too . . . the fear being, Mr. Secretary, that they'll wind up having fewer people to do business with and it will be a small handful of the biggest institutions."

Lucas concluded that "there are real concerns out in the countryside that these pieces of legislation as proposed will drive more business to the biggest, will put the biggest at an even greater advantage over everyone else."

Geithner was testifying in a House Financial Services Committee hearing on "The Administration's Proposals for Financial Regulatory Reform." He replied to Lucas that "On derivatives, we very much want to make sure that we preserve the capacity of people in many different industries to use the derivatives markets to hedge and protect themselves against the risks they confront." Geithner said the administration recognizes the importance of derivatives and will work with Congress to provide this needed hedging protection "without creating just a huge loophole that allows people to evade the basic protections we think the country needs." He added that "People who provide that protection and write those commitments, whatever the form is, they need to hold margin and capitol that allows them to meet those commitments. That was the big failure in the system."

Addressing the overall need for financial reform, Geithner said reforms are urgently needed to avoid a repeat of "the worst financial crisis since the Great Depression." He reminded members that a year ago, "In September alone, Fannie Mae and Freddie Mac were put into government conservatorship. Lehman Brothers collapsed. Merrill Lynch, Wachovia and Washington Mutual were acquired in distress. A $62 billion dollar money market fund 'broke the buck.' The world's largest insurer avoided bankruptcy only with the help of $85 billion in emergency aid. Goldman Sachs and Morgan Stanley announced they would protect themselves by becoming bank holding companies." He said the government must now "do everything in our power to reform the system that contributed to this breakdown."

To avoid a repeat, Geithner said the administration proposal includes:

- bringing "unregulated firms and markets into the system by requiring registration of hedge funds, and setting clear rules for all derivatives markets."
- ". . . comprehensively regulating over-the-counter (OTC) derivative markets, including by substantially increasing the use of well-regulated central clearing platforms."
- ". . . strengthening supervision and regulation of critical payment, clearing, and settlement systems."

House Financial Services Committee Chair Barney Frank (D-MA) agreed on the urgent need for reform. He also explained that despite predictions that Congress will run out of time to pass a financial reform bill this year, he expects the House to pass its reform bill in November. To make this happen, Frank warned members to expect a very busy committee schedule over the coming weeks followed by at least three days of House floor debate in November on the final financial reform bill.

Voicing opposition to the administration plan for comprehensive financial reform, the Committee's Ranking Member Spencer Bachus (R-AL) said "we do need smarter regulations, but not necessarily more regulation. We need enforcement of existing regulations, not another layer of regulation or more government bureaucracy."

To watch a webcast of the two and a half hour Sept. 23rd House hearing on "The Administration's Proposals for Financial Regulatory Reform," go to: http://financialserv.edgeboss.net/wmedia/financialserv/hearing092309.wvx

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