10-14-09

OTC derivatives markup reveals sharp party differences

By Jon H. Harsch

In five hours of non-stop action Wednesday, House Financial Services Committee Chair Barney Frank (D-MA) completed committee work by racing through more than two dozen amendments that fine-tuned Frank's "Over-the-Counter Derivatives Markets Act of 2009." All that's left is the formality of roll-call votes Thursday morning to confirm the committee's wish to transform the largely unregulated $500-trillion derivatives market into a closely regulated "transparent" market. Most derivatives trades will be forced onto exchanges or clearing houses and all transactions and prices will be reported to federal regulators.

The principal exception to exchange trading will be for commercial end users which rely on derivates for risk protection. But these end users will be required to report over-the-counter (OTC) trades and prices. As well, new capitol and margin requirements will apply to all transactions. Frank commented that with the legislative language agreed on so far, "There will be no more hidden trades where we don't know the price."

Some of the tougher issues are being left up to the House Agriculture Committee because it has jurisdiction over the Commodity Futures Trading Committee. Once the Ag Committee completes its own markup on the derivatives legislation introduced by Committee Chair Collin Peterson (D-MN), the Peterson and Frank bills will be combined for final consideration on the House floor.

The fact that the Financial Services Committee completed its markup work in a single five-hour session does not mean that there was universal support. On the contrary, Republican committee members voiced solid opposition to the bill introduced by Barney Frank and offered their own substitute version. Both Frank's version and the Republican substitute face roll-call votes Thursday morning, with virtual certainty that the Frank version will be approved and the Republican substitute will be rejected on straight party-line votes.

During Wednesday's markup, Frank welcomed a number of Republican amendments making relatively minor changes to the bill. But despite those points of agreement, there were sharp disagreements as well. Rep. Scott Garrett (R-NJ) warned that if Congress decides to "force everything on the exchanges, there may not be anything on the exchanges," echoing earlier Republican warnings that tighter U.S. regulation will drive derivatives trading overseas. Rep. Spencer Bachus (R-AL), the committee's ranking member, pointed out that Cargill executive Jon Hixson warned the committee in testimony last week that higher margin and capital requirements could force Cargill and other companies to abandon expansion plans, costing jobs.

Rep. Frank Lucas (R-OK), the Ranking Member of the House Agriculture Committee, warned that "we should not artificially restrict our markets." Rep. Tom Price (R-GA) said that "increasing regulation will decrease jobs" and that it's wrong to focus on derivatives because "the vast majority of derivatives had nothing to do with the [financial] crisis."

Rep. Jeb Hensarling (R-TX) warned that imposing "mandatory exchange trading" would "take a bad situation and make it worse." He said the Republicans' approach is "if in doubt, err on the side of freedom" while the Democrats' approach is "if in doubt, err on the side of regulation." Hensarling joined other Republicans in saying that the cause of the Lehman/Bear Stearns/AIG financial crisis was not a lack of regulatory authority but instead poor enforcement. He insisted that "It wasn't derivatives that caused the problem" and that "with every single step, we are making the use of derivatives more costly, more cumbersome, more burdensome."

Frank's response to the Republicans was to say that Congress is "in such a bad mood" that each side seems to assume the worst about the other side. Given the solid Republican opposition, he predicted that comprehensive financial reform legislation, which will include the derivatives provisions hammered out Wednesday, will "probably not be enacted until the end of the year at the earliest."

#30