

Committee on Agriculture – U.S. House of Representatives
Review of Derivatives Legislation: Feb. 3, 2009

Witness: Michael Greenberger, Law School Professor, University of Maryland Law School

- Mr. Greenberger proposes a generic regulatory program designed to apply traditional tools of regulatory oversight now governing our equity, debt and regulated futures markets to our OTC derivatives markets.
- Mr. Greenberger supports the majority of the bill's provisions.
- In particular, he endorses:
 - o *The ban on "naked" credit default swaps.*
 - The undisputed harm done to the economy by "naked" CDS far outweighs any price discovery benefits from allowing the continued trading of naked CDS.
 - The outlawing of this product, had it occurred with the passage of the CFMA in 2000, would have substantially mitigated the worldwide financial meltdown we are currently experiencing.
 - o *Mandatory Clearing.*
 - The draft legislation provides a broader "individualized" exemption with the corresponding precise standards that assure that exemptions will only be granted when systemic risk will not be posed.
 - The draft legislation is a reasonable compromise that accommodates individually negotiated contracts that cannot be cleared.

Questions and/or Comments on the Draft Legislation:

- Express Pre-approval Findings of Suitability of Designated Clearing Organizations.
 - o In addition to the 14 core principles set out by the CFMA for the establishment of a DCO, the statute sets out an additional three new principles.
 - o However, the provision also allows facilities to self certify as DCOs and the CFTC would only then examine compliance with core principles after the fact.
 - o Pre-approval of a clearing facility should be required.
 - o The Commission, not just the staff should be required to issue affirmative and detailed findings about its confidence in the applicant.
 - o It is a small burden to require a transparent Commission document.
- Fraud and Manipulation.
 - o As the CFMA is currently drafted, the swaps exemption in section 2 (g) of the Act excludes swaps from the anti-fraud and anti-manipulation provisions within the statute.
 - o OTC swaps should be subject to fraud and manipulation prohibitions.
- Important Inconsistency between Sections 6 and 9 of the Discussion Draft.
 - o Section 9 should be struck from the statute.

- Moreover, Mr. Greenberger urges the Committee to require the CFTC to impose aggregated speculation limits upon U.S. traders and those trading in the U.S. across the energy and agriculture contract markets.
- Standards for Approving a Designated Clearing Organization.
 - The approval process is critical because it is recognized that a “risk management failure by a clearing facility has the potential to disrupt the markets it serves and...cause disruptions to securities and derivatives markets and to payment and settlement systems,...”
 - It is uncertain whether the CFMA’s generalized DCO approval criteria—even as supplement by the Discussion Draft’s three additional criteria—are detailed enough to ensure that only the most prudent and stable entities clear OTC derivatives.
 - The CPSS recommendations should be studied to ensure that the DCO criteria are complete.
 - Mr. Greenberger’s preference would be to adopt exchange trading criteria to OTC derivatives as is required by S. 272.