

## ATTACHMENT TO FUTURES INDUSTRY ASSOCIATION STATEMENT

### ANALYSIS OF DERIVATIVES MARKETS TRANSPARENCY AND ACCOUNTABILITY ACT OF 2009 (Jan. 29, 2009 DISCUSSION DRAFT)

#### Section 3 -- Speculative Limits and Transparency of Off-Shore Trading

Section 3 has three subsections. FIA opposes the first subsection and supports the other two subsections which parallel provisions in HR 6604 passed by the House last year.

FIA supports coordinated market surveillance for linked products offered by competing U.S. and foreign exchanges. Last session, Rep. Moran offered legislation that would have addressed these issues in a comprehensive and reciprocal manner. FIA supports that approach. Section 3(a), however, could spark retaliation by foreign regulators against U.S. firms and exchanges. The Moran approach is less likely to trigger that response and has broader application.

FIA supports subsections 3(b) and 3(c) which afford a safe harbor and legal certainty to CFTC-registered firms that execute or clear trades for customers on foreign exchanges even if those exchanges themselves do not comply with each and every CFTC requirement. U.S. firms should not be liable for any non-compliance by foreign exchanges. Last session, HR 6604 contained these provisions in a form that achieved the stated objectives. In the draft bill, important language has been inadvertently dropped from subsection 3(b). FIA would support the provision if the language from HR 6604 is restored.

#### Section 4 -- Detailed Reporting and Disaggregation of Market Data

Section 4 would add a new § 4(g) of the Commodity Exchange Act. FIA has no objection to having the CFTC define index traders and swap dealers. FIA also does not oppose monthly public reporting by the CFTC of the aggregate open positions held by index traders as a group and by swap dealers as a group using the data reported under the CFTC's large trader reporting system. FIA believes the CFTC also should consider other ways to make their Commitment of Trader Reports more granular and meaningful to all market participants.

FIA opposes requiring index traders and swap dealers to file "routine detailed" reports with the CFTC. (7:18) No other large traders -- speculators or commercials -- are subject to such a requirement. It should be sufficient to treat index traders and swap dealers that qualify as large traders like all other large traders for reporting purposes. FIA would also recommend the deletion of the language "in all markets to the extent such information is available." (8:11-12) The aggregate information included in the COT reports should be for futures and options positions only. Otherwise market participants that refer to the COT reports will receive a distorted view of the open interest and volume composition in futures and options markets.

#### Section 5 -- Transparency and Recordkeeping Authorities

Section 5 has three subsections.

Subsection 5(a) would require a CFTC-registered futures commission merchant, introducing broker, floor trader or floor broker to make reports and keep records as required by the CFTC for “transactions and positions traded” by those registered professionals or their customers in, generally, OTC derivatives transactions that are exempted from the CEA and CFTC rules. FIA does not object to giving the CFTC this authority but questions whether it is at least partially duplicative of the special call provisions provided in the second part of the Section.

Subsection 5(b) has two parts. First, Subsection 5(b) would require any large trader of futures contracts in a commodity to maintain books and records of transactions and positions in that commodity which are otherwise generally exempt and excluded from the CEA. FIA does not object to this provision. Second, Subsection 5(b) would codify the CFTC’s power to issue special calls for books and records relating to otherwise excluded or exempt transactions under the CEA when the CFTC determines it would be appropriate for market integrity purposes. FIA supports giving the CFTC this standby authority to enhance its market surveillance capabilities as circumstances require. Subsection 5(b) also requires large traders to retain the required books and record for five years. These required books and records shall include the “complete details” of all “such transactions, positions, inventories, and commitments, including the names and addresses of all persons having an interest therein.” (10:8-12) FIA questions whether these statutory requirements are necessary or whether it would be preferable to grant the CFTC general authority to adopt appropriate recordkeeping rules for large traders that engage in otherwise exempt or excluded transactions.

Subsection 5(c) contains conforming amendments to codify that the amendments in Subsections 5(a) and 5(b) create explicit exceptions to the statutory exclusions and exemptions in the CEA. FIA supports this legal certainty.

#### Section 6 -- Trading Limits to Prevent Excessive Speculation.

FIA opposes Section 6. FIA sees no reason to repeal the exchanges’ current authority to set position limits for their markets. (Today the CFTC sets position limits only for agricultural commodities.) The CFTC retains the power to review and amend any position limit set by an exchange if those limits are set in a manner that invites price manipulation or other market integrity concerns. Any member of the public is free to submit to the CFTC at any time a recommendation for changes to an exchange set position limit or accountability level. A formal advisory committee process is costly and unwarranted.

The major deficiency in Section 6 is its restrictive hedging definition. If a business establishes a futures position “which is economically appropriate to the reduction of risks in the conduct and management of the commercial enterprise,” that business is not a speculator. Instead, the business is managing an economic risk it faces in its business. Section 6 would misclassify that business as a speculator unless it also meets the “substitute transaction” and “change of held assets/liabilities” tests to become a physical hedger. These restrictions are bad economic policy and would impose unwarranted restrictions on businesses that want to use futures markets to hedge. Section 6 also would consider a swaps dealer to be a speculator if its futures positions are established to reduce the dealer’s price risk on its net swaps position simply because some of its swaps counterparties are not physical hedgers. The swaps dealer is managing its price risk prudently and doing so in a transparent market through transactions

without counterparty credit risk. That swaps dealer should be subject to all the market surveillance oversight faced by all large traders. But it should not be treated as a speculator because it is not speculating; it is trading futures to reduce its price risk in an economically appropriate manner.

Section 6 conflicts with the policy of promoting price risk management through exchange-traded and cleared markets. FIA strongly recommends that the Committee drop the hedging definition in Section 6 and instead direct the CFTC to conduct a rulemaking to define, for position limit purposes, speculation, hedging and price risk management consistent with the public interests to be served by the CEA.

#### Section 7 -- CFTC Administration

FIA supports Section 7's authorization of at least 200 new full time employees for the CFTC.

#### Section 8 -- Review of Prior Actions

FIA opposes requiring the CFTC to spend its resources reconsidering all of its currently effective regulatory actions as well as those of the exchanges to determine if they are consistent with the provisions of the Bill. CFTC has not yet adopted regulations to implement the provisions enacted in the Farm Bill in 2008, which would enhance customer protection and market surveillance. Before reviewing past actions, FIA believes the CFTC should implement the Farm Bill's reforms. FIA appreciates that the CFTC is given no deadline for completing this "prior action" review. We are sure the CFTC will move expeditiously to implement this Bill's regulatory provisions, if enacted, as well as the Farm Bill provisions from last year. The key is providing the CFTC with adequate resources to do the job and Section 7 is an important step in this direction.

#### Section 9 -- Review of Over-the-Counter Markets

FIA does not oppose having the CFTC study eventually whether position limits should be imposed on exempt transactions in physically-based agricultural or energy commodities when those transactions are fungible with regulated futures contracts and significant price discovery contracts. FIA also does not oppose including in that study whether it would be good policy for the CFTC to adopt umbrella limits for futures, swaps and any other fungible transactions in such commodities. FIA would urge the Committee, however, to remove the deadlines and timelines for such studies. The CFTC should be able first to adopt and implement its rules for Significant Price Discovery Contracts as required in the 2008 Farm Bill. Then, after it has had experience with such rules, the CFTC could tackle the required study. At this point, it seems to be premature to study what contracts are fungible with SPDC contracts, especially where the CFTC has not yet implemented its SPDC authority.

#### Section 10 -- Study Relating to International Regulation of Energy Commodity Markets

FIA does not oppose having the Comptroller General study the international regime for regulating the trading of energy commodity futures and derivatives. Some of the terms used in the study outline should be clarified. For example, it is not clear what is meant by

“commercial and noncommercial trading” (21:8-9). It is also not clear what constitutes “excessive speculation” (21:23-24) or “price volatility” (21:25). Last, the study contemplates a proper functioning market “that protects consumers in the United States.” (22:34) The phrase suggests that markets should have a downward price bias to serve the interests of consumers. FIA instead believes that markets should reflect accurately market fundamentals, including the forces of supply and demand. FIA recommends that the Committee adjust the study outline to ensure it will provide beneficial, not skewed, results for further deliberations.

#### Section 11 -- Over-The Counter Authority

FIA has no objection to having the CFTC analyze whether any exempt or excluded transaction is fungible with transactions traded on a registered entity, including an electronic facility that lists a Significant Price Discovery Contract. If such fungible contracts are found, and if the CFTC also finds that such contracts have the potential to harm the price discovery process on a registered entity, Section 11 provides that the CFTC may use its existing emergency authority in Section 8a(9) to impose position limits on such fungible contracts. This new authority would parallel the CFTC’s new Significant Price Discovery Contract authority provided in the 2008 Farm Bill. As written, however, FIA can not support this provision. FIA is concerned about the breadth of the language “have the potential to” (22:24) harm market integrity on registered entities. The CFTC should be empowered to use these regulatory authorities only if it finds an actual emergency condition to exist which affects trading on registered entities. Otherwise the CFTC could use a mere possibility of an impact on a registered entity to restrain or prevent competition from arising among trading facilities or dealer markets with exchange markets. FIA also believes the Committee should make clear in Section 11 that the CFTC should not apply its authority to restrict fair competition.

#### Section 12 -- Expedited Process

FIA has no objection generally to allowing the CFTC to use expedited procedures to implement the authorities in this Bill if the CFTC deems it to be necessary. FIA does not believe the authority in Section 12 itself is necessary because the Administrative Procedure Act provides the CFTC and other agencies with appropriate powers to expedite the kinds of rule making actions the Bill contemplates. FIA does object to this provision if it is misread to authorize the CFTC to expedite and disregard APA or even constitutionally-required procedural protections whenever the CFTC believes it to be necessary. That sweeping and standardless grant of authority could allow the agency to disregard well-established administrative procedural protections that have been adopted for many years to ensure reasoned and impartial agency decisions.

#### Section 13 -- Certain Exemptions and Exclusions Available Only for Certain Transactions Settled and Cleared Through Registered Derivatives Clearing Organizations

FIA supports encouraging market participants to clear appropriately standardized derivatives transactions. But FIA does not believe that mandatory clearing of all OTC derivatives is sound public policy. Clearing should only be available to those instruments that regulated clearing facilities decide they can safely clear. To date, no clearing facility believes it could or should clear **all** OTC derivatives. And even if a clearing facility believed it could clear

a particular class or type of OTC derivative (and some do now), FIA would want that private entity's judgment confirmed by an expert federal regulatory body, like the CFTC. FIA believes that clearing should be encouraged with incentives, not mandates, and only when the clearing entity and its government regulator agree that the particular class of OTC derivative could be submitted safely for clearing. Mandating clearing in a vacuum and without the necessary safety and soundness predicates, as Section 13 appears to do, would be most unwise.

Section 13 does grant to the CFTC the authority to declare spot and forward contracts immune from the mandatory clearing requirement. (31:12-17) The CFTC's authority is appropriately broad and flexible. But given the structure of Section 13 and the traditional meanings of the terms spot and forward contracts, FIA is uncertain whether most or all OTC derivatives could fall into the spot or forward category.

If not, the provisions in Section 13 granting the CFTC the power to exempt classes of OTC transactions from the clearing mandate become particularly important. Unfortunately, the criteria in Section 13 that would guide the CFTC's exemption decisions are much too rigid and constraining. As written, the CFTC would have to find a class of derivatives is "highly customized;" "transacted infrequently;" "serves no price discovery function;" and "being entered into by parties with demonstrated financial integrity." (29:23-30:9) It would be difficult, if not impossible, for the CFTC to craft an appropriate exemption under these mandatory criteria. The result would be that Section 13 would operate as a ban on all non-cleared OTC derivatives transactions in the U.S. and an invitation to market participants to enter into OTC transactions outside the jurisdictional reach of the CEA. Removing that significant market liquidity and making transactions more opaque to U.S. regulators would be detrimental to the public interest. FIA strongly opposes Section 13.

#### Section 14 --Treatment of Emission Allowances and Off-Set Credits

FIA supports defining emission allowances and off-set credits as "exempt commodities" like all other energy-related commodities. Section 14, however, excludes these commodities from the "exempt commodity" definition and would treat them like agricultural commodities. FIA does not know of any public policy reason to constrain the development of market innovations, including multilateral electronic trading facilities or clearing, for trading in these instruments in these energy commodities. Achieving energy policy goals will require promoting and expanding innovation, not restricting it. The Committee should reconsider the policy implications of treating these energy commodities like agricultural commodities.

#### Section 15 -- Inspector General of the CFTC

FIA has no objection to creating the Inspector General of the CFTC as a Presidential appointment, subject to Senate confirmation. At the same time, we do not believe the absence of an IG appointed by the President is a weakness in the current CFTC structure.

#### Section 16 -- Limitation on Eligibility to Purchase a Credit Default Swap

FIA opposes the ban on naked credit default swaps. Section 16 will effectively terminate the U.S. CDS market and send it overseas. CDS transactions have fostered many

economic benefits and it would be better to improve regulation and oversight of this market rather than jettisoning it to foreign shores.

FIA does support the provision that defines a credit default swap and allows registered entities that list for trading or clear CDS instruments to operate without having to comply with regulatory conditions imposed by the SEC. (38:1-9)