



Via Facsimile

November 13, 2009

The Honorable Barney Frank
Chairman, House Committee on Financial
Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

I am writing on behalf of the Council of Institutional Investors (“Council”), a nonprofit association of public, union and corporate pension funds with combined assets that exceed \$3 trillion. Member funds are major shareowners with a duty to protect the retirement assets of millions of American workers.

We are writing to express our appreciation for your willingness to “fashion amendments” to the Over-the-Counter Derivatives Markets Act of 2009 (“Act”) to “strengthen this legislation” prior to the floor debate.¹ As you are well aware, over-the-counter (“OTC”) derivatives contracts, and particularly credit default swaps, played a significant role in the current financial crisis.² This enormous financial market (more than \$592 trillion in notional amount) was nevertheless exempted from virtually all federal oversight and regulation by the Commodity Futures Modernization Act of 2000.³

Although derivatives can be useful vehicles for managing financial risk, unregulated and opaque OTC derivative contracts spread and multiplied risk throughout the global economy, causing great financial harm.⁴ Problems plaguing the market include lack of transparency and price discovery, excessive leverage, rampant speculation and lack of adequate prudential controls.⁵ Because of your leadership on this important reform issue, the Act goes a long ways to eliminating many of those problems.

The Council shares the concerns that you have heard from many other parties about the “exception” to the Act for end users of OTC derivatives.⁶ In our view, that exception leaves a gaping hole in the regulation of derivatives that will likely be exploited by self-interested parties to the detriment of investors and the capital markets. We, therefore, respectfully request that as you contemplate amendments to strengthen the Act, you consider the following two important improvements to Act’s provisions:

¹ Letter from the Honorable Barney Frank, Chairman, U.S. House of Representatives Committee on Financial Services, to The Honorable Mary L. Schapiro, Chairman, U.S. Securities and Exchange Commission et al. 1, 3 (Nov. 3, 2009) (on file with Council).

² See, e.g., Investors’ Working Group, U.S. Financial Regulatory Reform: The Investors’ Perspective 10 (July 2009),

[http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors'%20Working%20Group%20Report%20\(July%202009\).pdf](http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors'%20Working%20Group%20Report%20(July%202009).pdf) (endorsed by the membership of the Council of Institutional Investors in November 2009).

³ *Id.*

⁴ *Id.* at 11.

⁵ *Id.*

⁶ Letter from the Honorable Barney Frank, *supra* note 1, at 1 (“Some have suggested,. . . that we could more carefully limit the exception from the clearing and trading requirement.”).

1. **All OTC derivative transactions that can be cleared centrally should be required to be brought to a clearinghouse.**⁷ The Act narrowly limits the clearing requirement to transactions between swap dealers or major swap participants. Thus, a large volume of OTC derivative transactions that can be cleared will not be cleared because, as is often the case, one of the parties to the transaction is not a swap dealer or a major swap participant, but a hedge fund, investment fund, or other financial or nonfinancial firm.⁸ This deficiency leaves the entire financial system unnecessarily exposed to systemic risks that could otherwise be reduced if the Act simply requires that all clearable transactions be required to be cleared centrally.⁹

2. **All standardized OTC derivative contracts that can be exchange traded should be required to be traded on a regulated exchange.**¹⁰ While there might be some valid arguments as to why certain OTC derivative transactions should be exempt from the clearing requirements under the Act, we are unaware of any valid arguments for exempting standardized OTC derivative contracts from exchange trading.¹¹ The transparency provided by exchange trading not only lowers systemic risks, but, importantly, enhances the price discovery function of the markets.¹² The result should be lower costs for pension funds leaving more assets available to better provide for the retirement security of millions of U.S. workers.

We again very much appreciate your leadership in pursuing reform of OTC derivatives. Following the adoption of the above proposed improvements, we look forward to offering our support for the prompt passage of this important element of financial reform. If you have any questions, please feel free to contact me at (202) 261-7081 or jeff@cii.org, or Council analyst Jonathan Urick at (202) 261-7096 or jonathan@cii.org.

Sincerely,



Jeff Mahoney
General Counsel

⁷ See Investors' Working Group, *supra* note 2, at 11 ("Standardized derivatives should trade on regulated exchanges and clear centrally.").

⁸ See, e.g., Remarks of Chairman Gary Gensler, OTC Derivatives Regulation, George Washington University Law School Symposium 3 ("These entities [hedge funds and other financial firms currently excepted from the requirements] are responsible for a substantial share of the OTC derivatives market and they are capable of meeting these requirements that have such tremendous promise for the responsible management of financial risk.").

⁹ *Id.* at 2-3 ("To reduce systemic risk, it is critical that we move all standard swaps off the books of large financial institutions and into well-regulated clearinghouses.").

¹⁰ See Investors' Working Group, *supra* note 2, at 11.

¹¹ See, e.g., Remarks of Chairman Gary Gensler, *supra* note 8, at 3 ("I believe we can separate the debate of a corporate end-user clearing exception from whether there should be an end-user exception from transparency requirements.").

¹² *Id.*

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CC: The Honorable Spencer T. Bachus III, Ranking Member, Committee on Financial Services
The Honorable Collin C. Peterson, Chairman, Committee on Agriculture
The Honorable Frank D. Lucas, Ranking Member, Committee on Agriculture
The Honorable Louise McIntosh Slaughter, Chair, Committee on Rules
The Honorable David T. Dreier, Ranking Member, Committee on Rules
The Honorable Nancy Pelosi, Speaker of the House of Representatives
The Honorable Steny H. Hoyer, Office of the House Majority Leader
The Honorable John A. Boehner, Office of the House Minority Leader
The Honorable James E. Clyburn, Office of the House Majority Whip
The Honorable Eric I. Cantor, Office of the House Minority Whip