Consumer Federation of America
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CFA on Financial Reform:
A Daily Look at Reform Proposals and Their Effects on Consumers
April 29, 2010: Close the Regulatory Gaps on Derivatives

Dear Senator:

As the Senate moves forward with consideration of financial regulatory reform legislation, a top priority will be imposing strong regulations on the over-the-counter derivatives market. The history of derivatives regulation is one in which, time and again, the dealers have succeeded in convincing policymakers that regulation would stifle innovation, inhibit the ability of companies to hedge their risks, or drive the market overseas. The American people are paying a very heavy price for the lax regulation that resulted. Congress must not repeat that mistake this time.

The Dodd-Lincoln legislation developed jointly by the Agriculture and Banking Committees forms a good basis for bringing transparency to the derivatives market. The following are among the key provisions that must not be weakened during floor debate:

- **The bill provides for an appropriately narrow exemption for end-users hedging legitimate commercial risk. Any expansion of this exemption would expose the financial system to unacceptable risk.**
- **The bill requires most standardized derivatives to trade on exchanges, bringing both enhanced safety and price competition to the market.**
- **The bill contains a strong set of regulatory provisions governing dealers and major market participants, including business conduct rules and authority to prevent market participants from circumventing regulation.**
- **The bill imposes a fiduciary duty on swaps dealers when dealing with government entities, including public pension funds.**

Although the bill provides a strong package of reforms, some strengthening amendments are warranted to close regulatory loopholes, in particularly for foreign exchange swaps.

Closing regulatory gaps – most importantly by regulating the OTC derivatives market – is the single most important step Congress can take to reduce excessive risks in our financial system. Unless loopholes are closed, the financial system will remain exposed to excessive risks, dealers will continue to charge excessive spreads, end users will continue to use the opaque derivatives markets to engage in conduct indirectly that they would not be permitted to engage in directly, and Congress will have missed an important opportunity to address significant threats to the financial system and to the economy as a whole. For these reasons, we urge you to support the Lincoln-Dodd amendment to S. 3217.

Sincerely,

Barbara Roper

Barbara Roper
Director of Investor Protection