families. And they want those opportunities without pushing our country into greater debt. Unfortunately, this bill fails on all accounts.

□ 1720

Mr. FRANK of Massachusetts. I yield 1 minute to my colleague, the gentleman from Minnesota (Mr. PETERSON), the chairman of the Agriculture Committee.

Mr. PETERSON. Mr. Speaker, I would like to enter into the RECORD a letter that Chairman FRANK and I received from Chairmen LINCOLN and DODD on the treatment of end users under the derivatives title of the bill. As the letter makes clear, we have given the regulators no authority to impose margin requirements on anyone who is not a swap dealer or a major swap participant.

While the regulators do have authority over the dealer or MSP side of a transaction, we expect the level of margin required will be minimal, in keeping with the greater capital that such dealers and MSPs will be required to hold. That margin will be important, however, to ensure that the dealer or major stock participant will be capable of meeting their obligations to the end users. We need to make sure that they have that backing.

I would also note that few, if any, end users will be major swap participants, as we have excluded ''positions held for hedging or mitigating commercial risk'' from being considered as a ''substantial position'' under that definition.

I would ask Chairman FRANK whether he concurs with my view of the bill.

The SPEAKER pro tempore. The time of the gentleman has expired.

Mr. FRANK of Massachusetts. I yield the gentleman 15 additional seconds.

And the gentleman is absolutely right. We do differentiate between end users and others. The marginal requirements are not on end users. They are only on the financial and major swap participants. And they are permissive. They are not mandatory, and they are going to be done, I think, with an appropriate touch.

U.S. SENATE,
Washington, DC, June 30, 2010.

Hon. Chairman BARNEY FRANK,
Financial Services Committee, House of Representatives, Rayburn House Office Building, Washington, DC.

Hon. Chairman COLLIN PETERSON,
Committee on Agriculture, House of Representatives, Longworth House Office Building, Washington, DC.

DEAR CHAIRMEN FRANK AND PETERSON: Whether swaps are used by an airline hedging its fuel costs or a global manufacturing company hedging interest rate risk, derivatives are an important tool businesses use to manage costs and market volatility. This legislation will preserve that tool. Regulators, namely the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), and the prudential regulators, must not make hedging so costly it becomes prohibitively expensive for end users to manage their risk. This letter seeks to provide some additional background on legislative intent on some, but not all, of the various sections of Title VII of H.R. 4173, the Dodd-Frank Act.

The legislation does not authorize the regulators to impose margin on end users, those exempt entities that use swaps to hedge or mitigate commercial risk. If regulators raise the costs of end user transactions, they may create more risk. It is imperative that the regulators do not unnecessarily divert working capital from our economy into margin accounts, in a way that would discourage hedging by end users or impair economic growth.

Again, Congress clearly stated in this bill that the margin and capital requirements are not to be imposed on end users, nor can the regulators require clearing for end user trades. Regulators are charged with establishing rules for the capital requirements, as well as the margin requirements for all uncleared trades, but rules may not be set in a way that requires the imposition of margin requirements on the end user side of a lawful transaction. In cases where a Swap Dealer enters into an uncleared swap with an end user, margin on the dealer side of the transaction should reflect the counterparty risk of the transaction. Congress strongly encourages regulators to establish margin requirements for such swaps or security-based swaps in a manner that is consistent with the Congressional intent to protect end users from burdensome costs.

In harmonizing the different approaches taken by the House and Senate in their respective derivatives titles, a number of provisions were deleted by the Conference Committee to avoid redundancy and to streamline the regulatory framework. However, a consistent Congressional directive throughout all drafts of this legislation, and in Congressional debate, has been to protect end users from burdensome costs associated with margin requirements and mandatory clearing. Accordingly, changes made in Conference to the section of the bill regulating capital and margin requirements for Swap Dealers and Major Swap Participants should not be construed as changing this important Congressional interest in protecting end users. In fact, the House offer amending the capital and margin provisions of Sections 731 and 764 expressly stated that the strike to the base text was made ''to eliminate redundancy.'' Capital and margin standards should be set to mitigate risk in our financial system, not punish those who are trying to hedge their own commercial risk.

Congress recognized that the individualized credit arrangements worked out between counterparties in a bilateral transaction can be important components of business risk management. That is why Congress specifically mandates that regulators permit the use of non-cash collateral for counterparty arrangements with Swap Dealers and Major Swap Participants to permit flexibility. Mitigating risk is one of the most important reasons for passing this legislation.

Congress determined that clearing is at the heart of reform—bringing transactions and counterparties into a robust, conservative and transparent risk management framework. Congress also acknowledged that clearing may not be suitable for every transaction or every counterparty. End users who hedge their risks may find it challenging to use a standard derivative contracts to exactly match up their risks with counterparties willing to purchase their specific exposures. Standardized derivative contracts may not be suitable for every transaction. Congress recognized that imposing the clearing and exchange trading requirement on commercial end-users could raise transaction costs where there is a substantial public interest in keeping such costs low (i.e., to provide consumers with stable, low prices, promote investment, and create jobs.)

Congress recognized this concern and created a robust end user clearing exemption for those entities that are using the swaps market to hedge or mitigate commercial risk. These entities could be anything ranging from car companies to airlines or energy companies who produce and distribute power to farm machinery manufacturers. They also include captive finance affiliates, finance arms that are hedging in support of manufacturing or other commercial companies. The end user exemption also may apply to our smaller financial entities—credit unions, community banks, and farm credit institutions. These entities did not get us into this crisis and should not be punished for Wall Street's excesses. They help to finance jobs and provide lending for communities all across this nation. That is why Congress provided regulators the authority to exempt these institutions.

This is also why we narrowed the scope of the Swap Dealer and Major Swap Participant definitions. We should not inadvertently pull in entities that are appropriately managing their risk. In implementing the Swap Dealer and Major Swap Participant provisions, Congress expects the regulators to maintain through rulemaking that the definition of Major Swap Participant does not capture companies simply because they use swaps to hedge risk in their ordinary course of business. Congress does not intend to regulate end-users as Major Swap Participants or Swap Dealers just because they use swaps to hedge or manage the commercial risks associated with their business. For example, the Major Swap Participant and Swap Dealer definitions are not intended to include an electric or gas utility that purchases commodities that are used either as a source of fuel to produce electricity or to supply gas to retail customers and that uses swaps to hedge or manage the commercial risks associated with its business. Congress incorporated a de minimis exception to the Swap Dealer definition to ensure that smaller institutions that are responsibly managing their commercial risk are not inadvertently pulled into additional regulation.

Just as Congress has heard the end user community, regulators must carefully take into consideration the impact of regulation and capital and margin on these entities.

It is also imperative that regulators do not assume that all over-the-counter transactions share the same risk profile. While uncleared swaps should be looked at closely, regulators must carefully analyze the risk associated with cleared and uncleared swaps and apply that analysis when setting capital standards for Swap Dealers and Major Swap Participants. As regulators set capital and margin standards on Swap Dealers or Major Swap Participants, they must set the appropriate standards relative to the risks associated with trading. Regulators must carefully consider the potential burdens that Swap Dealers and Major Swap Participants may impose on end user counterparties—especially if those requirements will discourage the use of swaps by end users or harm economic growth. Regulators should seek to impose margins to the extent they are necessary to ensure the safety and soundness of the Swap Dealers and Major Swap Participants.

Congress determined that end users must be empowered in their counterparty relationships, especially relationships with swap dealers. This is why Congress explicitly gave to end users the option to clear swaps contracts, the option to choose their clearinghouse or clearing agency, and the option to segregate margin with an independent 3rd party custodian.

In implementing the derivatives title, Congress encourages the CFTC to clarify through rulemaking that the exclusion from the definition of swap for ''any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled'' is intended to be consistent with the forward contract exclusion that is currently in the Commodity Exchange Act and the CFTC's established policy and orders on this subject, including situations where commercial parties agree to ''book-out'' their physical delivery obligations under a forward contract.

Congress recognized that the capital and margin requirements in this bill could have an impact on swaps contracts currently in existence. For this reason, we provided legal certainty to those contracts currently in existence, providing that no contract could be terminated, renegotiated, modified, amended, or supplemented (unless otherwise specified in the contract) based on the implementation of any requirement in this Act, including requirements on Swap Dealers and Major Swap Participants. It is imperative that we provide certainty to these existing contracts for the sake of our economy and financial system.

Regulators must carefully follow Congressional intent in implementing this bill. While Congress may not have the expertise to set specific standards, we have laid out our criteria and guidelines for implementing reform. It is imperative that these standards are not punitive to the end users, that we encourage the management of commercial risk, and that we build a strong but responsive framework for regulating the derivatives market.

Sincerely,

Chairman CHRISTOPHER DODD,
Senate Committee on Banking, Housing, and Urban Affairs, U.S. Senate.

Chairman BLANCHE LINCOLN,
Senate Committee on Agriculture, Nutrition, and Forestry, U.S. Senate.

Mr. BACHUS. At this time I yield 4 minutes to the gentleman from California (Mr. ROYCE), a senior member of the committee.

Mr. ROYCE. Mr. Speaker, yesterday a small community banker in Ohio by the name of Sarah Wallace wrote a letter. She wrote about what she believed will be the end of community banking as we know it. And Sarah Wallace notes, in her words: ''Going forward, we will no longer be able to evaluate loan applications based solely on the creditworthiness of the borrower. We will be making regulation compliance decisions instead of credit decisions.''

And this gets to the heart of the issue with the underlying legislation that we're discussing. Despite the fact that every failed financial firm had some type of Federal regulator overseeing it, the answer put forward in this bill is to give broad, largely undefined powers to those regulators and not, by the way, in the interest of safety and soundness. If the objective was safety and soundness, the amendment that I put forward to allow the safety and soundness regulator to overrule the Consumer Financial Protection Bureau in cases where safety and soundness was at stake, that would have been upheld. No, that's not the goal here.

And to get back to the point that Sarah Wallace makes, her observation is that instead of focusing on providing credit and providing the best possible service to the customers in these small towns that need that credit, these institutions will instead focus their efforts on appeasing the Federal Government and on appeasing their allies in Congress.

Well, why should that give us concern? It should worry us because whether it is striving toward another altruistic goal, such as Congress' interest in subsidizing housing—and by the way, that's what happened during the housing crisis—or whether it's funneling cash into friendly community activist organizations, like ACORN, the fact is, the closer big government gets to business, the more likely these favors will become the rule instead of the exception.

What I don't like about this is the political pull that comes out of it. What I don't like about it is the market discipline being replaced. And I think on a massive scale, this bill replaces objectivity with subjectivity. It replaces the market discipline on Main Street with political pull in Washington, and regulators will now decide which firms will be treated differently and, therefore, moved through the resolution process and which firms should be left to the bankruptcy courts.

Why would we care about that in terms of these big firms having this ability now to have this alternative means of resolution? Well, once in the resolution process, the government will have the authority to provide a 100 percent bailout to whichever creditor it favors while imposing severe losses on other institutions who bought the exact same bonds. Should we be concerned about abuse in this respect? I think so, because this type of bureaucratic discretion has led to abuse in the past.

We have already seen that abuse in the Obama administration's handling of the Chrysler bankruptcy last year. Secured creditors, typically entitled to first priority payment under the absolute priority rule, ended up receiving less than the union allies of the administration who held junior creditor claims. The fact that the regulatory reform approach injects politics into the process ensures this kind of favoritism in the future.

Mr. FRANK of Massachusetts. Mr. Speaker, I yield 1 minute to the gentleman from Maryland (Mr. HOYER), the majority leader.

Mr. HOYER. I thank the chairman for yielding, and I congratulate the chairman for the extraordinary work he has done. I thank Mr. BACHUS too, who is, I think, one of the really responsible leaders in the minority in terms of issues of substance. And when there are differences, they are honest differences.

Mr. Speaker, I come to the floor, and when I do, I hear portions of the debate, sometimes not all of the debate. I want to make an observation, though. I listened to the gentleman from New Jersey, and he remarked on what the people were saying. And I think that, frankly, his remarks reflected the difference in the perspective between the two parties.

Indeed, that perspective has been reflected in my three decades here, under Mr. Reagan and others who have served as President and lastly with Mr. Bush, Mr. Obama's immediate predecessor. And that perspective was, if the regulators would simply get out of the way, things would be fine. Mr. ROYCE indicates that the market will take care of things. ''The market will discipline itself,'' he said. Phil Gramm said that with respect to the derivatives.

Unfortunately, I voted for that bill that Mr. Gramm was for. I made a mistake. Brooksley Born was correct. The market did not discipline itself. In fact, the market took extraordinarily irresponsible steps. What I hear, I tell my friend from New Jersey, the people saying is, Don't let the big guys trample on us. Don't let the big guys put us at great risk. Don't let the big guys make decisions that they take the risk and we take the loss. That's what I hear the people saying, and that's what I think this bill is designed to respond to.

This week Mr. BOEHNER compared reforming Wall Street to killing an ant with a nuclear weapon. Well, that may sound colorful, but this is the greatest economic crisis that any of us—I'm looking around on this floor—have experienced in our lifetimes. And I am closer to experiencing the last one than any of you, I think, on the floor are. But none of us, even at my advanced age, were alive during the Great Depression. So this is the first time that we have experienced such a deep, deep recession.

But I will tell you, the 8 million Americans whose jobs it took away think it was a mighty big ant that squashed them and their families, or the millions more who saw their savings devastated or the families in every one of our districts who have lost their homes. They're thinking to themselves, Mr. BOEHNER, that was a mighty big ant that came my way. And not to more than half of the Nation's working adults who report that they have been pushed by the recession into ''unemployment, pay cuts, reduced hours at work or part-time jobs,'' according to a Pew Research Center Survey reported in today's Washington Post.

□ 1730

Now, some of you may think that was an ant that walked through here, but some think it was a pretty big elephant. It squashed them and hurt them.

I don't mean an elephant in the symbol of your party, a respected animal with a long memory.