United States Senate
WASHINGTON, DC 20510

April 23, 2010

The Honorable Harry Reid
Majority Leader
S-211 The Capitol
United States Senate
Washington, DC 20510

Dear Senator Reid:

To address a principal cause of the recent financial sector crisis, the regulatory reform bill that will soon come before the Senate must include strong regulation of trading in over-the-counter (OTC) derivative contracts. The Senate Agriculture and Banking Committees have put forward proposals that will help to create transparency, stability, accountability, and reduce systemic risk in the derivatives market. Our next challenge is to merge these proposals together, so that the Wall Street reform bill that reaches the floor includes the strongest and most effective possible regulation of OTC derivatives.

To ensure that the strongest possible product reaches the Senate floor, we believe that these respective measures should be viewed as complements, not competitors. The Agriculture Committee, which has well-established jurisdiction over swaps and derivatives, has approved a strong bill with critical elements, which should serve as a solid foundation that can be buttressed by provisions reported by the Banking Committee. If we are to effectively regulate the derivatives market, we must start the Senate floor debate with the strongest proposal we can craft and defend against the inevitable attempts to weaken it – rather than rely upon later amendments to add essential reforms.

Therefore, we believe that the measure upon which Senate floor debate begins should include the following components, some of which are included in the Agriculture Committee's measure, some of which are in the Banking Committee's measure, and some of which are in both:

1. **Mandatory Execution Requirement:** All trades that the CFTC or the SEC requires to be cleared must also be traded on an exchange or on a swap execution facility. Trading on exchanges or execution facilities provides for pre-trade transparency, which is necessary to fully understand and manage the risks being taken by market participants, to provide more efficient and accurate pricing, and to facilitate more cost-effective risk management.

2. **Mandatory Clearing Requirement:** Along with an execution requirement, a robust mandatory clearing requirement for derivative contracts is needed in order to assess, manage and collateralize risks, to ensure post-trade accountability, to ensure market stability, and to reduce systemic risk. Mandatory clearing provides an essential safety net in the market by requiring market participants to post margin and hold capital to support their positions in the market, and to prevent the default of any one party from putting the entire market at risk.

3. **Real Time Public Reporting:** Even with clearing and exchange trading, all trades – including those that are not required to be cleared or traded on an exchange or execution facility – need to be reported to the appropriate regulator in real time so regulators will for the first time have a full understanding of the aggregate positions held by each entity. To serve as large a share of the transparency objectives that would otherwise be served by the trading requirement, regulators should be required to disclose those trades to the public as soon as technologically feasible and in a manner that protects market integrity.

4. **Foreign Exchange Swaps:** Foreign exchange swaps should not have a statutory exemption from the clearing and execution requirements or any other requirements in the bill.

5. **Definition of Major Swap Participant:** Under both the Banking Committee and Agriculture Committee proposals, major swap participants would face tougher regulatory standards. This definition of Major Swap Participant should include any firm whose positions in swaps could jeopardize the financial stability of a counterparty or the financial system.

6. **Aggregate Position Limits:** Position limits provide an important restriction on market manipulation and the amount of risk that can build up in any one market participant. The CFTC and SEC should be required to set and enforce strong position limits.

7. **Regulatory Standards for Foreign Boards of Trade:** Foreign boards of trade must be prohibited from allowing members or participants located in the United States to have access to the foreign board of trade for contracts that settle against prices for contracts traded on CFTC-(or SEC)-registered entities unless the foreign board of trade adheres to minimum standards comparable to those in the United States and reports all trading activity in these contracts to U.S. regulators on a timely basis.

8. **Margin for Non-Cleared Swaps:** Swaps that are not cleared are likely to be some of the riskiest contracts. To mitigate the risks that these contracts pose to financial stability, it is important that the CFTC and SEC have the authority to set margin requirements for

swaps that are not required to be cleared in addition to any capital requirements that may be set by a prudential regulator.

9. **Capital for Non-Cleared Swaps:** As with margin-setting, the CFTC and SEC should have authority (in addition to the authority of any prudential regulator) to require market participants to hold substantially higher levels of capital to support any swaps that they determine should be required to be cleared but that are not cleared. The substantially higher capital standard is essential to ensure that firms can adequately cover the risk of non-cleared swaps in times of market distress.

10. **Fiduciary Duty:** Swaps dealers should have a special duty of care to pension funds, endowments, retirement funds, and state and local governments to protect vulnerable market participants from being taken advantage of by dealers.

11. **Prohibition on Derivatives Contracts that are Abusive or Against the Public Interest:** The CFTC and SEC should have specific authority to prohibit trading of futures, swaps, or other derivative contracts of a similar nature (whether traded on an exchange, execution facility, or OTC) if they are created with the purpose of defrauding a third party, are otherwise abusive, or if their trading is against the public interest. More general protections that may presently exist in federal, state, or common law against fraud, for example, are not sufficient.

Furthermore, any exemption to the clearing requirements, such as an exception for commercial end-users, must be narrowly constructed. If an end-user provision is included, it must apply only to commercial entities that use swaps to hedge their commercial risk. Financial entities of any type should not be allowed to qualify as end users. Counter-parties to end-users must be required to hold adequate capital to protect against risk, including systemic risk, associated with swaps eligible for the end-user exemption, and end-users must be given the option to clear standard transactions at their discretion.

We urge a constructive process in which the strongest provisions of each bill are combined into a proposal to reform the derivatives market that is more effective than either current proposal, and is supported by both Chairmen. In the absence of such an agreement, we would find it difficult to support comprehensive reform legislation unless the best provisions of the Agriculture Committee's bill were included as the derivatives title of the legislation. Otherwise, we will find ourselves in the disadvantageous position of facing a potential 60-vote threshold to include this bipartisan bill as an amendment, assuming it would be possible to call up such an amendment. We believe the Senate should start with a comprehensive, strong reform proposal and defend attempts to weaken it, not the other way around. Starting the amendment process from a position of weakness is no way to start.

We stand ready to work with you, Chairman Lincoln, and Chairman Dodd to achieve strong Wall Street reform, including strong regulation of the $600 trillion over-the-counter derivatives market.

Sincerely,

Bill Nelson

cc: The Honorable Christopher J. Dodd
The Honorable Blanche L. Lincoln