

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

April 11, 1991

The Honorable Christopher S. Bond
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Senator:

Thank you for your letter of April 9, 1991, requesting my views on a proposed alternative to the exclusivity provisions of S. 207 as reported by the Committee on Agriculture, Nutrition and Forestry. As I have previously indicated, under the current approach to the implementation of the Commodity Exchange Act ("CEA") instruments with elements of futurity may be considered to be futures contracts and therefore required to be traded on futures exchanges. This approach has led to confusion in financial markets and involvement of the courts, of which the situation involving index participations is a good example. The developers of new financial instruments -- including risk-shifting products -- are responding to perceived economic needs, but uncertainty about the treatment of new financial instruments under the CEA tends to discourage such efforts and to give an edge to financial centers abroad.

In my view, the approach taken in S. 207, as passed by the Agriculture Committee, would continue to preserve impediments to innovation in hybrid's and risk management products and would forestall developments in swap markets that could reduce systemic risk. The exemptive authority given to the Commodity Futures Trading Commission ("CFTC") under this bill is narrow and in some cases would prohibit the CFTC from making appropriate exemptions. The hearing requirement could lead to a cumbersome exemptive process which itself would pose an obstacle to innovation. Further, the use of regulatory exemptions, once granted, itself creates uncertainty, as they may be revoked at a future date.

Moreover, with respect to swap transactions, S. 207 could impede the development of netting arrangements designed to reduce counterparty risks and, therefore, systemic risks in the financial markets. In addition, S. 207 also suggests that the CFTC would have jurisdiction over some depository instruments and pending transactions, even though banks are subject to a comprehensive system of federal regulation designed to ensure the safety of the institutions and to protect their depositors. Finally, S. 207 as reported by the Agriculture Committee could be

read to preclude banking regulators from overseeing banking transactions that are exempted by the CFTC, a situation that could be inadvisable.

The approach taken by your proposed alternative to S. 207 goes further to alleviate the difficulties for the financial markets created by the provisions of the CEA than the Agriculture Committee version and therefore is preferable, particularly in the areas of swaps, bank deposits and lending instruments. Your alternative would exclude certain swap transactions from the coverage of the CEA altogether thus avoiding problems that may arise from a cumbersome exemptive process and the potential for revocation of any exemptions that may be granted. The exclusion approach would also remove possible conflicts in regulatory jurisdiction that might arise from continued CFTC jurisdiction over swaps. Further, the alternative would define swaps in a way that would permit the development of risk-reducing bilateral or multilateral netting arrangements of facilities for swap transactions. Such facilities can be an important means of containing systemic risks in the financial markets.

Similarly, your alternative would exclude certain deposit and lending transactions from the coverage of the CEA. Like the swap exclusion, these exclusions would avoid the difficulties of the exemptive process. Further, they would ensure that bank supervisors' ability to oversee these banking activities is unimpaired.

I hope you find these comments to be helpful.

Sincerely,

Alan Greenspan

Identical letter sent to Sen. Timothy Wirth