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U.S. House of Representatives
Committee on Energy and Commerce
Washington, DC 20515-6115

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June 6, 2006

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The Honorable David M. Walker
Comptroller General
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Walker:

We are writing with reference to your follow-up study of financial market preparedness as it relates to matters within this Committee's Rule X jurisdiction over interstate and foreign communications.

The Government Accountability Office (GAO) has committed to report to us on, among other things, the progress of financial regulators, market participants, and telecommunications providers in improving the reliability, resiliency, and physical security of the telecommunications infrastructures and services critical to the functioning of financial markets.

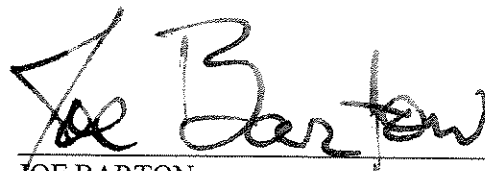
Recent press reports suggest that special attention needs to be focused on the \$12 trillion market for credit derivatives. See, "Wall Street Is Cleaning Derivatives Mess," Wall Street Journal, Thursday, February 16, 2006; "Concerns Dog Credit Derivatives," Wall Street Journal, Wednesday, March 1, 2006; and "Greenspan Expresses Concerns on Derivatives, Medicare Costs," Wall Street Journal, Friday, May 19, 2006 (copies enclosed). Dealers are relying on telephones and faxes to conduct and confirm trades instead of using information technology systems to help them conduct and manage their credit derivative activities and exposures. As a result, some firms had long backlogs of transactions that they had yet to confirm and others had transactions that they had not entered into their risk systems. Firms also were transferring obligations from one party to another without notifying the original party and lacked systems and procedures for managing these notifications. Another concern is whether the existing trading and settlement infrastructure can cope with the volume of activity that would result from a large bankruptcy filing, however widely anticipated. Former Federal Reserve Board Chairman Alan Greenspan said that he was "frankly shocked" at this "unconscionable" state of affairs: "This is 19th-century technology that I find appalling."

Ensuring that market participants make better use of sophisticated information technology systems to assist with initiating and confirming transactions, tracking portfolio obligations and performance, and managing the risk of credit derivative activities is critical. Market participants and regulators have announced actions to help address these deficiencies. For example, Mr. Patrick M. Parkinson, Deputy Director, Division of Research and Statistics, Federal Reserve Board, testified recently before Congress that credit derivatives dealers have committed to the creation of a largely electronic marketplace for the processing of trades, and to work with the Depository Trust & Clearing Corporation to develop a trade information warehouse and support infrastructure to standardize and automate the processing of events throughout the life of each contract (copy enclosed). These actions are expected to be completed by October 31, 2006.

We commend the ongoing efforts described in this testimony. Given the seriousness of the concerns with the infrastructure of this market, coupled with the red flags raised in GAO's previous reports on market preparedness, we are writing to ask GAO to conduct a review of the issues surrounding credit-derivatives markets and the information technology systems being developed to bring them into this century and reduce systemic risk. Specifically, we ask that you, either as part of your follow-up report or in a separate report:

- (1) Determine the extent to which dealers are using information technology systems to conduct, confirm, transfer, and manage the risk of credit derivatives transactions, as well as the reliability, resiliency, and security of any such systems;
- (2) Determine the extent to which financial regulators are overseeing dealers' credit derivatives activities and related systems, especially the extent to which these activities are accurately being monitored by firms' risk management and capital adequacy systems; and
- (3) Identify any actions that other organizations, such as industry associations and clearing organizations, are taking to improve information technology systems and reduce risk in the credit-derivatives markets.

Thank you for your cooperation and attention to our request. We look forward to receiving and reviewing your final work product. For further information, please contact Consuela Washington of the Committee on Energy and Commerce Democratic staff at 202-225-3641, or Brian McCullough, Committee on Energy and Commerce Republican staff at 202-225-2927.



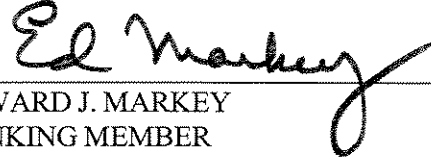
JOE BARTON
CHAIRMAN

Sincerely,

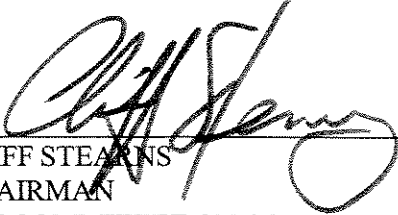

JOHN D. DINGELL
RANKING MEMBER



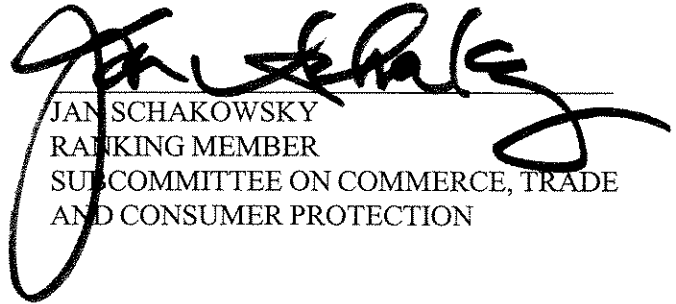
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SUBCOMMITTEE ON TELECOMMUNICATIONS
AND THE INTERNET



CLIFF STEARNS
CHAIRMAN
SUBCOMMITTEE ON COMMERCE, TRADE,
AND CONSUMER PROTECTION



JAN SCHAKOWSKY
RANKING MEMBER
SUBCOMMITTEE ON COMMERCE, TRADE
AND CONSUMER PROTECTION

Attachments

cc: The Honorable Michael G. Oxley, Chairman
Committee on Financial Services

The Honorable Barney Frank, Ranking Member
Committee on Financial Services