Department of the Treasury
Board of Governors of the Federal Reserve System
U.S. Securities and Exchange Commission
Commodity Futures Trading Commission

June 11, 2003

The Honorable Michael D. Crapo
United States Senate
111 Russell Senate Office Building
Washington, DC 20510

The Honorable Zell B. Miller
United States Senate
257 Dirken Senate Office Building
Washington, DC 20510

Dear Senators Crapo and Miller:

Thank you for your letter of June 10, 2003, requesting the views of the President's Working Group on Financial Markets (PWG) on proposed Senate Amendment #876 to S.14, the pending energy bill. As this amendment is similar to a proposed amendment on which you sought the views of the PWG last year, we reassert the positions expressed in the PWG's response dated September 18, 2002, a copy of which is enclosed. The proposed amendment could have significant unintended consequences for an extremely important risk management market -- serving businesses, financial institutions, and investors throughout the U.S. economy. For that reason, we believe that adoption of this amendment is ill-advised.

We would also point out that, since we wrote that letter last year, various federal agencies have initiated actions against wrongdoing in the energy markets. As you note, the CFTC has brought formal actions against Enron, Dynegy, and El Paso for market manipulation, wash (or roundtrip) trades, false reporting of prices, and operation of illegal markets. The Securities and Exchange Commission, the Federal Energy Regulatory Commission, and the Department of Justice have also initiated formal actions in the energy sector. Some of these actions have already resulted in substantial monetary penalties and other sanctions. These initial actions alone make clear that wrongdoers in the energy markets are fully subject to the existing enforcement authority of federal regulators.

The Commodity Futures Modernization Act of 2000 brought important legal certainty to the risk management marketplace. Businesses, financial institutions, and investors throughout the economy rely upon derivatives to protect themselves from market volatility triggered by unexpected economic events. This ability to manage risks makes the economy more resilient and its importance cannot be underestimated. In our judgment, the ability of private counterparty surveillance to effectively regulate these markets can be undermined by inappropriate extensions of government regulation.

Yours truly,

John W. Snow
Secretary
Department of the Treasury

Alan Greenspan
Chairman
Board of Governors of the Federal Reserve System

William H. Donaldson
Chairman
U.S. Securities and Exchange Commission

James E. Newsome
Chairman
Commodity Futures Trading Commission

Enclosure

Department of the Treasury
Board of Governors of the Federal Reserve System
U.S. Securities and Exchange Commission
Commodity Futures Trading Commission

September 18, 2002

The Honorable Michael D. Crapo
United States Senate
111 Russell Senate Office Building
Washington, DC 20510

The Honorable Zell B. Miller
United States Senate
257 Dirksen Senate Office Building
Washington, DC 20510

Dear Senators Crapo and Miller:

In response to your letter of September 13, we write to express our serious concerns about the legislative proposal to expand regulation of the over-the-counter (OTC) derivatives markets that has recently been proposed by Senators Harkin and Lugar.

We believe that the OTC derivatives markets in question have been a major contributor to our economy's ability to respond to the stresses and challenges of the last two years. This proposal would limit this contribution, thereby increasing the vulnerability of our economy to potential future stresses.

The proposal would subject market participants to disclosure of proprietary trading information and new capital requirements. We do not believe a public policy case exists to justify this governmental intervention. The OTC markets trade a wide variety of instruments. Many of these are idiosyncratic in nature. These customized markets generally do not serve a significant price discovery function for non-participants, nor do they permit retail investors to participate. Public disclosure of pricing data for customized OTC transactions would not improve the overall price discovery process and may lead to confusion as to the appropriate pricing for other transactions, as terms and conditions can vary by contract. The rationale for imposing capital requirements is unclear to us, and the proposal's capital requirements also could duplicate or conflict with existing regulatory capital requirements.

The trading of these instruments arbitrages away inefficiencies that exist in all financial and commodities markets. If dealers had to divulge promptly the proprietary details and pricing of these instruments, the incentive to allocate capital to developing and finding markets for these highly complex instruments would be lessened. The result would be that the inefficiencies in other markets that derivatives have arbitraged away would reappear.

It is also unclear who would benefit from the proposed disclosures and regulations other than whoever simply copied existing products and instruments for their own short-term advantage. Weakening the protection of proprietary intellectual property rights in the market arena would undercut a complex of highly innovative markets that is among this nation's most valuable assets.

While the derivatives markets may seem far removed from the interests and concerns of consumers, the efficiency gains that these markets have fostered are enormously important to consumers and to our economy. We urge Congress to protect these markets' contributions to the economy, and to be aware of the potential unintended consequences of current legislative proposals.

Yours truly,

Paul H. O'Neill
Secretary
Department of the Treasury

Alan Greenspan
Chairman
Board of Governors of the
Federal Reserve System

Harvey L. Pitt
Chairman
U.S. Securities and Exchange
Commission

James E. Newsome
Chairman
Commodity Futures Trading
Commission

cc: Senator Daschle
Senator Feinstein
Senator Gramm
Senator Harkin
Senator Lugar
Senator Lott
Senator Sarbanes