ROBERT P. CASEY, JR.
PENNSYLVANIA

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JOINT ECONOMIC

United States Senate

WASHINGTON, DC 20510

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OFFICE OF THE SECRETARIAT

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

The Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

COMMENT

Dear Chairmen Gensler and Schapiro,

New regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act are crucial to curtailing systemic risk and preventing another financial crisis. However, these regulations must be implemented in a manner that avoids unnecessarily burdening our economy during the recovery. Towards that end, I continue to hear concerns about the potential impact of some of the proposed rules, including the potentially negative effects of derivatives regulations on small banks and commercial end-users.

Pennsylvania relies heavily on small, community banks; more than 98 percent of FDIC insured financial institutions in Pennsylvania have assets of less than $10 billion. These banks have a vested interest in their communities, and are a crucial part of local economies throughout the Commonwealth. These small institutions use derivatives in a limited—but necessary—fashion. From hedging risk on commercial lending to offering a small number of derivatives products to end-users, these services are typically focused on fixing interest or exchange rates.

Small institutions do not engage in trades of the size or scope necessary to create systemic risk. To that effect, the Dodd-Frank Act allows the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) to exempt small banks from the definition of 'financial entity,' and allow them to take advantage of the end-user exemption from clearing requirements. I urge the CFTC and the SEC to seriously consider providing such an exemption and to set an appropriate threshold for the *de minimis* exception that will allow small banks to continue offering a limited range of derivative products to commercial end-users, without being categorized as a 'swap dealer,' and being subjected to potentially expensive compliance costs.

The proposed rules are also of concern to commercial end-users whose use of derivatives represents only a small portion of the derivatives market—estimated at less than 10 percent by the Bank of International Settlements—and poses little systemic risk. This risk is also widely dispersed throughout the market, as the CFTC estimates that there are approximately 30,000 non-financial end-users. Although only a small part of the market, these derivatives allow end-users to hedge business risk, and also serve an important price discovery function. The law recognizes this, and provides a clear exemption from clearing requirements for end-users.

I encourage the CFTC to work with the prudential regulators to also ensure that commercial end-users are exempt from margin requirements, and to set capital requirements at a level that recognizes the lower risk posed by end-user trades. Rules should also recognize the inherent differences between commercial end-users and the financial entities that perform that vast majority of derivatives trades. Real-time reporting requirements, for example, are especially onerous for end-users who engage in trades where the counterparty is also an end-user. Additionally, as with small banks, it is important for commercial end-users that the *de minimis* threshold be increased from its proposed level to ensure that they do not have to register as swap dealers.

Lastly, I have heard widespread concern about the timing of the rules. I believe regulations should be implemented in a logical sequence that allows time for adoption, and ensures that new systems are functioning before their use is mandated. A clear schedule of when the various rules will be implemented should be published to give all participants the ability to prepare for the new regulatory structure.

The financial crisis made it clear that new regulations are needed to address the potential risk over-the-counter derivatives pose to our economy as a whole. Nevertheless, we must be careful not to paint with too broad a brush, as different segments of the derivatives market pose different risks. Small banks and commercial end-users do not create the same systemic risk that major financial entities do. Regulating them in the same fashion is unnecessary, and could impede effective risk management, and reduce the availability of capital at a time when we need additional investment to create jobs. New rules must create a balance that allows low-risk practices to continue without imposing prohibitive costs.

Sincerely,

Bob Casey, Jr.

Robert P. Casey, Jr.
United States Senator

CC: Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System
Martin J. Gruenberg, Acting Chairman, Federal Deposit Insurance Corporation
John G. Walsh, Acting Comptroller of the Currency
Leland A. Strom, Chairman and CEO, Farm Credit Administration
Edward DeMarco, Acting Director, Federal Housing Finance Agency