NYSE Euronext

Testimony of
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NYSE Liffe, LLC
on behalf of NYSE Euronext
before the
U.S. House of Representatives
Committee on Agriculture

Derivative Markets Transparency and Accountability Act of 2009

February 4, 2009

Chairman Peterson, Ranking Member Lucas, members of the Committee. My name is Karl Cooper, and I am the Chief Regulatory Officer of NYSE Liffe, LLC ("NYSE Liffe"), a subsidiary of NYSE Euronext. NYSE Liffe is a relatively new exchange, having been designated by the Commodity Futures Trading Commission ("Commission") as a contract market in August 2008. I am pleased to appear this morning on behalf of NYSE Euronext and its affiliated exchanges as the Committee considers the Derivative Markets Transparency and Accountability Act of 2009.

NYSE Euronext operates the world's largest and most liquid exchange group. NYSE Euronext brings together seven cash equities exchanges in five countries and seven derivatives exchanges. In the United States, we operate the New York Stock Exchange, NYSE Arca, NYSE Alternext (formerly the American Stock Exchange), and NYSE Liffe. In Europe, we operate five European-based exchanges that comprise Euronext — the Paris, Amsterdam, Brussels and Lisbon stock exchanges, as well as the Liffe derivatives markets in London, Paris, Amsterdam, Brussels and Lisbon. We also provide technology to more than a dozen cash and derivatives exchanges throughout the world. NYSE Euronext's geographic and product diversity has helped to inform our analysis of the bill you are considering today.

NYSE Euronext supports the essential purposes of the Committee draft legislation: (i) enhancing the integrity of U.S. contract markets; and (ii) bringing transparency and risk reduction to the over the counter ("OTC") derivatives markets. Nonetheless, we are concerned that the breadth of the bill may have unintended consequences. Our comments today focus on those provisions of the bill that we believe could inhibit the ability of U.S. exchanges to compete globally and deny U.S. market participants access to critical risk management products.

The Commission, with the encouragement and active support of Congress and market participants, has long played an active role in developing standards of regulatory best practices and strengthening customer and market protection through international cooperation including, in particular, information sharing among regulatory authorities. The Commission has been an

active participant in the meeting of the International Organization of Securities Commissions ("IOSCO") and, more recently, has joined with the Committee of European Securities Regulators ("CESR") to consider ways to facilitate the conduct and supervision of international business. In addition, the Commission is party to a number of bilateral and multilateral memoranda of understanding, each of which is designed to assure timely access to critical market information.

Similarly, the regulatory relief that the Commission has provided to foreign exchanges that seek to do business with U.S. market participants is predicated on a Commission finding that the exchange is subject to a comprehensive regulatory program that is comparable, though not identical, to the Commission's own regulatory program. As important, such relief is subject to extensive terms and conditions. In particular: (i) satisfactory information sharing arrangements must be in place among the Commission, the foreign exchange, and the foreign exchange's regulatory authority; and (ii) the foreign exchange and each member of the exchange that conducts business under the relief must consent to the Commission's jurisdiction. In all cases, the Commission retains authority to modify, suspend, terminate or otherwise restrict the terms of any relief that it may provide.

By any measure, we believe the Commission's approach to international regulation has been a success, assuring the protection of customers and the integrity of the exchange-traded markets, while facilitating the development of global derivatives markets. A critical key to this success has been the Commission's willingness to cooperate with those regulatory authorities in foreign jurisdictions that share a common regulatory philosophy. A different regulatory approach, one that imposed our regulatory structure on any foreign exchange or intermediary that sought to do business with U.S. market participants, might well have led to regulatory retaliation, causing the global competitiveness of U.S. exchanges to suffer.

As the Committee continues its consideration of the Derivative Markets Transparency and Accountability Act of 2009, we ask the Committee to ensure that this legislation will in no way weaken the spirit of international cooperation that has played such an important role in the growth of the regulated derivatives markets, and which the Commission has so successfully fostered.

Section 3. Transparency of Off-Shore Trading. It is the fear of regulatory retaliation that underlies our concern with the provisions of section 3 of the Committee draft legislation. We appreciate the Committee's desire that the Commission have access to critical trade information relating to contracts listed for trading on foreign exchanges that settle to a contract listed for trading on a U.S. contract market. We also recognize that this section is narrowly written to target a specific perceived problem. Nonetheless, as written, section 3 appears to subject the foreign exchange to the direct supervision of the Commission.

As discussed above, the Commission has full authority through its information sharing arrangements with a foreign exchange authorized to permit direct access and its home country regulator to obtain the type of information described. Further, the Commission can rescind this authorization at any time, if the requested information is not provided. In the absence of evidence that the Commission has been unable to obtain required trade information through

cooperative means, we believe section 3 sets an unnecessarily confrontational tone and risks setting off a chain reaction of retaliatory measures.

Section 13. Clearing of OTC Derivatives. For many of the same reasons, we are troubled by the provisions of section 13, which would require that, except for OTC derivatives instruments on "excluded commodities," all OTC derivatives must be cleared through a derivatives clearing organization registered with the Commission. To be clear, NYSE Euronext strongly supports legislative action that would encourage and facilitate the clearing of OTC derivatives instruments.

In this regard, we note that, on December 22, our London derivatives exchange, Liffe, acting in cooperation with LCH.Clearnet Ltd., launched the first clearing solution for the processing and clearing of credit default swaps ("CDSs") based on certain credit default indexes. Shortly thereafter, we received necessary exemptions from the Securities and Exchange Commission to offer CDS clearing to qualified U.S. customers. (Both Liffe and LCH.Clearnet are supervised by the U.K. Financial Services Authority.)

Nonetheless, we believe section 13 goes too far in seeking to force a clearing solution for OTC derivatives instruments limited to DCOs. We are especially concerned that this section apparently would no longer permit a multilateral clearing organization supervised by a foreign financial regulator that the Commission determines "satisfies appropriate standards" to clear OTC derivatives instruments, as is currently provided under section 409 of the FDIC Improvements Act of 1991.

Liffe expects to receive authorization shortly from the Financial Services Authority to act as a self-clearing recognized investment exchange. Among other services, Liffe anticipates acting as a central clearing counterparty for OTC derivatives instruments. Under the provisions of section 13, however, Liffe could not offer these services to U.S. persons (except with respect to excluded commodities), unless it first applied for registration with the Commission as a DCO. Such registration would subject Liffe to duplicative and, in some instances, potentially conflicting regulatory requirements.

The OTC derivatives market is a global market, which demands a global response. An American solution to clearing OTC derivatives instruments is no less palatable than a European solution. Yet, this legislation would lend support to those in Europe who are urging such action.

Separately, we believe the standards pursuant to which the Commission would be able to grant an exemption from clearing are too narrow. Fully implementing a clearing solution for OTC derivatives will be very difficult. The Commission should have broader authority to grant exemptions where appropriate.

Section 16. Credit Default Swaps. With all of the negative publicity that credit default swaps have received over the past several months, we appreciate the Committee's concern and its desire to restrict in some way the volume of trading in these instruments. But the fact remains that credit default swaps are a vitally important tool in managing risk. In difficult economic times, the diversification of risk, if used properly, will continue to add value to the marketplace.

We believe section 16 goes too far in seeking to reduce any perceived financial risk in the trading of CDS. Its provisions would effectively close the market in the U.S., driving the business overseas. This is because it is impossible to conceive of a situation in which both parties to a CDS would experience a financial loss if an event to a credit default swap occurs. By definition, one party must benefit from such a trade. The market for CDS, no less so than the market for exchange-traded futures, needs speculators if it is to maintain sufficient depth. Without the liquidity that speculators bring to the market, price spreads would widen, severely reducing, if not eliminating, its value.

Moreover, we are concerned that the provisions of section 16 would prohibit swaps on credit default indexes. We believe it is unlikely that institutional participants that use these indexes to hedge their securities portfolios hold all of the securities that comprise the index. Nonetheless, these swaps are more liquid and are easier to trade than CDSs on a single name security. Although not perfect, they provide a sufficient hedge at a lower cost than a series of CDSs on single names.

Conclusion. Thank you, again, for the opportunity to appear before the Committee today. I would be happy to respond to any questions you may have.

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