Oppose Creation of New Carbon Derivatives Market

From: The Committee on Financial Services - Minority Staff
Bill: H.R. 2454
Date: 6/24/2009

Dear Colleague:

Later this week, the House is expected to consider H.R. 2454, the Waxman-Markey climate change bill. Because this complex legislation was not vetted by many of the key committees of jurisdiction, you may not be aware of a troublesome provision that could put our financial markets further at risk and potentially lead to another taxpayer bailout.

Specifically, H.R. 2454 creates a multi-trillion dollar market for Carbon Allowance Derivatives that would exceed the size of the entire market for all carbon allowances. The new market would be open to potential abuse because it will be difficult for regulators to understand and monitor.

While Congress and financial regulators continue to work to determine how best to oversee existing derivatives markets, it is ill-advised to rubber stamp the creation of a brand new, hard to price, and convoluted Carbon Allowance Derivative Market. As former Under Secretary of Commerce Robert Shapiro recently said, "We are on the verge of creating a new trillion-dollar market in the financial assets that will be securitized, derivatized, and speculated by Wall Street like the mortgage backed securities market."

Clearly, this new carbon derivatives market has the potential to pose a systemic risk to our financial markets at the expense of taxpayers who could be on the hook for any abuses and losses that take place. Now is no time to repeat mistakes of the past that allowed Wall Street to engage in risky practices that privatized profits and socialized losses.

The bill also creates carbon offsets, which allow companies to emit greenhouse gases in excess of the federal limit by investing in projects that reduce emissions. It is anticipated that many of these projects will be created in developing countries. Tree-planting projects, for example, could be used as carbon offsets. But the trees could be in Brazil or Borneo. If there is a tree-planting project in Brazil, worthy as that may be, should American taxpayers pay for it? In addition, such projects, particularly in remote or developing countries, are notoriously difficult to confirm and monitor. The legal description of the land could be changed and offsets potentially securitized many times over. We found that even in the U.S., with an established rule of law and a well-established regulatory system, the subprime mortgage market was subject to countless schemes and manipulation.

H.R. 2454 boldly overreaches and proposes vast and sweeping new regulation of the derivatives market by requiring all over-the-counter derivatives trades to be regulated, setting position limits, mandating clearing of all swap transactions, and banning certain credit default swaps. Acting on this proposal before the Administration has had a chance to submit its regulatory reform legislation to Congress undermines our efforts to enact comprehensive regulatory reforms to the financial system.

Provisions in H.R. 2454, like those creating a Carbon Allowance Derivative Market, should not be buried in a nearly 800 page bill and not subject to proper review by the committees of jurisdiction. The House Financial Services Committee is on track to report regulatory reform legislation that is expected to address problems in the derivatives markets, so now is not the time to create a new market outside that framework.

Sincerely,

Spencer Bachus
Ranking Member