

## Energy and Commerce Leadership Releases GAO Report; Credit Derivatives Confirmation Backlogs Increased Dealers' Operational Risks, But Were Successfully Addressed After Joint Regulatory Action

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NEWS RELEASE  
Committee on Energy and Commerce

Rep. John D. Dingell, Chairman

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In Follow-Up Letter, Committee Leaders Commend Progress, But Note GAO Findings That More Needs To Be Done

Washington, D.C. - Credit derivatives, which are privately negotiated contracts that allow a party to transfer the risk of a default on a bond or loan to another party without transferring ownership, have increased dramatically in recent years &ndash; resulting in thousands of contracts with unconfirmed trade terms. The unconfirmed trades raised the risk that losses could arise from human errors or system failures, with dire consequences for dealers, end-users, and consumers. A Government Accountability Office (GAO) report released today concludes that the 14 largest credit derivatives dealers dramatically reduced the number of total confirmations (outstanding more than 30 days) to 5,500 trades as of October 2006.

The 5,500 outstanding confirmations represent a 94 percent reduction from the previous backlog of more than 150,000

unconfirmed trades that had accumulated between 2002 and 2005. The dealers worked together in response to a joint initiative by U.S. and foreign regulators to reduce dangerous backlogs and address underlying causes by increasing automation and requiring end-users to obtain consent before assigning trades.

"It is an enormous relief that these sophisticated markets have traded in 19th-century mechanics for modern information technology, and not a moment too soon," said Rep. John D. Dingell (D-MI), Chairman of the Committee on Energy and Commerce, pointing to subprime woes haunting credit markets. "We look forward to additional progress, and commend the joint regulatory action and industry response as a model for tackling similar problems in global markets."

The large number of accumulated backlogs resulted from reliance on inefficient manual confirmation processes that failed to keep up with rapidly growing volume and because of difficulties in confirming information for trades that end-users transferred to other parties without notifying the original dealer. The GAO report finds that, although these trades were being entered into systems that dealers used to manage the risk of loss arising from price changes (market risk) and counterparty defaults (credit risk), the backlogs increased dealers' operational risk by potentially allowing errors to go undetected.

The report, requested by Rep. Dingell along with Rep. Joe Barton (R-TX), Rep. Edward Markey (D-MA), Rep. Fred Upton (R-MI), Rep. Bobby Rush (D-IL), Rep. Cliff Stearns (R-FL) and Rep. Jan Schakowsky (D-IL), examined the causes of the backlog of credit derivatives confirmations, steps taken to address them, and related operational risks, including the security and resiliency of related information technology systems. The 14 dealers are Bank of America; Barclays Capital; Bear, Stearns & Co.; Citigroup; Credit Suisse; Deutsche Bank; Goldman Sachs Group; HSBC; JP Morgan Chase; Lehman Brothers; Merrill Lynch & Co.; Morgan Stanley; UBS; and Wachovia Bank.

Rep. Dingell and five other Energy and Commerce Committee leaders followed up the report with a letter to Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve; Christopher Cox, Chairman of the Securities and Exchange Commission; and John C. Dugan, Comptroller of the Currency. The letter commended the joint regulatory action and actions to date by the dealers, but strongly urged further steps to reduce backlogs, improve automation, and increase the reporting of standardized data not only in credit derivatives but also in OTC equities, interest rate, foreign exchange, and commodity derivatives. The Congressmen asked to be notified if progress lags, and promised to follow up on technology matters as needed.

Read the July 13, 2007 letter

For a copy of the GAO report, please visit the GAO website at <http://www.gao.gov/new.items/d07716.pdf>.

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Prepared by the Committee on Energy and Commerce

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