DERIVATIVES OVERSIGHT AND TAXPAYER PROTECTION ACT

Risky derivatives were at the heart of the 2008 financial crisis. The Financial Crisis Inquiry Commission found that there was a stunning lack of oversight of the multi-trillion dollar derivatives market, leading to the buildup of massive leverage and risk. In addition, the Commission found that the "existence of millions of derivatives contracts of all types between systemically important financial institutions – unseen and unknown in this unregulated market – added to uncertainty and escalated panic, helping to precipitate government assistance to those institutions."

In response, Congress enacted the Dodd-Frank Act, which gave the Commodity Futures Trading Commission (CFTC) new authority to regulate and oversee the derivatives market. Dodd-Frank also included several provisions intended to ensure that big financial firms could not pass on the risk from their derivatives positions to taxpayers again.

Unfortunately, six years after Dodd-Frank, it's clear that more needs to be done to address both derivatives oversight and taxpayer protection. The CFTC is woefully underfunded and lacking in enforcement tools; weak CFTC rules have opened up massive gaps in the regulatory framework; and financial institutions are still able to pass along significant derivatives risk to taxpayers. The Derivatives Oversight and Taxpayer Protection Act builds on Dodd-Frank to address each of these problems and to help ensure that derivatives will not be the cause of another financial crisis.

The Act strengthens derivatives oversight by:

- Directing the CFTC to collect user fees from financial firms to cover its budget, similar to the Securities and Exchange Commission, which will help the CFTC manage the enormous new oversight responsibilities it was given in Dodd-Frank.

- Updating the CFTC's enforcement authority so that the agency can impose meaningful civil penalties on firms that break the law and deter misconduct by repeat offenders.

- Closing the cross-border loophole, which currently allows big financial firms with operations abroad to circumvent many key CFTC requirements.

- Ending the exemption of certain foreign exchange swaps from CFTC jurisdiction, ensuring adequate oversight of a key derivatives market.

- Improving data sharing between financial firms and the CFTC and between the CFTC and other financial regulators.

The Act protects taxpayers by:

- Ending the favorable treatment of derivatives in bankruptcy, creating an incentive for private parties to better assess the risk of the derivatives contracts they enter.

- Strengthening the CFTC's margin rule by requiring the posting of initial margin in inter-affiliate swaps.

- Banning the use of closeout netting for purposes of calculating minimum capital requirements.

- Requiring the CFTC and other financial regulators to issue a report addressing concerns about derivatives clearinghouses.