



STATE STREET®

**TESTIMONY OF
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BEFORE THE UNITED STATES
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
SUBCOMMITTEE ON SECURITIES, INSURANCE, AND INVESTMENT
HEARING ON
“DERIVATIVES CLEARINGHOUSES: OPPORTUNITIES AND CHALLENGES”
MAY 25, 2011**

Chairman Reed, Ranking Member Crapo, and Members of the Subcommittee, thank you for the opportunity to testify today regarding the clearing-related provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

As an initial comment, I commend the CFTC for their efforts to date on Dodd-Frank implementation, where they are working on a broad range of highly complex issues, on a very aggressive timeframe.

State Street is one of the world's largest custodial banks and processors of derivatives transactions, and we support regulations which will benefit our customer base of large, buy-side, institutional investors, such as pension funds, mutual funds, and endowments. We support the Dodd-Frank mandates for both derivatives clearing and execution, which we believe will reduce global systemic risk, and, properly implemented, benefit our institutional investor customer base.

Like most market participants, our buy-side clients are concerned by the current regulatory uncertainty and the potentially significant cost and market liquidity impacts that may result from the new rules. At State Street, we are well positioned to provide our clients with full-service clearing and other services that can help them realize the benefits of the new derivatives regime, through enhanced transparency, more open execution platforms, and central clearing.

In relation to central clearing, the key issue for State Street is effective implementation of the Dodd-Frank Act's requirement that clearinghouse membership requirements "permit fair and open access." Open access will reduce systemic risk by avoiding concentration of clearing activity with a small number of existing "dealer" members, and benefit the buy-side by allowing netting across dealers on swaps that clear through the same clearinghouse.

State Street intends to pursue membership in a variety of derivatives clearinghouses, and the Dodd-Frank requirement for open access is an important element in our ability to increase competition in the clearing services marketplace.

I'd like to make a few specific recommendations:

First, we support the CFTC's participant eligibility rules as proposed, but note these rules will require vigilant oversight by the CFTC. The proposed rules recognize the critical importance of strong clearinghouse risk management practices, while, at the same time, permit broader clearinghouse membership, reducing systemic risk and allowing buy-side market participants to benefit from alternative clearing member business models. As we noted in our comment letter to the CFTC, we are concerned that some clearinghouses will carry forward their current restrictive membership requirements, in direct contradiction of the spirit and intent of Dodd-Frank.

Second, clearing members must be required to demonstrate the necessary financial and operational resources to execute their duties to customers and the clearinghouse. Strong capital rules are important, but should be risk-based rather than arbitrary dollar amounts. We have suggested linking capital requirements to other risk-based clearinghouse measures, such as a multiple of default fund contributions. Other arbitrary requirements linked to a dealer-specific

business model, such as a minimum swap book, are not risk-based and will prohibit membership by non-dealer firms. Outsourcing of certain functions should be allowed, provided that the execution risk associated with such outsourcing rests with the member firm and not the clearinghouse. By way of example, the current model of the futures markets showed itself well structured to handle such crises, as the successful wind-down of Lehman's futures positions by non-members demonstrated at the time of its bankruptcy.

Third, both the clearing and the execution mandates should go into effect at the same time. Clearing is most effective when tied to execution, providing market participants with greater transparency, tighter spreads and cost reduction. Phasing-in the clearing requirement in advance of the execution requirement would burden market participants with increased costs while denying them the corresponding benefits. If some form of phasing is deemed necessary by the CFTC, it should be done by instrument and require that as each new instrument is folded under the regulatory regime, both the clearing and execution requirements attach simultaneously.

Fourth, to the extent possible, regulations governing clearinghouse membership rules should be coordinated globally, to avoid regulatory arbitrage that could frustrate the Dodd-Frank requirements for open access.

Finally, in order to allow the markets and participants to adjust to new ways of doing business, we suggest that a six month transition period be given between finalization of the mandatory clearing and execution rules and mandatory compliance. The final rules will provide certainty to the markets as to what the new regulatory demands are, and only then will businesses be in a position to plan and adapt accordingly.

Again, State Street strongly believes in the importance of the clearing and execution mandates as spelled out in Dodd-Frank, and we stand ready to help Congress, the Administration and the regulators as the process of rule-writing and implementation goes forward.

Thank you for the invitation to testify before you today. I will be happy to take your questions.