U.S. Securities and Exchange Commission Acts On Credit Default Swaps

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WASHINGTON _ The U.S. Securities and Exchange Commission took a step Tuesday toward a new system of central clearinghouses for credit default swaps, complex investments traded globally that have been partly blamed for the financial crisis.

The SEC commissioners approved temporary exemptions from agency rules, a move that will allow LCH.Clearnet Ltd., a British firm, to operate as a central clearinghouse for transactions involving credit default swaps.

Traded in a $60-trillion market that is unregulated and secretive, credit default swaps have come under scrutiny by Congress and federal regulators in the wake of the financial and credit crises that have plunged economies around the world into recession. The idea behind a system of central clearinghouses _ promoted by a White House advisory group of regulators _ is to bring transparency to the market, possibly reducing risks to the financial system.

The SEC move Tuesday ``is an important step in our efforts to add transparency and structure to the opaque and unregulated" market for credit default swaps, SEC Chairman Christopher Cox said in a statement. ``These ... exemptions will allow a central (clearinghouse) to be quickly up and running, while protecting investors through regulatory oversight."

The swaps are commonly used contracts to insure against the default of financial instruments such as bonds and corporate debt. But they also are bought and sold as bets against bond defaults.

They played a prominent role in the credit crisis that brought the downfall of Lehman Brothers Holdings Inc., a government rescue plan for giant insurer American International Group Inc., and Merrill Lynch & Co. selling itself to Bank of America Corp.

The huge volume of credit default swaps sold by AIG, for example, coupled with rising levels of defaulted mortgage and other debt, threatened the company's existence and prompted the government to spend $150 billion to bail it out to avoid a catastrophic collapse. If AIG were to fail, the losses would spread to the companies and investors who bought swaps from it.

In announcing the exemptions for LCH.Clearnet, the SEC did not specify how long they would remain in force.

They will allow firms such as LCH.Clearnet to quickly put in a centralized system for clearing swaps trades, while giving the SEC time to review their operations and assess whether permanent exemptions should be granted, the agency said in a statement.

Well-regulated central clearinghouses ``should help promote stability in financial markets" by reducing the risks from the default or financial distress of a major market player, the SEC said.

Cox has urged Congress to enact legislation to regulate the market for credit default swaps, and he noted Tuesday that ``more needs to be done in this area legislatively."

Several companies are seeking similar exemptions to operate as clearinghouses, some of them from other federal agencies that oversee them such as the Commodity Futures Trading Commission.

Executives of CME Group Inc. and IntercontinentalExchange Inc. in the U.S., Britain's LIFFE exchange and Eurex Clearing AG of Germany assured the House Agriculture Committee at a recent hearing that they would provide safe, neutral central structures that would contain risk and manipulation in the market for the swaps.

The committee's chairman, Representative Collin Peterson (D-Minn.) supports the idea of making the use of clearinghouses mandatory for credit default swap transactions.

The head of the Senate Agriculture Committee, Senator Tom Harkin (D-Iowa) has proposed giving the CFTC primary authority to regulate the swaps.