



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

November 5, 2003

The Honorable Michael D. Crapo
United States Senate
Washington, D.C. 20510

Dear Senator:

You have asked me for my views on Senator Feinstein's latest proposal for additional regulation of energy derivatives. By imposing large trader reporting requirements on bilateral transactions in energy commodities, the proposal would take the first steps toward introduction of an ex ante prophylactic regulatory regime for the OTC energy derivatives markets. Such a regime would undermine market discipline to the extent that market participants come to depend on the Commodity Futures Trading Commission (CFTC) to protect their interests and therefore fail to do more to protect themselves. Reliance on market discipline rather than government regulation has allowed derivatives markets to allocate risks very flexibly and effectively, which has contributed importantly to the resiliency of our financial system and our economy.

In my view, concerns about market manipulation in the energy derivatives markets would be addressed more effectively by a combination of: (1) enhanced market discipline on the processes through which price data are gathered and price indexes are constructed, and (2) more vigorous exercise of the CFTC's existing ex post enforcement authority with respect to market manipulation. Some clarification of the CFTC's enforcement authority would be desirable, but it is not at all clear that the provisions in the proposed amendment are the best way to accomplish that goal.

Sincerely,

A handwritten signature in black ink, appearing to be "Alan Greenspan", written over the word "Sincerely,".