

Statement of the International Swaps and Derivatives Association*
for the House and Senate Agriculture Committees'
Futures, Derivatives, and Public Policy Roundtable Program
February 25 and 26, 1999

Privately negotiated swap transactions have become an essential part of risk management for the American economy. Every day, companies, banks and governmental entities face unique financial risks—interest rates, currencies, commodity prices and securities prices. Users of swaps can manage these risks with swaps, which can be custom tailored to meet specific needs, but these users must have the legal certainty that the underlying contracts are enforceable in order to manage risk effectively.

Each attempt by the CFTC over the years to assert jurisdiction over swaps has created legal uncertainty. Congress should clarify once and for all that swaps are not subject to regulation under the Commodity Exchange Act (the "CEA"). Legal certainty has been aided by previous actions of Congress and the CFTC that recognized the unique nature of swap transactions, but the threat of legal uncertainty remains, as last year's issuance of the CFTC concept release showed. If clarification is not provided by Congress, the continuing threat of uncertainty will make it harder for firms to innovate, increase legal risk by undermining the enforceability of contracts, and potentially place these important hedging transactions out of the reach of many users.

Any legal uncertainty created by CFTC action is an outgrowth of the fact that the CEA is designed to regulate exchange-traded instruments only. The CEA is an inappropriate means for regulating privately negotiated swap transactions because they are fundamentally different from the standardized contracts traded on an exchange. In fact, applying the exchange-trading requirement of the CEA to swaps would render unenforceable thousands of outstanding swap contracts, representing billions of dollars of value to the American economy. The Treasury amendment recognized that financial contracts that are not traded on an exchange are not appropriately regulated as futures under the CEA. Off-exchange financial transactions common at the time the amendment was enacted (government securities and foreign exchange transaction) were excluded from regulation under the CEA. Although swaps were developed later, they are also off-exchange financial transactions and should be excluded from regulation under the CEA.

ISDA believes that the best path forward is clear: provide the legal certainty needed for privately negotiated swap transactions and free the regulated exchanges to be more competitive. A clear declaration from Congress that swaps are not subject to regulation under the CEA achieves the first goal; a firm instruction from Congress to the CFTC to lighten the regulatory burden on the exchanges accomplishes the second goal. The result will be a combination of CFTC-regulated exchange activity that can more effectively compete in today's global marketplace and privately negotiated activity that can thrive without recurring episodes of legal uncertainty.

Any policy that increases the cost of swaps or reduces the flexibility and innovation that have been their hallmarks will hurt banks, brokers, corporations and governmental entities that use them to manage risk. Public policy should ensure the availability of a wide range of reliable and affordable risk management tools, both privately negotiated and exchange-traded, for the many users who can benefit from them. The competitiveness of American business, the success of the U.S. economy and the safety and soundness of the financial system will be enhanced if Congress acts to ensure the reliability and affordability of these tools.

* The International Swaps and Derivatives Association ("ISDA") is an international organization whose membership comprises over 390 of the world's largest commercial, merchant and investment banks and other corporations and institutions that engage in significant activities in swaps and other privately-negotiated derivatives transactions (collectively, "swap transactions"). A list of ISDA's current members is attached to this statement. In addition to our Primary Members, who represent all the major dealers in swaps and derivatives, ISDA has a growing number of Subscriber Members, many of whom are active end-users of swaps and derivatives. Additional information about ISDA and its activities can be found on its web site, www.isda.org.