

PREPARED STATEMENT OF JOSEPH BAUMAN
ON BEHALF OF
THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.
BEFORE
THE HOUSE SUBCOMMITTEE RISK MANAGEMENT AND SPECIALTY CROPS
JUNE 10, 1998

Mr. Chairman and Members of the Subcommittee, I am Joseph Bauman, a Managing Director, of Bank of America. At the Bank I have responsibility for providing risk management products such as swaps to the Bank's clients. However, I am here today in my capacity as a member of the Board of Directors of the International Swaps and Derivatives Association (widely known as "ISDA").

ISDA's more than 350 members include most swap dealers, many of the large end users of swaps and many of the principal customers of the futures exchanges. We have on several occasions appeared before this Subcommittee to support proposals to modernize the Commodity Exchange Act by reducing the regulatory burdens on the futures exchanges, and by providing greater legal certainty that the Act does not apply to privately negotiated swaps transactions.

Unfortunately, Mr. Chairman, recent actions and statements of the CFTC, culminating in its Concept Release concerning privately negotiated swaps have undercut and imperiled the legal certainty that has until now existed for swaps through, in large measure, the foresight and efforts of Congress. Moreover, the CFTC has sent a chill through this business by raising the specter that it may seek to impose new restrictions upon privately negotiated swap transactions. For these reasons, ISDA wholeheartedly supports the proposal of the Treasury, Federal Reserve, and SEC that emergency legislation be enacted to preserve the current legal framework for swap transactions and the stability of

these financial markets, until you and your colleagues in the next Congress have the opportunity to renew your efforts to modernize the Act.

In these brief remarks, I'd like to explain why this action is imperative. Swap transactions are custom-tailored to manage the unique risks of each firm. These custom tailored swaps are very different from the standardized futures contracts traded on organized exchanges. Both Congress and the CFTC have for many years recognized that swaps are not - I repeat not - appropriately regulated as futures under the CEA. By writing the 1989 Swaps Policy Statement, enacting the 1992 Futures Trading Practices Act, and issuing the 1993 Swaps Exemption, Congress and the CFTC have created an umbrella of legal certainty which covers a broad array of transactions, including transactions such as swaps on securities prices which are not, and often cannot be, covered by the Swaps Exemption. This environment has encouraged innovation in risk management, and contributed to the nation's economic growth and stability.

But all of this is now in jeopardy because the CFTC has broken from the pack and reversed course. By issuing its concept release on swaps, the CFTC has ignored the goal of legal certainty established by this Subcommittee. Treasury Secretary Rubin, Federal Reserve Chairman Greenspan, and SEC Chairman Levitt put it best in their joint statement that "[w]e seriously question the scope of the CFTC's jurisdiction in this area, and we are very concerned about reports that the CFTC's action may increase the legal uncertainty concerning certain types of OTC derivatives".

Secretary Rubin and his colleagues are not crying wolf. When the CFTC asserts jurisdiction over swaps as it has by issuing the concept release, it implies that certain categories of swaps are futures contracts. If so, swaps that don't fit within the four corners of the Swaps Exemption could be deemed illegal because under the CEA, off-exchange futures contracts are illegal and unenforceable. In this

way the CFTC has called into question the enforceability of thousands of swap transactions and put at risk tens of billions of dollars of value on the books of American banks, brokers and corporations.

The CFTC can't calm the markets by saying that any new regulations will be only prospective. A CFTC assertion of jurisdiction over swaps may tempt private litigants to challenge their agreements in court as unenforceable, off-exchange futures. This legal risk is undermining market confidence.

Markets are fragile. Market confidence can be lost quickly. Once lost market confidence is not easily regained.

The growth of the swap business is evidence of the extent to which American businesses have embraced swaps as tools that allow them to hedge financial market and commodity risks and to focus on their core business. The increase in legal risk that is occurring as the result of the CFTC's actions represents an unfortunate and unnecessary deterrent to firms like mine that offer swaps and an unequally unwelcome deterrent to end-user firms that should continue to benefit from these competition-enhancing risk management tools. This is clearly not in the public interest. As I said, ISDA represents both dealers and end-users in the swaps business. And I can assure you that, just like our dealer members, end-users are very concerned about the CFTC's new course of action.

The CFTC's actions are already making it harder for agribusiness to hedge. In its new rule on agricultural trade options, which was adopted in April and takes effect next week, the CFTC announced that agricultural trade options are no longer prohibited. But they can only be agreed to under a cumbersome, costly regulatory regime. What is worse, in its announcement, the CFTC asserted that agribusinesses who use options to hedge are no longer protected by the 1993 Swaps Exemption when they hedge agricultural commodities. This has cut back the range of hedge

transactions available to the agricultural community.

Mr. Chairman, we recognize that this session of the Congress will rapidly draw to a close and that the proposed legislation asks much of you and your colleagues. Unfortunately, the CFTC has made it necessary for us to ask for your help to preserve the umbrella of legal certainty that all of us have worked so diligently to create, and, as others have pointed out, for which Congress has reserved for itself the right to change. None of us can prudently ignore the considered judgment of the Treasury, the Federal Reserve and the SEC that legislation is needed this year to assure continued stability in the financial markets and continued confidence by U.S. business in their contractual rights under their risk management transactions.