May 17, 1999

Statement Submitted on Behalf of
The International Swaps and Derivatives Association, Inc.
To the Subcommittee on Risk Management and Specialty Crops
Committee on Agriculture
United States House of Representatives

This statement is submitted by the International Swaps and Derivatives Association, Inc. ("ISDA") to the House Subcommittee on Risk Management and Specialty Crops (the "Subcommittee") in connection with the Subcommittee's May 18-20, 1999 hearings on the Commodity Exchange Act ("CEA") and reauthorization of the Commodity Futures Trading Commission ("CFTC").

ISDA is an international organization whose membership includes more than 400 of the world's largest commercial, merchant and investment banks and other corporations and institutions that conduct significant activities in swaps and other privately negotiated derivatives transactions (collectively, "swap transactions"). Moreover, ISDA s dealer-members are among the principal customers of the regulated futures exchanges. The issues to be addressed in these hearings are of great importance to ISDA's members and ISDA welcomes the Subcommittee's invitation to testify.

I. Need for CEA Reform

ISDA believes that the time has come to modernize the CEA. The objectives of modernization should be to provide legal and regulatory certainty for financial contracts, to encourage financial innovation and to facilitate competition in the United States and abroad. A modernized CEA should foster efficient, liquid and low cost financial transactions. Regulatory burdens that increase the cost or availability of essential risk management tools to America's businesses and other end-users should be imposed only in those cases where less burdensome means, including market discipline, have not been effective. Congress should also recognize that America's businesses benefit when they can choose among different risk management tools and that the continued development of a diverse array of these tools will be enhanced by different regulatory structures, including private regulation through market discipline.

There are a number of actions that Congress should take to achieve these broad policy goals for CEA reform. First, Congress should clarify once and for all that the CEA does not apply to swap transactions. In addition, broad regulatory relief should be provided to the organized futures exchanges to the maximum extent Congress concludes that it would be prudent to do so. ISDA and its members would welcome legislation that modernizes exchange regulation, increases the autonomy of the exchanges, and enables them to move promptly to offer a broad array of low cost risk management products.

As discussed more fully in this statement, ISDA has been particularly concerned with the legal uncertainties relating to the status of swap transactions under the CEA. Swaps and

related off-exchange transactions serve important economic and risk management functions. Swap transactions are custom tailored to meet the unique needs of individual firms. Due to the tailored nature of such transactions, swap transactions differ substantially from the standardized exchange-traded futures contracts governed by the CEA. As a result, swap transactions cannot fit within the regulatory framework defined by the CEA. In fact, the CEA is an inappropriate framework for the regulation of swap activity to such an extent that, if that framework were imposed on these contracts, the exchange trading requirements of the CEA would instantly call 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.

Historically, the CFTC has recognized this fact and acted to make it clear that swap transactions are not appropriately regulated under the CEA, by issuing the 1989 Swaps Policy Statement and 1993 Swaps Exemption, which are discussed in detail below. Nevertheless, and despite significant efforts by Congress, the inapplicability of the CEA to these transactions has not been fully and adequately clarified. ISDA has actively supported the Subcommittee in its efforts to resolve these uncertainties by modernizing the CEA.

The importance of Congressional action with respect to legal certainty and related issues was underscored by the course of action unilaterally followed by the CFTC in 1998. In a comment letter to the Securities and Exchange Commission on a new category of limited purpose securities dealer (or "broker-dealer lite"), in its interim final rule on agricultural trade options, and in its concept release on off-exchange derivatives, the CFTC took three major steps away from the goal that Congress, the CFTC and the industry have worked toward. These actions were harmful and increased legal uncertainty regardless of the motivation of the CFTC in taking these actions. Many parties, our members among them, were extremely concerned about the regulatory actions the CFTC has taken. We wholeheartedly supported the "standstill" legislation enacted in 1998 to give Congress adequate time to weigh these important issues.

II. Importance of Swap Transactions

Many corporations, financial institutions and government entities in the United States rely on swap transactions to manage risk. Ordinary financial and commercial activities of these firms give rise to a host of risks, many of which could not be hedged or managed in an efficient manner, if at all, without the use of swap transactions. Therefore, the availability of swap transactions at low cost and within a strong legal framework in the United States is of vital interest to all ISDA members and the other institutions who rely on swap transactions. Any legal uncertainty presents a significant source of risk to individual institutions and to the financial markets as a whole and precludes the full realization of the powerful benefits such transactions provide.

Derivatives, particularly privately negotiated swaps, are powerful tools which allow the counterparties to adjust the risk characteristics of their assets and liabilities, fine tune their risk exposures and lower their costs of capital. In such a transaction, two counterparties establish a custom-tailored bilateral agreement to exchange cash flows at periodic intervals during the life of the deal according to a prearranged formula. These cash flows are determined by applying the prearranged formula to the "notional" principal amount of the swap transactions. In most

swaps, such as interest rate swaps, this notional amount never changes hands and is merely used as a reference for calculating the future cash flows.

For example, if a corporation has floating-rate debt outstanding and is concerned that interest rates might rise, it could use an interest rate swap to convert its floating-rate debt into a fixed-rate obligation. Similarly, if a corporation earns non-dollar revenues from a foreign subsidiary and wants to avoid the risk of fluctuating exchange rates, it could use a currency swap to hedge this exposure. Almost any kind of swap can be created. The flexibility and benefits that swap transactions provide have led to dramatic growth in the use of such transactions. In addition to interest rate and currency swap transactions, commodity, equity, credit and other types of swap transactions are widely used. Transactions take place around the globe, and U.S. institutions are leaders in this business at home and abroad.

III. Introduction to the Problems

One of ISDA's main goals since its inception has been to promote legal certainty for swap transactions. ISDA has sought to establish (i) clarity concerning how swap transactions will be treated under U.S. law and laws in other jurisdiction, (ii) certainty that they will be legally enforceable and not subject to avoidance and (iii) certainty that key provisions in swap transactions (including termination and netting provisions) will be enforceable, even in the case of bankruptcy of one of the parties. For example, ISDA has worked with the Congress to pass legislation establishing the enforceability of master agreement netting provisions in the case of insolvency of a U.S. counterparty. In addition, ISDA has developed model swap contracts that are used in the United States and around the world by the vast majority of swap participants for their transactions.

The CFTC's actions in 1998 were reminiscent of previous events that have cast doubt on the legal certainty that the CEA does not apply to swap transactions. That legal certainty has been undermined on several occasions in the past decade by the structure of the CEA, which bans off-exchange "futures" contracts without defining the term. The statute has not easily accommodated the great innovations in financial products that have taken place since the enactment of the CEA. In 1974, Congress excluded from the CEA certain wholesale privately negotiated transactions that might otherwise have been thought to be futures. However, at that time, swap transactions did not yet exist and therefore were not specifically excluded. The resulting legal uncertainties, which will be explained in more detail below, have inhibited the evolution of swap transactions in the United States and the natural and beneficial growth in their use.

IV. History of CEA's Relationship to Swap Transactions

In 1922, Congress enacted the original version of what is now the CEA to protect farmers and other producers and merchants of certain agricultural commodities from the perceived abuses of futures contracts. The protective scheme mandated that all trading of futures contracts on certain commodities be regulated by the Department of Agriculture and conducted on organized futures exchanges (the "exchange trading requirement").[1] During the period from 1936 to 1974, the list of covered commodities was expanded periodically.

[1] Before trading in a particular contract may lawfully occur, an exchange must apply for and

The statute was substantially revised in 1974 by (i) establishing the CFTC to administer the CEA and regulate U.S. commodities exchanges, (ii) expanding the definition of "commodity" to cover (with certain exceptions) "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt with"[2] and (iii) providing a statutory exclusion from the CEA for "transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade" (the "Treasury Amendment").[3]

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receive "designation" as a "contract market" for the trading of a particular product. However, certain exceptions to the exchange trading requirement and other provisions of the CEA exists, such as the forward contract exclusion. Considerable litigation has resulted over what transactions Congress intended to cover with this exclusion.

[2] 7 U.S.C. § 2, CEA § 1(a)(3).

[3] 7 U.S.C. § 2(ii), CEA § 2(a)(1)(A)(ii).

In the 1980's, the rapid growth in the use of innovative interest rate and currency swaps as well as related privately negotiated derivatives transactions to manage financial risk brought with it a desire to ensure a clear and unambiguous legal status for these transactions. In 1987, these legal concerns were significantly heightened when it was widely reported that the CFTC had commenced a formal investigation into the commodity swap business of Chase Manhattan Bank. Despite the fact that no enforcement action was ever commenced, these reports alone created significant uncertainty regarding the status of swap transactions under the CEA. It was feared that swap transactions would be deemed to be illegal and unenforceable off-exchange futures contracts. This uncertainty was exacerbated when the CFTC issued an Advance Notice of Proposed Rulemaking in which it effectively stated that transactions such as swaps which include certain elements of futures contracts may be subject to the CEA.[4] In response to these concerns, large segments of U.S. swap activity moved offshore, and some U.S. firms ceased development of swaps entirely, reducing the ability of U.S. firms to manage risk and inhibiting the growth of these activities at U.S. institutions.

These events prompted ISDA and other industry participants to seek action by the CFTC to reduce the substantial legal uncertainty which resulted from these developments. To address these concerns, in 1989 the CFTC issued a policy statement (the "Swaps Policy Statement") stating its view "that at this time most swap transactions, although possessing elements of futures or options contracts, **are not appropriately regulated as such under the [CEA] and regulations [emphasis added]**".[5] Thus, a nonexclusive "safe harbor" was extended by the CFTC to those swap transactions that met a series of tests intended to distinguish them from their exchange-traded counterparts.[6] However, the Swaps Policy Statement did not explicitly include interest rate option products. The application of the Swaps Policy Statement to interest rate caps, floors and collars was subsequently clarified in a series of no-action letters. These events were welcomed in the marketplace, and swap transaction

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[4] 52 Fed. Reg. 47022 (Dec. 11, 1987).

[5] 54 Fed. Reg. 30694 (July 21, 1989).

[6] In order to qualify for the nonexclusive safe harbor under the Swaps Policy Statement, swap transactions, among other things, must (i) reflect individually-tailored terms based upon individualized credit determination, (ii) lack an exchange-style offset, (iii) lack a clearing organization or margin system, (iv) be undertaken in conjunction with a line of business and (v) not be marketed to the general public.

activity expanded substantially in subsequent years. However, legal uncertainties relating to the applicability of the CEA to swap transactions remained.

These uncertainties were further heightened in 1990 as the result of a decision by a United States District Court in New York in Transnor v. BP America Petroleum, which determined that contracts for future delivery of Brent blend crude oil constituted futures contracts and were therefore subject to the CEA.[7] Although swap transactions were not at issue in Transnor, it was feared that if another court were to apply to swap transactions Transnor's limited view of the forward contract exclusion and its expansive definition of a futures contract, and at the same time were to ignore the Swaps Policy Statement, such a court might determine that certain swap transactions were futures contracts under the CEA. The importance and potential consequences of legal risks applicable to swap transactions were subsequently brought to light in 1991 when the London Borough of Hammersmith and Fulham, which had repudiated numerous losses from swap contracts, was able to convince the House of Lords (England's highest court) that it was *ultra vires* to have entered into the contracts in the first instance, thereby voiding the contracts. Concern increased that similar losses could be realized in the U.S. as a result of ambiguities under the CEA.

In 1992, Congress took a major step to provide legal certainty that the CEA was not generally applicable to swap transactions by passing the Futures Trading Practices Act of 1992 (the "FTPA"). The FTPA provided the CFTC with the power to create exemptions from the CEA for futures contracts and transactions with futures-like elements. The Report of the Committee of Conference of the U.S. House of Representatives and the U.S. Senate for the FTPA (the "Conference Report") stated that the intent of this authority was "to give the [CFTC] a means of providing certainty and stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner".[8] In passing the FTPA, Congress specifically directed the CFTC to resolve legal uncertainty concerns by promulgating an exemption for swaps and certain hybrid contracts. In order to avoid any implication that swaps are futures, Congress expressly noted in the Conference Report that the granting of an exemption does not "require any determination beforehand that
the agreement, instrument or transaction for which an exemption is sought is subject to the [CEA]".[9]

In response to the FTPA, the CFTC adopted an exemption for "swap agreements" in January 1993 (the "Swaps Exemption").[10] Reflecting Congress' direction in the FTPA, the

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[7] 738 F. Supp. 1497. Since the Brent contracts in question were routinely settled without physical delivery by means of certain offset techniques, the court concluded that Brent contracts did not qualify for the forward contract exclusion, and then went on to determine that they were futures contracts.

[8] H.R. Rep. No. 978, 102d Cong., 2d Sess. at 81 (1992).

[9] Id.

[10] 58 Fed. Reg. 5587 (Jan. 22, 1993).

CFTC did not make any determination that swap agreements would otherwise be subject to the CEA. The Swaps Exemption exempted certain types of swap transactions, when entered into by "eligible swap participants", from selected provisions of the CEA, including the exchange-trading requirement.[11] Exempted transactions still must meet certain criteria that are intended to distinguish them from exchange-traded agreements.[12] In general, the Swaps Exemption covers a broader range of swap transactions than does the Swaps Policy Statement.

As a result of the Swaps Exemption, even if a swap were found to be a futures contract, and none has, it would only be subject to (i) the market manipulation and anti-fraud provisions of the CEA and (ii) Section 2(a)(1)(B) of the CEA, which was enacted pursuant to the Futures Trading Act of 1982, otherwise known as the Shad-Johnson jurisdictional accord (the "Jurisdictional Accord"), and which (A) divides jurisdiction over exchange-traded derivative transactions on securities between the Securities and Exchange Commission (the "SEC") and the CFTC, and (B) establishes that futures contracts on individual securities and certain narrow securities indices are illegal.

Also in January 1993, the CFTC adopted an exemptive framework for certain hybrid instruments, which provides an exemption for instruments such as equity or debt securities or depository instruments with imbedded futures or commodity option characteristics. If applicable, the exemption extends to all provisions of the CEA except the provisions adopted pursuant to the Jurisdictional Accord. Other relevant exemptions which exist include those granted for (i) certain contracts for the deferred purchase or sale of specified energy products entered into between commercial participants meeting certain criteria and (ii) trade options sold

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[11] Eligible swap participants include: banks and trust companies; saving associations and credit unions; insurance companies; commodity pools having assets exceeding $5,000,000 and meeting certain other criteria; broker-dealers; futures commission merchants; certain employee benefit plans with total assets exceeding $5,000,000; governmental entities; natural persons with total assets exceeding $10,000,000; and corporations, partnerships, trusts or other entities that satisfy certain criteria.

[12] Such transactions, among other things, must (i) not be part of a fungible class of agreements that are standardized as to their material economic terms; (ii) involve individualized creditworthiness determinations, and (ii) not be traded on or through a multilateral execution facility.

to commercial counterparties who are entering into a transaction for purposes related to their business.

V. Swaps Differ from Futures

The importance of swap transactions to global commerce and finance has been well-documented. Careful tailoring of the nature, timing and amount of a transaction can insulate a swap participant from adverse movements in market prices, reduce its cost of capital or allow it to take a view on market changes. Efficiency gains are created when risks are shifted to those best able to beat them.

These useful transactions, as the Conference Report noted, "may contain some features similar to those of regulated exchange-traded products but are sufficiently different in their purpose, function, design or other characteristics that, as a matter of policy, traditional futures regulation and the limitation of trading to the floor of an exchange may be unnecessary to protect the public interest and may create an inappropriate burden on commerce".[13] Section 3 of the CEA describes the necessity for regulation of "[t]ransactions in commodities. . . [that] are carried on in large volume by the public generally and by persons engaged in the business of buying and selling commodities and the . . . byproducts thereof in interstate commerce". Section 3 notes that such ". . . transactions and prices of commodities on such boards of trade are susceptible to excessive speculation and can be manipulated, controlled, cornered or squeezed, to the detriment of the producer or the consumer. . . rendering regulation imperative for the protection of [interstate] commerce and the national public interest therein".

Several factors clearly differentiate swap transactions from the transactions regulated under the CEA. First, such transactions are not "carried on in large volume by the public generally". Swap transactions are entered into on a customized, privately negotiated basis by sophisticated parties, including governments and government-sponsored entities, commercial and investment banks, corporations, and, to a very limited extent, certain individuals. Second, swap transactions are transactions in which each party assumes the credit risk of the other and thus each party requires specific knowledge about the other. The limits set forth in the Swaps Exemption preclude transactions that are standardized and fungible, i.e., transactions that are capable of being traded in large volumes. In addition, since such transactions are not standardized and fungible, they are simply not capable of being systematically traded on the floor of an exchange.

The exemption of swap transactions from the CEA has promoted economic and financial innovation and fair competition. As stated earlier, swap transactions are used today by a large variety of entities to manage financial risks and develop new opportunities to raise capital. The growth of swap activities has been fueled by demand from these entities for new structures and refinements to address their diverse needs and the ability of swap intermediaries to develop transactions which meet those needs efficiently.

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[13] H.R. Rep. No. 978, 102d Cong., 2d Sess. 80 (1992).

VI. Continuing Legal Uncertainties

Despite the efforts referred to above and the related subsequent legislative and regulatory pronouncements, there continue to be concerns about the legal uncertainty with respect to the inapplicability of the CEA to swap transactions. The first stems from the very nature of the Swaps Exemption as an administrative pronouncement that can be revoked or modified by the CFTC. The recent CFTC actions are evidence that this is a real concern. This leaves open the possibility that direct regulation will be imposed over swap transactions; rendering them illegal except when traded on an organized exchange and enabling parties to privately negotiated derivatives transactions to seek to avoid their contractual obligations by asserting that the transactions are illegal unless they either conform to any new or changed conditions added to the Swaps Exemption by the CFTC or are traded on an organized exchange. This could result in substantial losses to swap participants, including the loss of hedges which companies rely on to manage risk. We have previously testified before this Subcommittee that even the potential for such action could cause disruption to the financial markets. Unless Congress acts, the CFTC's recent actions are likely to have this effect.

Second, the various exemptions from the CEA applicable to swaps have stated that swaps are not "appropriately regulated" as futures under the CEA. However, they have not established with the force of a statute that swaps are not futures. Therefore, problems could arise inadvertently, as the CFTC exercises its enforcement authority. The July 1995 enforcement proceeding against MG Refining and Marketing, Inc. and MG Futures, Inc. (the "MG Enforcement Order") raised such concerns. In the MG Enforcement Order, the CFTC took the opportunity to define "all the essential elements of a futures contract" in a way which was so broad as to encompass practically any privately negotiated cash-settled forward contract, including most swap transactions. Although the CFTC sought on two separate occasions to reassure key members of Congress and industry participants that its orders in these cases were not intended to, and did not, change the scope of the term "futures contract" under the CEA, MG Refining and Marketing, Inc. and MG Futures, Inc. have used the Enforcement Order to attempt to avoid their obligations under unprofitable transactions in litigation. This is an example of the negative impact legal uncertainty can have with respect to undermining the enforceability of swap transactions. Problems like this highlight the fact that the current structure of the CEA is inadequate to provide the requisite degree of legal certainty to swap participants. Repeated episodes of similar events, such as the CFTC's actions during 1998, may lead some to conclude that the United States lacks a sufficiently stable legal framework to continue to function as a center for swap transactions. In fact, the United States has become such a center as a result of the establishment of legal certainty with respect to other aspects of swap transactions, such as the enforceability of master agreement netting provisions in the case of insolvency of a U.S. counterparty.

The possibility that some or a substantial category of privately negotiated derivatives transactions may be interpreted, even inadvertently, to be futures contracts also raises serious concerns with respect to those transactions falling outside the scope of the current or a future revised Swaps Exemption, particularly equity swaps and other swaps based on the prices of securities.

VII. Legal Uncertainties Relating to Swap Transactions Involving Securities Prices

Legal uncertainty is particularly acute with respect to credit and equity swaps. As discussed above, the CEA prohibits the entering into of futures contracts, unless made on or subject to the rules of an approved futures exchange. Therefore, any financial transaction that is a futures contract must either be (i) transacted on an approved board of trade or (ii) exempted from the exchange trading requirement by the CFTC. The CFTC has the power to exempt certain types of financial transactions from the requirements of the CEA under the FTPA, and promulgated the Swaps Exemption based on this authority. The FTPA, however, limits the exemptive authority of the CFTC by prohibiting the CFTC from exempting any futures contracts from the provisions of the Jurisdictional Accord.

Pursuant to the Jurisdictional Accord, the CFTC may not designate a board of trade for futures contracts on individual securities and certain narrowly defined securities indices, and since the CFTC can not issue an exemption for such futures contracts, such futures contracts are essentially illegal. Under the Jurisdictional Accord, the CFTC and SEC were granted jurisdiction, respectively, over futures and securities; futures contracts based on a group or index of securities are treated like other futures contracts under the jurisdiction of the CFTC (i.e., they must be traded on an exchange) and jurisdiction over options on individual securities was granted exclusively to the SEC. As a result, the Swaps Exemption does not cover transactions that are proscribed by the Jurisdictional Accord, and the conclusion that those transactions will not be regulated as futures must instead rest on the Swaps Policy Statement, which provides comfort that transactions within its limit are not "appropriately regulated" as futures contracts. To the extent, however, that swaps ever are deemed to be futures contracts, even inadvertently, (i) swaps on single securities and certain narrow indices or groups of securities could be rendered illegal under the Jurisdictional Accord and (ii) swaps on broad-based groups or indices would be required to be traded on an approved board of trade, which in each case would render a privately negotiated transaction pertaining to such securities, groups of securities or indices, as the case may be, subject to challenge by the parties to the transaction as unenforceable. Such risks have led many participants to enter into such swap transactions on securities prices through off-shore affiliates.

VIII. Legal Uncertainty Relating to Certain Foreign Currency Transactions

The Treasury Amendment, which excludes certain foreign exchange transactions from the CEA, is statutory in nature and broader in scope than the Swaps Exemption. Therefore, unlike the Swaps Exemption, the Treasury Amendment may not be revoked or modified by the CFTC and creates a statutory exclusion from the CEA for the transactions to which it applies.

Nevertheless, a tremendous amount of litigation has arisen with respect to the scope of the Treasury Amendment. Without limiting its benefits to certain classes of participants, the Treasury Amendment excludes from the scope of the CEA "transactions in foreign currency . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade".[14] Ambiguity existed over the potential difference between transactions "in" foreign currency and transactions "involving" foreign currency, giving rise to potential legal concerns,

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[14] 7 U.S.C. § 2, CEA § 1(a)(3).

but was settled in Dunn v. CFTC.[15] However, the meaning of the term "board of trade" continues to give rise to potential legal concerns.[16]

[15] 117 S. Ct. 913 (1997)

[16] In Salomon Forex, Inc. v. Tauber, 8 F.3d 966, the United States Court of Appeals for the Fourth Circuit constructed the "Treasury Amendment" exempting transactions in foreign currency to reach beyond transactions in the commodity itself and to include all transactions in which foreign currency is the subject matter, including futures and options. Id. at 975. This reasoning was subsequently supported by the United States Supreme Court in Dunn. 117 S. Ct. 913 (1997).

IX. Legal Certainty Proposals

The unilateral actions taken by the CFTC in 1998 confirmed that the heart of the legal certainty problem is in the structure of the CEA itself. This means that the legal certainty issue can be clarified with the necessary finality only by Congress. There are several frameworks within which Congress could clarify that the CEA does not apply to swaps transactions. These range from a complete restructuring of the CEA to a more targeted and incremental approach to reform involving the clarification and expansion of exclusions. Both of these reform frameworks would readily accommodate broad regulatory relief for the organized futures exchanges as well as clarification of the legal certainty issues.

Whatever CEA reform framework Congress chooses, there are four legal certainty issues that must be addressed. First, Congress should clarify that the CEA does not apply to swaps contracts and this clarification should extend to all forms of swaps contracts, including credit swaps and those based on securities prices, and not just to contracts described in the Treasury Amendment. Similar statutory clarifications should be provided for so-called "hybrid" instruments that are predominantly securities or depository instruments.

Second, Congress the Treasury Amendment should be retained and clarified in certain respects to assure continued legal certainty that the CEA does not apply to contracts in or involving government securities, foreign currencies and the other contracts enumerated in the Treasury Amendment. For example, the term "board of trade" should be replaced with a more precise concept such as "organized futures exchange" or designated contract market . Congress should also clarify that contracts otherwise excluded from the CEA under either the Treasury Amendment or the proposed exclusion for other swaps contracts will not become subject to the CEA merely because of the use of more prudent "clearing" and settlement arrangements.

Third, the CFTC's 1998 concept release on over-the-counter derivatives envisioned use by the CFTC of the exemptive authority granted by Congress as the basis for a broad range of regulatory burdens. To prevent a recurrence of such agency initiatives, Congress should take affirmative measures to assure that the statutory provisions it enacts to provide legal certainty that swaps and hybrid transactions are not subject to the CEA are not used by the CFTC to impose a broad range of non-legislative regulatory burdens on swaps transactions or on participants in those transactions. The imposition of such regulatory burdens is and should be a matter for Congressional decision and Congress should affirmatively preserve its prerogative to do so.

Fourth, while enactment of the "legal certainty" proposals outlined above will greatly reduce the deterrents to risk management and financial innovation that are inherent in the CEA, these changes are not in and of themselves sufficient. Specifically, Congress needs also to specify with reasonable precision whether there are any circumstances under which the use of electronic facilities will trigger CEA regulation of swaps transactions (or of participants in those transactions) that are otherwise excluded from the CEA under the proposals outlined above. Absent a definitive resolution of these issues, the obvious positive benefits of emerging technologies could well be offset by yet another round of legal and regulatory uncertainty that would in turn deter improvements in risk management techniques and other financial innovations. ISDA is prepared to work with the Subcommittee to fashion an appropriate

"bright line" resolution of these issues that will foster financial innovation in a manner responsive to appropriate public policy concerns.

ISDA appreciates this opportunity to express its views regarding these important issues and would invite any further inquiries from the Committee. If you should have any questions or comments, please feel free to contact any member of the ISDA Board of Directors listed in Annex A.