

# ISDA

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September 12, 2002

Senate Judiciary Committee  
United States Senate  
Washington, DC 20510

RE: S. 2798 (Employee Abuse Prevention Act of 2002)

Dear Senator:

The International Swaps and Derivatives Association ("ISDA") is the global trade association representing leading participants in the privately negotiated derivatives industry. ISDA was chartered in 1985, and today has more than 575 member institutions from 46 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities.

ISDA supports the views expressed by The Bond Market Association (TBMA) in its August 20, 2002 letter to you regarding the Employee Abuse Prevention Act of 2002 (S. 2798/H.R. 5221) (the "Act"). Like the Bond Market Association, ISDA believes that Sections 102, 103 and 105 of the Act will have unprecedented adverse consequences for the financial markets. ISDA is also concerned about the adverse impact of Section 203 of the Act.

## Section 102

ISDA is especially concerned that Section 102 would add a vague, untested federal recharacterization provision to the Bankruptcy Code that, as a result, would create unnecessary uncertainty for over-the-counter derivatives. Section 102 would authorize a bankruptcy court, notwithstanding any otherwise applicable provision of law, to recharacterize any transaction as a secured loan if the "material characteristics" of the transaction are "substantially similar" to the characteristics of a secured loan. Section 102 is both broad and vague. It is very unclear to what extent a transaction will be "substantially similar" to a secured loan, and what characteristics constitute "material characteristics". The vague, untested provisions of Section 102 would cast doubt on the proper characterization of many currently existing over-the-counter derivatives transactions as well as on established methods of collateralizing the risk of nonpayment under these transactions (*e.g.*, one of the English law ISDA Credit Support Annexes is based on the concept of transfer of title to collateral).

The uncertainty created by Section 102 could create systemic disturbances adversely affecting the future growth and development of over-the-counter derivatives activities in the United States. ISDA is not aware of any other major country that would impose a similar recharacterization risk on various types of financial market transactions. This would adversely affect the competitive position of the United States in global financial markets.

Section 103

Section 103 would allow a bankruptcy trustee to set aside even correctly perfected security interests. This would be an enormous expansion of a trustee's rights beyond those that exist under current law. Section 103 would undermine the ability of secured creditors to rely on their security interests in collateral to protect them in the event of a default and would lead to a sharp decrease in credit-based transactions with counterparties that rely on those transactions to manage their business.

Section 105

Section 105 would, by making margin and settlement payments between clearing systems and financial institutions such as banks and broker-dealers vulnerable to avoidance by a bankruptcy trustee, introduce the type of systemic risk into the clearance and settlement system that the protections of the Bankruptcy Code were intended to avoid.

Section 203

We are also concerned with Section 203 in Title II of the legislation. Subordinating the claims of secured creditors (including derivatives counterparties) to certain claims of ERISA pension plan beneficiaries will not achieve the intended goal of creating an incentive for financial institutions to protect their collateral by requiring assurances that a counterparty is living up to its fiduciary obligations. Even if appropriate representations have been made, a secured party can be subordinated if the representations turn out to be false. Instead, this section may raise the cost of credit and will increase risk and uncertainty for all secured parties. These costs far outweigh any possible benefits.

We appreciate your attention to the important issues raised in this letter and urge you to oppose this initiative when it is considered in Committee. Please do not hesitate to contact Stacy Carey, ISDA Policy Director, at (212) 901-6000 with any questions or concerns.

Sincerely,



Robert G. Pickel  
Executive Director and CEO

cc: The Honorable Tom Daschle, Majority Leader  
The Honorable Trent Lott, Republican Leader