



INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

NEWS RELEASE

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Waiver of Mandatory Clearing Requirements for Certain OTC Derivatives Would Reduce Risk, says ISDA

NEW YORK, Monday, November 22, 2010 — The waiver of mandatory clearing requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act for certain OTC derivatives transactions would reduce risk in the financial system and help to achieve the risk-reduction goals of the Act, the International Swaps and Derivatives Association, Inc. (ISDA) said today. ISDA believes that the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) should grant such waivers in limited circumstances where bilateral and/or systemic risk would be reduced.

A swap that is required to be cleared may hedge the market and counterparty risk of a swap that is not able or required to be cleared. In such circumstances, managing both transactions on a bilateral basis reduces risk. The alternative -- clearing one swap through a central counterparty clearing facility (CCP) and managing the other on a bilateral basis -- increases risk between the two counterparties as well as in the CCP and the financial system more broadly. Waiving mandatory clearing for swaps in these specific circumstances would have the effect of reducing risk.

“ISDA is committed to working with policymakers in the US to implement the provisions of the Dodd-Frank Act that pertain to OTC derivatives and to make our markets safer and more efficient,” said Conrad Voldstad, Chief Executive Officer, ISDA. “This specific provision of the Act has unintended consequences that could be damaging to the marketplace and the level of risk in the marketplace. We believe the CFTC and SEC should exercise flexibility in interpreting the Act through rulemaking to achieve its objectives.”

The Association estimates that addressing swaptions, caps and floors would be the biggest reason for waivers. Over \$40 trillion of these transactions are currently reported in the TriOptima Rates Repository, indicating that splitting the risk management of the trades would increase counterparty risk by a significant amount. These products should become eligible for clearing in the relatively near future and once they are, the waivers need not be granted for them.

In addition, the Commissions could put in place reporting requirements and waiver limits to ensure the use of the waivers is not designed to avoid clearing.

Example

The simplest example of a paired trade where one leg is eligible for clearing and the other is not involves a swaption (an option on a swap). A swaption user often buys or sells options to take positions on volatility. In these cases, the swaption user also needs an interest rate swap to hedge the market risk inherent in the swaption. The interest rate swap used to hedge the swaption would be for a notional amount equal to a percentage of the swaption. The maturity and coupon would mirror those of the swap that underlies the swaption but the user would pay fixed on the swap if the user purchased a receiver option and would receive fixed on the swap if he purchased a payer option. If the swap is cleared and the swaption is executed bilaterally, the daily exchange of collateral between the two parties will be greater than what would be needed if the swap was kept with the swaption. In other words, counterparty risk is increased. Similarly, adding an extra swap to the CCP might increase its risk to one or both of the parties.

About ISDA

ISDA, which represents participants in the privately negotiated derivatives industry, is among the world's largest global financial trade associations as measured by number of member firms. ISDA was chartered in 1985, and today has over 830 member institutions from 59 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. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

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