TESTIMONY OF
EDWARD J. ROSEN
ON BEHALF OF THE
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION
BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON AGRICULTURE

"DERIVATIVES MARKETS TRANSPARENCY AND ACCOUNTABILITY ACT OF 2009"

FEBRUARY 4, 2009

Introduction

Chairman Peterson, Ranking Member Lucas, and members of the Committee:

My name is Edward Rosen[1] and I am appearing today on behalf of the Securities Industry and Financial Markets Association (SIFMA).[2] We thank you for the invitation to testify today on the Committee's draft legislation, entitled "Derivatives Markets Transparency and Accountability Act of 2009".[3] My testimony today reflects the views

[1] Mr. Rosen is a partner in the law firm Cleary Gottlieb Steen & Hamilton LLP, testifying on behalf of and representing the views of SIFMA and not those of Cleary Gottlieb Steen & Hamilton LLP.

[2] SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers locally and globally through offices in New York, Washington, DC and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA's mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring and upholding the public's trust in the industry and the markets. (More information about SIFMA is available at http://www.sifma.org).

[3] Draft dated January 28, 2009 (1:08pm).

of SIFMA member firms active in both the listed and over-the-counter (OTC) derivatives markets in the United States and abroad.

Overview

Preservation of the integrity of U.S. markets must be a paramount concern for the public sector and the private sector alike. SIFMA thus appreciates the Committee's current attention to this objective and commends the Committee for the ongoing leadership role that it has played over many years in sponsoring measures necessary to ensure the integrity of U.S. derivatives markets.

SIFMA wholeheartedly endorses a number of the central themes that underpin the draft bill. Specifically, we agree that:

- Regulatory Transparency. Effective regulatory oversight of commodity markets requires appropriate regulatory transparency that ensures timely CFTC access to relevant position information;
- OTC Clearing. The clearance of OTC derivatives can and, we think, will play an important role in mitigating operational and counterparty risks for large segments of the OTC derivatives markets and, where appropriate, should be given a high priority by supervisors and the private sector;
- Speculative Limits. Limits on the size of speculative positions can play an important role in preserving orderly markets; and
- Global, Linked Markets. Listed derivatives, OTC derivatives and physical commodity markets are global and inextricably linked.

We commend the draft bill's focus on these themes.

Nonetheless, SIFMA and its members are deeply concerned by a number of provisions in the draft bill. We believe these provisions do not represent the most effective solutions to current market issues. Instead, we believe these provisions would have profound adverse consequences not merely for OTC and listed derivatives markets, but also for mainstream American companies. Specifically, key provisions in the draft bill would:

- Prohibit the purchase of uncovered CDS protection;
- Require the clearing of all OTC derivatives, subject to limited exceptions;
- Authorize the imposition of position limits for OTC derivatives;
- Prohibit off-exchange trading in futures on carbon credits and emission allowances; and
- Eliminate position limit exemptions for risk management strategies.

We believe these provisions would:

- Deepen the current crisis by fundamentally undermining both the efficacy and availability of listed and OTC derivatives as risk management tools for large and small American businesses, thereby increasing costs, risks and earnings volatility for such companies throughout the economy; the draft bill's CDS-related provisions in particular would significantly and adversely impact access to, and the cost of, financing for American companies, which could lead to continued job losses;
- Increase (and not decrease) the susceptibility of commodity markets to manipulation and disorderly trading and enhance the ability of

commercial traders with a vested interest in commodity prices to influence such prices;

- Impede successful development of cap and trade programs by prohibiting non-exchange derivatives on carbon offsets and emission allowances;
- Preclude pensioners, retirees and those saving for retirement from protecting the real dollar value of their retirement income against erosion from the effects of commodity price inflation through the use of commodity derivatives; and
- Drive the development outside the United States of markets in energy and other core commodities and financial products that are key to the U.S. economy, with the result that, while these markets would have the ability to inform or drive U.S. prices for the affected commodities and products, the U.S. Congress would have no ability to influence these markets.

We believe the potential consequences of these provisions run directly counter to the Committee's own well-intentioned objectives. They also run counter to the efforts of Congress and the supervisory community to address the credit crisis and, if enacted, would almost certainly exacerbate the crisis.

SIFMA understands that there is a need for regulatory reform and that such reform will need to address issues such as regulatory transparency and prudential oversight with respect to OTC derivatives. However, SIFMA strongly believes that any statutory changes in the regulation of OTC derivatives, particularly changes that would have such far-reaching consequences as those proposed in the draft bill, should only be undertaken in the context of broader regulatory reform and should focus on decreasing

risk and improving transparency and efficiency in the OTC derivatives markets, while maintaining the significant benefits these markets currently provide for mainstream American companies and institutional investors.

It is estimated that more than 90% of the 500 largest companies in the world use OTC derivatives.[4] An even greater percentage (94%) of the American companies in this group use OTC derivatives. More than half of medium-sized American companies are estimated by Greenwich Associates to use OTC derivatives.[5] These companies rely on access to OTC derivatives for important risk management purposes (some of which may, but many of which will not, fall within the draft bill's proposed definition of bona fide hedging).

Mainstream American companies in every sector of the U.S. economy, including within the agricultural sector, depend on access to efficiently priced financing in order to make capital investments, purchase inventory and equipment, hire employees and otherwise fund their businesses. The availability of a robust corporate CDS market is essential if lenders are to meet the demand for these borrowings and to be in a position to do so on an efficiently-priced basis.

CDS and other OTC derivatives thus not only play an important market function, they also play a critical role in enabling ordinary companies, outside the financial sector, to manage the risks of their businesses and to obtain the financings necessary to expand, and in many cases to sustain, their businesses. And, as the statistics cited above indicate, significantly more than half of the U.S. economy would be directly and adversely

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4 International Swaps and Derivatives Association, Inc., 2003 Derivatives Usage Survey, http://www.isda.org/statistics/.

5 Greenwich Associates, http://www.greenwich.com.

affected by the inability of professional intermediaries to make these products available and to utilize them themselves.

Against this background and, particularly in the context of the current crisis, it is all the more important that Congress adopt legislative initiatives that preserve the benefits of these products, and access to these products, while carefully targeting those measures that are appropriate to protect the public interest.

Our comments with respect to specific provisions of the draft bill are summarized in the following section.

Section-by-Section Comments

Prohibition of "Naked" CDS (Section 16)

Section 16 of the draft bill would prohibit the purchase of CDS protection by any person who does not have direct exposure to financial loss should the referenced credit events occur. Very simply, the proposed prohibition would effectively eliminate the corporate CDS market.

Although CDS are a relatively recent financial innovation, they have quickly become the most important tool available to banks and institutional investors, such as pension funds, for managing the credit risks arising from commercial loans and corporate bond investments. CDS, which are typically fully collateralized, are the only liquid financial instruments that enable a company exposed to a third party's default risk to manage that credit risk in an efficiently priced market. As such, CDS enable lenders to hedge the credit risks inherent in corporate financings that are essential to economic growth, and, in turn, reduce the cost of funds for borrowers. CDS also free up additional

credit capacity, which enables banks to expand credit facilities available to their corporate clients.

In addition, CDS provide important benefits for other market participants as well. For example, asset managers and other institutional investors use CDS as a liquid instrument through which to obtain credit exposure to particular companies and to adjust their credit exposures quickly and at a lower cost than alternative investment instruments. In addition, many market participants use CDS pricing to provide a more accurate valuation of credit risk than would otherwise be possible by looking solely to less liquid cash markets.

No traded product is subject to a restriction similar to the one proposed to be imposed on CDS by the draft bill. This is not surprising given that the proposal would strictly limit CDS to hedging transactions and would significantly restrict the involvement of professional intermediaries and investors in these products.

As a policy matter, the purchase of uncovered CDS protection is no different than buying or selling futures, options, stocks or bonds because the relevant product is perceived to be undervalued or overvalued by the market. These investment activities are critical to liquidity, reduced execution costs and efficient price discovery in these markets and all involve legitimate and, indeed, desirable investment activities.

Absent the participation of intermediaries and non-hedgers, CDS would cease to trade in a market, and they would become extremely illiquid and costly – both to enter into and to terminate.[6] As a direct result, lenders and investors would be left with far

[6] The proposed requirement could also subject CDS to regulation as a form of financial guarantee insurance, thereby subjecting providers of protection to the additional burdens and inefficiencies of regulation by insurance supervisors in each of the 50 states.

more limited and more expensive alternatives for managing the credit risks arising from their lending and investment activities. In turn, American companies, including those in the agricultural sector, would have significantly reduced access to financing, and the financing that would be available would be more costly. Bank revenues from lending activity would also be reduced, placing further pressure on the financial strength of the banking sector.

The impact of these effects on the credit crisis, and efforts to reverse the credit crisis, are plain.

The OTC derivatives markets in general, and the corporate CDS market in particular, have performed extremely well and have remained liquid throughout the current market turmoil, providing important benefits not only for financial market participants but also for large numbers of mainstream American companies. The corporate CDS market in particular has provided a critical price discovery function for the credit markets, which have otherwise become extraordinarily illiquid during the crisis and, as a result, provide extremely little credit market price discovery apart from corporate CDS. Measures that would interfere with this function would be highly undesirable and would further exacerbate the credit crisis.

The segment of the CDS market in which extremely significant losses have been incurred involved the writing of CDS protection on mortgage-related asset-backed securities; in many ways, a very different product than corporate CDS. The market for CDS on asset-backed securities is also a relatively small segment of the overall CDS market; generally less than 2% of the aggregate CDS market.[7] Losses in this segment

[7] DTCC Deriv/SERV Trade Information Warehouse Reports (data as of the week ending January 23, 2009), http://www.dtcc.com/products/derivserv/data/index.php.

led, in part, to the rescue of the AIG insurance conglomerate and the failure or near failure of many monoline financial guarantee insurers subject to oversight by state insurance supervisors. The losses incurred through these products did not result, however, from flaws in the products; in fact, the products transferred the risk of the referenced asset-backed securities as intended by the parties. These losses were directly related to the unexpectedly large losses in the sub-prime mortgage sector and the leveraging of these exposures through highly structured securities, such as mortgage-related collateralized debt obligations (CDOs – not to be confused with CDS). A number of capital market participants incurred significant losses in the sub-prime mortgage-related CDS and CDO market.

Although some CDS market participants have incurred large losses in connection with corporate CDS, for example, in the case of CDS referencing financial institutions such as Lehman Brothers, the corporate CDS market nonetheless functioned well as a result of effective bilateral mark-to-market collateral arrangements. The private sector's initiative to establish a clearinghouse for CDS will further reinforce the salutary and stabilizing effects of appropriate bilateral collateral arrangements.

The measures proposed in the draft bill would do little to address the regulatory issues actually presented by the failures and near failures resulting from these events; and we see nothing in the events of the recent past that would justify a response in the form of the effective elimination of corporate CDS.

Mandatory Clearing of OTC Derivatives (Section 13)

Section 13 of the draft bill would require the clearing of all OTC derivatives, subject to a very limited exemptive process in the case of products that are infrequently transacted, highly customized, do not serve a price discovery function and are entered into by parties able to demonstrate their financial integrity.

The clearing of OTC derivatives transactions has the potential to provide many important benefits, including the mitigation of operational and counterparty risks and facilitation of regulatory oversight, and should be encouraged where appropriate. However, Section 13 of the draft bill would mandate that all OTC derivative contracts must be cleared, including not only CDS but also other OTC derivatives such as interest rate and currency swaps, the markets for which are also significant and have performed well throughout the current credit crisis, with an extremely narrow exception for certain infrequently traded and highly customized contracts. Such a clearing requirement is unworkable as a practical matter and would adversely affect mainstream American companies and reinforce conditions contributing to the current credit crisis.

As a threshold matter, not all OTC derivatives contracts are suitable for clearing or can be cleared without presenting unacceptable risk management challenges for a clearinghouse, and not all market participants can participate in a clearing system. In order to mitigate its counterparty risk, a clearinghouse must determine the aggregate risk to which it is exposed as a result of its clearing activities and must collect mark-to-market margin, in cash or liquid securities such as U.S. Treasury securities, every day from each of its members with respect to such members' positions in the clearinghouse. In order to do this, the clearinghouse must be able to model the risks associated with the products it

clears and must be able to determine the amount of the market-to-market margin it is to pay or collect each day, a process that requires access to price data. The administrative and financing demands of participating in a clearinghouse on members are significant, and as a practical matter, mainstream American companies that are end users would not participate because they do not have the personnel, operational infrastructure and expertise, nor the cash and securities on hand, to do so. As evidence of this, although exchange-traded interest rate and currency futures are widely available, mainstream American companies are negligible users of such products.

Reliable risk modeling requires statistically robust historical price data sets for each cleared product. Reliable mark-to-market margining, in turn, requires (1) products that are both completely standardized and sufficiently liquid (one or the other of these characteristics is not sufficient) and (2) ready access to reliable price sources. Even where these conditions are present, existing clearinghouses must have developed an approved risk modeling approach in order for market participants to clear their positions without subjecting themselves or the clearinghouse to inappropriate market and counterparty risks.

Against this background, it is clear that a regulatory model that requires market participants to obtain a prior exemption based on highly subjective criteria before they transact would be utterly unworkable, would inject unnecessary legal uncertainty (potentially subjecting transactions to after-the-fact legal challenges), would interfere with the execution of risk management transactions and would impede new product development. Further, as noted above, limitations on the availability of CDS would directly and adversely affect American companies.

While measures to promote standardization can afford risk-reducing benefits, there are many circumstances in which customized solutions will be more appropriate. For example, standardization of products effectively precludes the application of hedge accounting by American companies, as standardization vitiates the ability to structure customized hedges that comply with the requirements of Financial Accounting Standard 133. Without hedge accounting, American companies who do choose to use derivatives would experience significant volatility in their reported earnings, for reasons altogether unrelated to their core businesses. The potential for such volatility in reported earnings would result in less hedging and more risks being borne by companies who are ill-equipped to manage them.

Moreover, the proposed provision is unnecessary and exemplifies the pitfalls of addressing the regulation of OTC derivatives outside of an appropriate comprehensive regulatory framework. As a practical matter, the major OTC derivatives intermediaries (at least in financial derivatives) are subject to supervision by federal regulators, including the Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve System, as national banks, Federal Reserve System member banks or members of bank (or financial) holding company groups. These supervisors have plenary authority to identify those circumstances in which clearing is appropriate and to require such clearing and/or impose capital charges that address any incremental risks that are associated with transactions not so cleared. Indeed, the industry has been working with the Federal Reserve since 2005 on various voluntary initiatives to reduce risk and improve the infrastructure of the CDS market, including the development of a CDS clearinghouse. We believe a model under which these issues are addressed by a direct

prudential supervisor of all systemically significant participants in the OTC derivatives markets is a far more effective approach than, and one that would avoid the significant pitfalls of, a more rigid statutory mandate such as the one included in the draft bill.

Imposition of Position Limits on OTC Derivatives (Section 11)

Section 11 of the draft bill would authorize the CFTC to impose position limits on "speculative" OTC transactions that are fungible with exchange-traded futures. The potential limitation on the scope of permitted OTC derivatives exposures as contemplated by Section 11 of the draft bill would have potentially profound ramifications. The potentially adverse implications of such limits for mainstream American companies are significantly exacerbated by the draft bill's proposed categorization of risk management transactions as "speculative." (See the immediately following discussion of Section 6 of the draft bill.)

The CFTC and the futures exchanges have been able to ensure orderly futures markets through, among other measures, limitations on speculative futures positions without having to limit, for example, off-exchange positions in fungible (i.e., deliverable) physical commodities. It is plain that large physical positions on either side of the market have a far greater potential to disrupt futures markets than do purely notional, financially-settled OTC derivatives. In the absence of such limitations on physical positions, or any perceived need for such limitations, we question the need to impose such limits on purely notional, financially-settled OTC derivatives positions. As noted above, any such proposal for direct and restrictive regulation of OTC derivatives would, in any event, be more appropriately considered in the context of broader regulatory reform.

Elimination of Risk Management Exemption (Section 6)

Section 6 of the draft bill would limit the availability of position limit exemptions for risk management positions other than those held by commercial entities directly engaged in a physical merchandising chain under a highly restrictive definition of bona fide hedging.

The policy rationale for position limit exemptions has historically been based on the inference that a trader who is directionally neutral with respect to the price of a commodity underlying its futures position lacks the motivation to engage in abusive price manipulation. Thus, hedging, arbitrage and spread trading were early examples of cases in which such exemptions were available. As portfolio theory evolved, and financial futures and OTC derivatives became prevalent, a variety of risk management strategies became the basis for similar exemptions.

The draft bill would reject this policy rationale and would arbitrarily subject broad ranges of financial hedging and risk management activity to the limitations applicable to truly speculative positions. SIFMA believes that these limitations would have a profound adverse impact on futures and OTC derivatives markets, on retirees and investors, and on companies seeking to manage the commercial and financial risks to which they are subject.

These adverse effects are all the more troubling in light of the absence of any rigorous analysis of empirical data indicating that the involvement of non-commercial entities in the futures markets has caused the recent volatility in energy and other commodity prices. Indeed, the only rigorous analysis to date of relevant empirical data by the CFTC has reached precisely the opposite conclusion.

Swap dealers and mainstream American companies.

Section 6 of the draft bill would severely restrict the ability of swap dealers to provide customized OTC derivatives hedges to commercial end users and corporations. In most cases, swap dealers use a portfolio approach under which they manage price risk using combinations of physical transactions, OTC financially-settled transactions and exchange-traded futures. Thus, when entering into an OTC swap transaction with a counterparty, the dealer does not necessarily hedge that specific transaction with a specific offsetting transaction in the U.S. futures markets or the OTC derivatives markets. Rather than hedge the price risk created by a specific OTC transaction, the dealer might use the U.S. futures markets or the OTC derivatives markets to hedge the net exposure created by multiple transactions conducted contemporaneously or even at another point in time.

Known as "warehousing risk", a dealer may also enter into numerous or long-dated OTC transactions with a client that is seeking to hedge its price risk. At the time of entering into the transactions, it may not be prudent or possible for the dealer to enter into offsetting transactions in the futures markets or with other OTC dealers. Thus, in warehousing risk, the dealer assumes the price risk from its client and manages it in its trading book using the portfolio approach described above.

By requiring that dealers, in order to qualify for the hedge exemption from speculative position limits, be able to demonstrate that any given position in the futures or OTC derivatives markets (hedged by futures) serves as a hedge against a specific OTC transaction with a counterparty that is itself hedging price risk, the draft bill would prohibit useful and risk-reducing hedging, which clearly runs counter to the public policy

goals of the draft bill, and would significantly limit dealers' ability to effectively intermediate the risks of their end user and corporate clients which, in turn, would likely significantly reduce liquidity in the futures and OTC derivatives markets, increase hedging costs and leave the markets far more susceptible than they are today to undue influence by commercial interests that have a stake in directional price movements. It would also increase hedging costs for mainstream American companies, leaving them more susceptible to price risk and less competitive.

Index strategies.

The draft bill's proposed speculative position limit provisions would limit futures trading that is not, in fact, speculative and that does not have a market impact analogous to speculative trading, and, in turn, could potentially interfere with commodity price formation to the detriment of the markets.

As an example, pension plans and other investment vehicles hold portfolios whose "real dollar" value is eroded by inflation. Investment of a targeted allocation of the portfolio in a broad-based commodity index can effectively "hedge" that risk financially. Such a strategy, like "bona fide" physical hedging, is undertaken for risk management and risk reduction purposes, is passive in nature (i.e., positions are bought in accordance with the index algorithm and asset allocations and are generally held, not actively traded) and is not speculative in purpose or effect. The strategy does not base trading decisions on expectations as to whether prices will go up or down – the strategy is generally indifferent as to whether prices go up or down. The strategy generally leads to trading in the opposite direction of speculators, offsetting their impact: when commodity index levels rise, portfolio allocations to index strategies are reduced (resulting in

selling), when commodity index prices fall, allocations to index strategies are increased (resulting in buying). Over the long term, the strategy acts as a stabilizing influence for commodity prices.

These trends were found by the CFTC in its recent study to be consistent with its analysis of relevant trading data. On the other hand, we are unaware of a rigorous analysis of empirical trading data that supports the correlations that have been alleged between index trading and increasing commodity prices. In addition, investing on a formulaic basis in a broad-based commodity index would be the least effective means of "manipulating" the market for an individual commodity.

Increased susceptibility to manipulation.

By restricting the hedge exemption to commercial entities, the draft bill would, in effect, significantly increase the relative market share of these entities and simultaneously reduce liquidity, by reducing the sizes of positions of traders employing risk management strategies that are truly market neutral. Any proposed legislation on this topic must take into account three basic facts. First, although a commercial user's futures position may be offset by a physical position, commercial entities are almost never price neutral. Second, the category of market participant that is best positioned to influence market prices are commercial users controlling large physical positions. Third, significantly increasing the relevant market share of commercial entities increases the ability of such traders to influence prices.

As a result, SIFMA believes that the draft bill would make the U.S. futures markets far more susceptible than they currently are to price manipulation by commercial traders with directional biases. Indeed, nearly all of the CFTC energy manipulation cases

that have been brought over the last five years have been brought against traders at firms that would be considered commercial entities under the draft bill.

Carbon Offset Credits and Emission Allowances (Section 14)

Section 14 would establish an exchange monopoly for the trading of futures on carbon offset credit and emission allowances and criminalize off-exchange trading in such products.

The most successful, liquid and efficient markets are those in which trading is permitted both on-exchange and off-exchange. Indeed, exchange markets are generally enhanced by the success of related off-exchange markets. Off-exchange trading is also essential for a number of reasons. Off-exchange markets serve as the incubators through which trading terms are able to coalesce around agreed market conventions that promote liquidity and efficiency. This process facilitates the evolution of standardized and liquid products that can be effectively exchange traded. Off-exchange trading also enables derivatives to be tailored to the risk management needs and circumstances of individual companies. Off-exchange trading also facilitates the cost-effective execution of large wholesale transactions for which an exchange environment can be inefficient. Finally, the proposed prohibition would eliminate the fundamental salutary market benefits of inter-market competition – a cornerstone of efficient markets and American capitalism.

As a result, we believe the proposed prohibition would impair market efficiency and impede innovation and the successful development of these products. As a direct consequence of these effects, the proposed provisions would, in our view, undermine

rather than promote the important national policy objective of encouraging the development of successful and efficient trading markets in these important products.

OTC Reporting Requirements (Section 5)

Section 5 of the draft bill would require the CFTC to impose detailed reporting requirements with respect to OTC derivatives. We note that the CFTC currently has the authority to ascertain information regarding the OTC derivatives positions of large traders holding reportable positions in related futures contracts.

SIFMA urges the Committee to avoid the creation of an ongoing detailed reporting regime applicable to OTC derivatives generally, as such a regime has the potential to result in large amounts of, but disproportionately little useful, information, imposing significant costs and burdens on the resources of the private sector and the CFTC alike. SIFMA would not, however, be opposed to a carefully tailored reporting regime (similar to that currently employed by the CFTC) under which the CFTC may require firms to provide upon request targeted information regarding large positions in OTC derivatives that are fungible with exchange-traded futures contracts (or significant price discovery contracts) that are under review by the CFTC as part of its market surveillance function or in connection with any investigation.

Reporting Entity Classification (Section 4)

Section 4 of the draft bill addresses the classification and disaggregation of large position data and would require disaggregation and reporting of positions of swap dealers and index traders. SIFMA supports the classification of position data into categories that

promote the market surveillance function of the CFTC. The distinction between market participants who have directionally biased positions and those that are directionally neutral is a key one in this context. On the other hand, since swap dealers and index traders may fall into either of these categories, it is not clear that the proposed disaggregation would promote the CFTC's surveillance function.

<u>Foreign Boards of Trade (Section 3)</u>

Section 3 of the draft bill would require the CFTC to impose specific rule mandates on foreign boards of trade. Recognizing that our markets are global and inextricably linked, international coordination and harmonization are important objectives. However, these objectives can be better accomplished without the prescriptive imposition of U.S rules on foreign markets. In addition to potentially curtailing U.S. access to foreign markets, any such approach would likely be regarded as imperious and may well invite retaliatory measures that could compromise the ability of U.S. exchanges to compete for international business – currently an important growth segment of U.S. exchange markets.

Conclusion

OTC derivatives markets play a key role in the functioning of the American economy by helping companies, lenders and investors to manage risk and arrange financing. With the limited exception noted above involving the writing of CDS protection on mortgage-related asset-backed securities by AIG and monoline financial guarantee insurers, the OTC markets have performed well and remained liquid

throughout the current market turmoil, providing important benefits for a large number and wide range of companies.

It must be recognized that the consequences of many of the proposed provisions in the draft bill would not fall solely or even most heavily on the professional intermediaries participating in these markets. Instead, the consequences of these provisions would, if enacted, harm very large numbers of mainstream American companies whose financial strength is critical to the welfare and recovery of our national economy.

As noted above, many American companies use OTC derivatives to hedge their cost of borrowing or the operating risks of their businesses. Many of those who do business overseas use OTC derivatives to hedge their foreign exchange exposures. Many companies also hedge their commodity and other price exposures. For many companies, the availability of efficiently priced access to financing and other products depends on access by their counterparties to OTC derivatives such as CDS and interest rate and currency swaps. By limiting or eliminating access to basic risk management tools that American companies routinely use in the day-to-day management of their businesses, the draft bill could have a potentially profound negative impact on these companies and our nation's economic recovery.

Recognizing the importance of OTC derivatives, we continue to support efforts to address the risks and further improve the transparency and efficiency of the OTC derivatives markets. Similarly, recognizing the importance of efficient and orderly exchange markets we continue to support tailored measures to improve the efficiency and integrity of listed futures markets. We look forward to working with this Committee,

Congress and regulators on initiatives designed to improve oversight of OTC derivatives, while maintaining the significant benefits the OTC derivatives markets currently provide, and to promote orderly and efficient exchange markets.

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Edward J. Rosen is a partner based in the New York office.

Mr. Rosen's practice includes domestic and international matters, specializing in the structuring of complex securities and derivatives transactions, U.S. securities and commodities law regulation and financial product development and documentation. Mr. Rosen advises a broad range of market participants, including trade associations, exchanges, clearinghouses, investment banks, commercial banks, brokers, electronic trading platforms, money managers, traders, professional intermediaries and end users, in the U.S. and abroad.

Mr. Rosen has served as counsel to the Securities Industry and Financial Markets Association, the Securities Industry Association, the Futures Industry Association, the International Swaps and Derivatives Association and The Bond Market Association. Mr. Rosen acted as counsel to each of the Derivatives Policy Group and the Counterparty Risk Management Policy Group. Mr. Rosen also served as counsel to and as a member of the Counterparty Risk Management Policy Groups II and III.

Mr. Rosen is internationally distinguished as a "leader" in the field of derivatives by The Best Lawyers in America, Superlawyers, Chambers Global Guide to the World's Leading Lawyers, Chambers USA America's Leading Lawyers for Business and PLC Which Lawyer?.

Mr. Rosen is a co-author of the two volume treatise U.S. Regulation of the International Securities and Derivatives Markets. Mr. Rosen is a member of the International Swaps and Derivatives Association Regulatory Committee, the Board of Directors of the Futures Industry Association and the CFTC Technology Advisory Committee. Mr. Rosen is also on the International Advisory Board of the Oxford University Press Capital Markets Law Journal. Mr. Rosen is a regular speaker, and has frequently testified before Congress, on topics relating to derivatives and financial market issues. Mr. Rosen is the current chair of the Practicing Law Institute Annual Program on Swaps and Other Derivatives.

Mr. Rosen received a J.D. degree from Columbia University School of Law in 1982, where he was a Stone Scholar, and an undergraduate degree with honors from Balliol College, Oxford University, in 1975. He is admitted to the New York State Bar and the U.S. Supreme Court.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2004.

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1. **Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2004, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:**

Source: I have personally received none. **Amount:** ______

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* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

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