

Release: #4142-98

For Release: May 7, 1998

CFTC ISSUES CONCEPT RELEASE CONCERNING OVER-THE-COUNTER DERIVATIVES MARKET

The Commodity Futures Trading Commission today issued a "concept release" seeking public comments to assist it in reexamining its approach to the over-the-counter (OTC) derivatives market. The release was issued as part of a comprehensive regulatory reform effort designed to update the agency's oversight of both exchange and off-exchange markets. The Commission hopes that the comments received will help it in assessing whether its current regulatory approach to OTC derivatives is appropriate or should be modified.

In describing the Commission's action, CFTC Chairperson, Brooksley Born stated, "The substantial changes in the OTC derivatives market over the past few years require the Commission to review its regulations. The Commission is not entering into this process with preconceived results in mind. We are reaching out to learn the views of the public, the industry and our fellow regulators on the appropriate regulatory approach to today's OTC derivatives marketplace."

OTC derivatives are contracts executed outside of the regulated exchange environment whose value depends on (or derives from) the value of an underlying asset, reference rate or index. Market participants use these instruments to perform a wide variety of important risk management functions. Recent industry estimates peg the notional value of outstanding OTC derivatives contracts at over \$28 trillion worldwide.

The CFTC's last major regulatory actions involving OTC derivatives, adopted in January 1993, were regulatory exemptions from most provisions of the Commodity Exchange Act for certain swaps and hybrid instruments. Since that time, the OTC derivatives market has experienced significant changes - dramatic growth in both volume and variety of products offered, participation of many new end-users of varying degrees of sophistication, standardization of some products, and proposals for central execution or clearing operations. While OTC derivatives serve important economic functions, these products, like any complex financial instrument, can present significant risks if misused or misunderstood. A number of large, well-publicized financial losses over the last few years have focused the attention of the financial services industry, its regulators, derivatives end-users and the general public on potential problems and abuses in the OTC derivatives market. Many of these losses have come to light since the CFTC's last major OTC derivatives regulatory actions in 1993.

In view of these developments, the Commission believes it is appropriate to review its regulatory approach to OTC derivatives. The goal of this reexamination is to assist it in determining how best to maintain adequate regulatory safeguards without impairing the ability of the OTC derivatives market to grow and the ability of U.S. entities to remain competitive in the global financial marketplace. In that context, the Commission is open both to evidence in support of broadening its existing exemptions and to evidence of the need for additional safeguards. Thus, the concept release identifies a broad range of issues in order to stimulate public discussion and elicit informed analysis. The Commission seeks to draw on the knowledge and expertise of a broad spectrum of interested parties, including OTC derivatives dealers, end-users of derivatives, other industry participants, other regulatory authorities, and

academicians.

The Commission emphasized that it is mindful of the industry's need to retain flexibility permitting growth and innovation, as well as the need for legal certainty. The release does not in any way alter the current status of any instrument or transaction under the Commodity Exchange Act. All currently applicable exemptions, interpretations and policy statements issued by the Commission remain in effect, and market participants may continue to rely on them. Any proposed regulatory modifications resulting from the concept release would be subject to rulemaking procedures, including public comment, and any changes that imposed new regulatory obligations or restrictions would be applied prospectively only.

The concept release seeks comment on a number of areas where potential changes to current CFTC exemptions might be possible, including eligible transactions, eligible participants, clearing, transaction execution facilities, registration, capital, internal controls, sales practices, recordkeeping and reporting. The release also asks for the views of commenters as to whether issues described in the release might be addressed through industry bodies or self-regulatory organizations.

The release concludes with the following summary of the Commission's request for comment:

Commenters are invited to discuss the broad range of concepts and approaches described in this release. The Commission specifically requests commenters to compare the advantages and disadvantages of possible changes discussed above with those of the existing regulatory framework. In addition to responding to the specific questions presented, the Commission encourages commenters to submit any other relevant information or views.

The concept release will be published shortly in the *Federal Register* and will be subject to a 60-day comment period. [The concept release also will be available on the Commission's Internet web site at http://www.cftc.gov](http://www.cftc.gov). Copies of the concept release may be obtained by contacting the Commission's Office of the Secretariat, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581, (202) 418-5100.