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Chairman Bachus, Ranking Member Frank and Members of the Committee:

Thank you for the opportunity to testify today. As the Committee's hearing demonstrates, there is significant interest and concern among corporations, asset managers, government entities and financial institutions in the US and abroad regarding the impact of new regulatory frameworks that are being proposed or implemented in key jurisdictions.

In my time today, I will focus on the over-the-counter (OTC) derivatives markets, and will discuss the major differences that appear to be developing between US and foreign regulatory regimes. I will also discuss the potential impact of those differences for US financial markets and the US economy.

I would like to begin by making five key points:

- First, ISDA and our members completely support and are committed to a robust regulatory framework for OTC derivatives – one that creates level playing fields across borders for all market participants, for example for US firms doing business abroad and non-US institutions operating in the US.
- Second, we have over the past three years made substantial progress in implementing the most important aspects of that framework – those that address systemic risk issues, such as clearing and trade repositories.
- Third, while we have made significant progress in addressing systemic risk further improvements can and will be made. I should also note that in this area, the systemic risk rules relating to clearing and regulatory reporting, there is great consistency between the US and other major jurisdictions and this is very helpful for market participants.
- On the other hand, my fourth point is that there is far less consensus in the US and overseas regarding matters outside the systemic risk area. These issues relate primarily to

OTC derivatives market structure. They are the subject of considerable discussion and debate, both within the US, and between the US and other jurisdictions. It appears that there will be significant divergences from the US regulatory approach in international regulatory regimes.

- Fifth and finally, in addition to the potentially substantive ***policy*** differences between US and other regulatory regimes, there are equally significant ***timing*** differences between jurisdictions. Given the scope of US reform efforts, it is virtually impossible to determine how different aspects of the new regulations may interact or conflict with each other. And given the pace of those efforts, it is likely that there will be different playing fields between the US and foreign markets for some time. ISDA believes that the application and effect of US law and regulation should be as even handed as possible with respect to both US and non-US financial institutions. Currently, it appears as though this will not be the case.

To summarize, there are large and growing differences in the pace and scope of regulatory reform efforts in the US and other jurisdictions. These differences have less to do with key systemic risk issues and more to do with the structure and functioning of the OTC derivatives markets. They put US financial markets at a disadvantage by driving up costs and reducing liquidity. And they do so without demonstrating any clear benefit to equal or outweigh the considerable costs they impose.

Finally, ISDA is an international organization, representing the interests of firms across the globe and it is important to recognize that conflicting regulatory requirements will affect both US and non-US firms doing business here, which could limit participation by non-US firms in the US capital markets, potentially resulting in lower liquidity as well as business moving abroad.

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I would like to address each of my points in more detail. But before I do, it's important to note that much of my discussion of the regulatory regimes for OTC derivatives in the US, EU and elsewhere is based on our current reading of the proposals that are under consideration. Those proposals may change. In addition, the rule-making process in the US is in full swing. It will be some months before all of the proposed regulations are finalized and longer still until they are implemented and their impact assessed. Both of these factors make it somewhat more difficult to conduct a precise comparison of the different regulatory frameworks that are being developed.

I would also like to point out that we at ISDA are sensitive to the perceptions that surround any discussions or comments that we or other market participants may have regarding the implementation of the Dodd-Frank Act. The financial crisis was but a few short years ago, and our economy and our markets have still not fully recovered. It would be easy for many to dismiss our views as just another effort to block, impede or delay regulatory reform.

With the memory of the financial crisis so fresh in our minds, let me assure the Committee that we do not undertake our commitments to regulatory reform lightly. We recognize their importance and we understand our responsibility to act and speak responsibly.

That is why it is important to state clearly: The International Swaps and Derivatives Association squarely supports financial regulatory reform. What's more, we have worked actively and engaged constructively with policymakers in the US and around the world to achieve this goal.

This, indeed, is our mission: to make over-the-counter (OTC) derivatives markets safe and efficient. And it's one that we have remained committed to since our founding in 1985. ISDA has, for example, helped to significantly reduce credit and legal risk by developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions. The Association has also been a leader in promoting sound risk management practices and processes.

Today, ISDA has more than 800 members from 56 countries on six continents. These members include a broad range of OTC derivatives market participants: asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers, as well as global, international and regional banks.

In the years leading up to and since the passage of the Dodd-Frank Act, ISDA, the major dealers, buy-side institutions and other industry associations have worked collaboratively with global regulatory supervisors to deliver structural improvements to the global OTC derivatives markets. These structural improvements, which have helped to significantly decrease systemic risk, involve three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure.

One of the important ways that ISDA and the industry have worked to reduce counterparty credit risk is by embracing central clearing of derivatives transactions. Currently over 90% of new eligible credit and interest rate derivatives transacted between clearing house members are cleared on central counterparties. The volume of uncleared interest rate swaps has declined 42% between 2008 and 2010.

Another systemically important area of focus for ISDA and market participants is the establishment of trade repositories for the different OTC derivatives asset classes. Trade repositories collect and maintain a database of all OTC derivatives transactions, such databases being available to regulators at any time. They can play an important role in improving regulatory transparency by providing an unprecedented level of market and firm-wide risk exposures to the appropriate supervisors and regulators. ISDA has helped to establish repositories for interest rate, credit and equity swaps and is in the process of doing so for commodity swaps.

To strengthen the industry's operational infrastructure, ISDA and market participants have improved OTC derivatives processing, resulting in greater automation and reduced confirmation backlogs. Electronic confirmation of transactions is increasing across OTC asset classes.

In these and other ways, ISDA and the industry are demonstrating our long-standing commitment to build robust, stable financial markets and a strong financial regulatory framework. Our work is not done yet. Further progress lies ahead, and in fact we have always recognized that there must be a process of continuous improvement across all areas of our markets.

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Let me turn to address the issues that are the main focus of your hearing today.

Today, OTC derivatives market participants are concerned by the potentially divergent approaches being taken in key regulatory jurisdictions. While it is too early to know for sure what frameworks will be adopted in the EU, EC officials have indicated publicly that it is not their intention to change the structure of the OTC derivatives markets. It appears, rather, that the EC is focusing on the key systemic risk issues arising from the financial crisis that have been identified by the G-20 and the Financial Stability Board -- counterparty credit risk, regulatory transparency and operational infrastructure.

These systemic risk issues are, as you know, also the major drivers behind the Dodd-Frank Act. As I noted before, they are where ISDA and the industry are most heavily focused. There is, however, a significant US regulatory emphasis on areas not related to these systemic risk issues. This emphasis may go beyond the statutory requirements of the Act and will create new rules that will adversely affect the existing swaps markets with little apparent benefit. Requirements for the use and structure of execution platforms, capital and margin requirements, and business conduct standards are among the issues that could differ substantially between regimes.

The proposals regarding electronic trading platforms, which we in the US refer to as swap execution facilities (or SEFs) and those in the EC refer to as organized trading facilities (or OTFs) are one example.

In the US alone, there are different requirements proposed by the CFTC and the SEC regarding how derivatives are to be traded on SEFs. Under the CFTC SEF version, swap users requesting price quotes must do so from at least five dealers for swaps transactions that are required to be cleared and possibly traded on a SEF. The SEC SEF rule allows swap users to request a price quote from a single dealer for such transactions.

The CFTC SEF requirement has raised a number of questions among market participants. There is to our knowledge no objective evidence that supports or that indicates why five is the optimal number of dealers from whom quotes should be requested on a SEF. The law itself only specifies that participants have the ability to request quotes from multiple participants. It is widely believed that the requirement will adversely impact the liquidity of OTC derivatives markets and, perhaps most importantly, limit the liquidity available to entities using derivatives to hedge and mitigate risk, such as asset managers and corporate end-users. In addition, it would not offer any significant countervailing benefits. The prices of OTC derivatives transactions that will be cleared -- and which as noted must be traded on a SEF if there is one that makes them available for trading -- are already very competitive. It should be noted that regulatory visibility into trading patterns and risk exposures can already be provided by trade repositories without any downside.

At this point in the process, the CFTC SEF requirement has no regulatory parallel in the EC or other major jurisdictions. Consequently, the proposal could uniquely and adversely impact US markets and US competitiveness.

Similarly, banks operating in the US will be forced to comply with the Section 716 of the Dodd-Frank Act, the so-called "push-out" provision, which has no counterpart in proposed EU or Asian regulations. ISDA supports the removal of Section 716 to resolve inefficiencies, such as loss of exposure netting, that will be created by forcing institutions to conduct their swaps business across multiple legal entities. In addition, non-US firms may have a serious disadvantage with respect to the provision as they do not have the benefit of the Section 716 exemptions now enjoyed by US firms. At a minimum, ISDA believes the Section 716 exemptions should be extended to US branches of foreign banks.

Another important point of divergence relates to new rules regarding business conduct between swap dealers and their customers. The CFTC's proposed rules appear to apply concepts more applicable to the traditional agency role of securities and futures firms and do not recognize that the vast majority of swap counterparties are sophisticated financial market participants or at least have access to sophisticated advisors. The proposed rules would alter the arm's length nature of the relationship between swap dealers and their counterparties, creating confusion regarding the parties' respective responsibilities, and potentially resulting in severe market disruption, at least for certain type of counterparties. For example, in their current form, the new standards could effectively preclude participation in the OTC swap markets by pension plans, municipalities and other "Special Entities;" introduce substantial and unnecessary uncertainty and litigation into the swap markets; and subject market participants to unnecessary costs, execution delays, and risks. Furthermore, these standards go well beyond the protections required by the statute and are counter to Congress' intent of maintaining a robust and competitive US derivatives market. They also go well beyond the regulatory framework contemplated in other jurisdictions.

Another key area of potential divergence relates to clearing rules for transactions between affiliated institutions. Inter-affiliate trades are used for internal hedging and risk management, and do not increase systemic risk as such trades are not executed with external counterparties.

European policymakers are discussing an exemption for transactions between related EU affiliates from mandatory clearing requirements. The current US framework would not. In fact, given the Section 716 requirements of the Act, inter-affiliate trading is likely to increase. This means that two subsidiaries of a single US financial institution, and potentially two subsidiaries of a non-US firm, that engaged in a swap transaction could be required to post margin on that transaction, and potentially be required to centrally clear the transaction. In effect, this means that firms active in the US would need to post collateral and clear transactions with themselves. We believe that these provisions should not apply to inter-affiliate transactions of any financial institution. Inter-affiliate trades should be excluded from most Title VII requirements as their inclusion will only increase costs and burdens for US financial institutions and of trading in the US markets.

The potential solution for these areas of divergence is to build a rational dialogue around consideration and adoption of the well-considered positions of other countries. This would mitigate the negative impact to the US markets described earlier. In other situations where non-US proposals create potentially negative impacts, a solution would be to request harmonization of the non-US rules to US regulator proposals if our proposal causes less detriment and greater protection to the markets.

The final area of divergence that I would like to discuss today relates to the previously obscure issue of extraterritoriality, which has taken on added stature in recent weeks. There are today large and growing concerns regarding the applicability of the Dodd-Frank Act outside of the US. Concerns around the extraterritorial scope of Dodd-Frank are already creating a great deal of uncertainty among market participants about whether and how to implement a new regulatory framework that may duplicate or conflict with that of their parent country. For instance, if derivative transactions between an Italian company and the UK subsidiary of a US bank were subjected to transaction level Dodd-Frank rules, but similar transactions between that Italian company and a UK bank without a US parent were not subject to those same rules, the end result would be that foreign companies would avoid doing business with swaps dealers affiliated with US companies. They would instead transact with financial institutions not covered by the scope of these margin requirements. It could put US markets at a serious competitive disadvantage.

Adding to the uncertainty are new rules issued by federal regulators on margin requirements that included provisions regarding extraterritorial application of those requirements, at least for swap dealers subject to prudential regulation. These rules would create significant issues for swap dealers affiliated with US holding companies and unnecessarily drive up the expense for foreign companies doing business with these swaps dealers.

The extraterritoriality proposals are inconsistent with Congressional intent regarding the territorial scope of the new regulatory framework for derivatives. Congress included provisions in Dodd-Frank that explicitly instruct regulators to impose the regulations outside the US only if there is a "direct and significant connection" with US activities or commerce or as necessary to avoid evasion of Dodd-Frank. These provisions are intended to appropriately balance the protection of the safety of the financial system with the competitiveness of US institutions, which is also necessary for a healthy US banking system.

Disadvantaging foreign institutions and US subsidiaries of such institutions, through divergent capital requirements or otherwise, discourages foreign investment in US subsidiaries, which leads to fewer jobs and to less competition within our shores. Such divergent treatment also creates the potential for retaliatory measures abroad, thus limiting opportunities and creating a hostile market environment for both US- and foreign-based firms.

Unlike the potential solution for the first few issues, the solution here is to recognize rational limits on the extent to which US rules can govern offshore transactions. The goal should be a level playing field and the recognition that other jurisdictions will also have comprehensive and complementary regulatory regimes, even if not the same as ours.

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Each of the issues I have discussed reflects potentially important differences in policy across jurisdictions. These differences could significantly disadvantage participants in the US OTC derivatives markets – be they financial institution dealers (US or non-US), pension funds managing their risk and investment returns, corporations hedging their interest rate exposure, or energy firms managing their exposure to volatile commodity prices.

In addition to these policy differences, there are also important differences in timing that could significantly impact US financial markets. The fact that firms based or doing business in

US markets will be subject to a new regulatory framework well before a complementary framework is established in other key jurisdictions is itself a cause for concern. The potential for that US framework to inadvertently create an uneven playing field for the US markets adds to those concerns. So too does the prospect that some firms active in the US markets may have to comply with two sets of regulatory regimes. Ultimately this could lead to increased costs, decreased liquidity and a reduction in the overall availability of capital in the US markets.

As we all know, the volume of rulemakings in the US is very large, the rules are complicated, and there are significant interdependencies among many of them. Dealers and swaps market participants will need to devote significant resources to adapting to and implementing these new rules over the next few years. To make matters worse, many market participants do not yet know whether or how or when the new rules will apply to them. The scale of change required in the swaps market by the Dodd-Frank Act, including new trading, reporting and clearing requirements, registrations, compliance regimes, and documentation requirements cannot be overstated.

It's clear that additional time is required to review and evaluate the full mosaic of the proposed new rules. The CFTC's decision to reopen Title VII comment periods for 30 days is a step in the right direction. However, simply re-opening the comment period does not provide any insight on how the extensive prior comments on the original proposals may have influenced the Commission's thinking in crafting final rules. The comment period re-opening cannot replace the value of allowing consideration of how the thousands of comments will be incorporated into the rules, and how such re-proposed rules will interact and come together in an overall framework for market infrastructure. So it is essential that market participants have an opportunity for additional review and comment on the entire revised set of rules which the Commissions will publish after evaluating comments received.

In addition to the need for a second or subsequent comment period on rule proposals, there is also a significant need for a rational, appropriate phase-in of implementation of the rules across markets and market participants. The former will be essential so that rules are appropriately tailored, work in tandem, and avoid unduly impairing market liquidity or adversely impacting investors. The latter is about enabling market participants to implement the changes most effectively. Both issues are, however inter-related: it is not enough to phase-in implementation if the final rules themselves are unworkable or in conflict.

ISDA supports efforts to provide policymakers and market participants with additional time needed to weigh the individual and cumulative impact of the proposals, as well as their costs and benefits. This would help to ensure that US markets and their competitiveness are not unintentionally harmed by any aspects of the proposed rulemakings.

We have developed, and have discussed with the Commissions, suggested approaches that would phase in the implementation of new rules. Our approach is based on a series of key principles that we believe should govern the implementation schedule. We have outlined these principles in detail in a letter to the Commissions. To summarize them, ISDA believes that:

- Sufficient time should be granted to market participations to implement the final rules so as to avoid market disruptions;
- Our first implementation priority is providing regulators with enhanced transparency through the trade repositories;
- Requirements should be phased in by type of market participant and asset class;
- Systemically important initiatives should be phased in first;
- We need to allow adequate time for these changes to flow through to customers; and
- Regulators should rationalize how they implement different rules.

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It's clear that we are entering a new era of finance – and of financial regulation – in the US and abroad. ISDA supports public policy and industry efforts to build a more robust, stable financial system in which safe, efficient OTC derivatives markets enable more effective risk, investment and financial management.

As we work to do so, it is vitally important that the competitiveness of the US financial markets stay top of mind. Financial institutions, pension funds, asset managers, corporations, energy and commodity companies and others routinely use OTC derivatives. According to our research, over 90% of the largest US companies use OTC derivatives to manage their business and financial risks.

OTC derivatives play an important role in the American financial systems and the American economy. While we are all supportive of initiatives that decrease systemic risk, policy differences that impose significant costs but offer few, if any, offsetting benefits may lead to increase costs, decreased liquidity, a reduction in growth capital, the erosion of US competitiveness and the loss of jobs in the US financial markets. Although the US remains one of the most dynamic, innovative marketplaces in the world, we note that transaction volume in London already exceeds that in New York. We also note that the five largest US-based dealers reported a notional amount outstanding equal to only 37% of the total notional amount for interest rate, credit, and equity derivatives globally.

The best way to avoid many of the issues that I have discussed, and to protect the competitiveness of US markets, is to work with the EU and other overseas jurisdictions towards a convergence of the rule sets and a convergence of the timelines for implementation, thus reducing the impact of any temporary or permanent regulatory differences between the US and other financial markets and mitigating the damage that these differences will cause.

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