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SECURITIES AND EXCHANGE COMMISSION
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COMMENT

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September 11, 1998

COMMODITY FUTURES TRADING COMMISSION
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Ms. Jean A. Webb
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Concept Release Regarding Over-the-Counter Derivatives

Dear Ms. Webb:

On May 12, 1998, the Commodity Futures Trading Commission ("CFTC") published for public comment a concept release containing a series of questions regarding the CFTC's approach to the over-the-counter ("OTC") derivatives market ("Concept Release"). The Securities and Exchange Commission ("SEC") appreciates the opportunity to comment on the issues raised in the Concept Release. The SEC believes that issues relating to the federal regulation of transactions involving OTC derivatives involve significant questions of public policy that require the attention of Congress, members of the financial regulatory community, and interested industry participants. For the reasons discussed below, the SEC has several concerns with the Concept Release.

OTC derivative instruments provide significant benefits to corporations, financial institutions, and institutional investors by allowing them to manage risks associated with their business activities or their financial assets. Because of the range of benefits these products offer and the careful approach to regulation taken by Congress and U.S. financial regulators, the OTC derivatives market has grown significantly during the past two decades. Up to this point, the regulatory approach to the OTC derivatives market has focused on promoting legal certainty for OTC derivative transactions and encouraging the development of sound industry practices, while at the same time building consensus among U.S. financial regulators through their participation in the President's Working Group on Financial Markets ("Working Group").

The Concept Release deviates from this approach by raising the possibility that the CFTC would apply a comprehensive regulatory regime to transactions involving swaps and hybrid instruments as a condition for exempting such products from the requirements of the Commodity Exchange Act ("CEA"). Such a regulatory regime would necessarily be based on the CFTC's conclusion that swaps and hybrid instruments are futures contracts and, as such, are subject to CFTC jurisdiction under the CEA. Consequently, the CFTC's action may actually increase the legal uncertainty concerning swaps and other OTC derivative instruments and, thus, destabilize what has become a significant global financial market by increasing fears of market participants that their counterparties may attempt to repudiate trades that they argue are illegal off-exchange futures. This uncertainty and added concerns about the imposition of new regulatory costs may ultimately stifle innovation and push OTC derivative transactions offshore.

As suggested above, the Concept Release sets out a broad agenda for potential regulation of the OTC derivatives market and implies that the CFTC has jurisdiction over this market. For several reasons, we question whether the CFTC has jurisdiction over OTC derivatives. The SEC believes that traditional swaps that are not traded through a multilateral transaction execution facility are not futures and are not subject to regulation under the CEA.[1] We also have serious doubts as to the CFTC's ability to regulate appropriately OTC markets because the CEA provides for the regulation of exchange-traded futures, and off-exchange futures transactions are illegal under the statute.

The CEA should not be used as a foundation on which to build a system of regulation for the OTC derivatives market. Because of the difference in goals between exchange markets for futures and OTC derivatives markets, the CEA should be interpreted as providing for exclusive CFTC jurisdiction only over futures contracts that are traded on an exchange. For example, it is critically important to prevent manipulation of exchange markets that perform a price setting function. The OTC derivatives market does not set the price of underlying cash commodities. We believe that this difference should be acknowledged in the regulation of these two markets.

We also disagree with any plan by the CFTC to regulate the OTC derivatives market through exemption. In enacting the Futures Trading Practices Act of 1992, Congress gave the CFTC broad exemptive authority regarding OTC swap transactions. Congress granted this authority to the CFTC without making any determination regarding the status of swaps and other OTC derivative instruments under the CEA. We disagree with the potential exercise by the CFTC of its exemptive authority as a means to regulate areas that have not been determined by Congress to fall within the CFTC's authority.

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1 See Letter dated Jan. 4, 1993 from Jonathan G. Katz, Secretary, SEC, to Jean A. Webb, Secretary, CFTC, commenting on proposed rules regarding the regulation of swaps and hybrid instruments.

The SEC believes that questions relating to what kind of regulation, if any, is appropriate for the OTC derivatives market are ones that should not be addressed by an agency acting under a statute intended to govern only exchange trading in futures and commodity options. Instead, to protect the market from unreasonable and potentially harmful legal uncertainty, the Working Group clearly should study the issues raised by activities in the OTC derivatives market and develop appropriate recommendations to Congress. Congress would then be in a position to decide on a proper regulatory course of action to ensure the continued growth and strength of the OTC derivatives market.

The SEC appreciates this opportunity to set forth its views on these important issues.

By the Commission,

Jonathan G. Katz
Secretary