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International Symposium on Derivatives and Risk Management

Alan M. Rechtschaffen

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FOREWORD

INTERNATIONAL SYMPOSIUM ON DERIVATIVES AND RISK MANAGEMENT

*Alan N. Rechtschaffen**

Fordham University School of Law and the Fordham Institute on Law and Financial Services were pleased to sponsor once again the International Symposium on Derivatives & Risk Management. The 2000 faculty includes judges, regulators and attorneys. These discussions allow world leaders to exchange ideas about markets and regulatory constructs affecting the world economy. The Fordham Symposium has become an integral part of the financial landscape as a source of information and innovation in the capital markets.

The derivatives market is one of the largest financial markets in the world. Companies use the capital markets and derivatives¹ as part of a comprehensive program of managing market, credit, and financial risks. Derivatives may also be used as a means of increasing yield. The market for Over The Counter² ("OTC") derivatives has expanded steadily and rapidly over the past two decades. According to data from the Bank for International Settlements, outstanding OTC derivative contracts were estimated at the end of 1998 to total \$80 trillion, reflecting an increase of 11 percent from June of the same year.³

Because derivatives are highly leveraged, a severe market condition, which might occur in a remote part of the world (while most domestic regulators are asleep), might have a profound effect on the financial stability of the domestic economy. Innovation, the speed

* Professor Alan N. Rechtschaffen is a member of the Fordham University School of Law faculty. Professor Rechtschaffen conceived of and chairs the Fordham University School of Law's International Symposium on Derivatives & Risk Management.

1. Derivatives are contractual agreements that fluctuate in value based on price changes in an underlying commodity, interest rate, index, or other investment. They are generally highly leveraged financial contracts.

2. Over-The-Counter are derivatives contracts negotiated between counterparties outside of the framework of a recognized board of trade or regulated exchange (e.g., the Chicago Mercantile Exchange).

3. See Report of The President's Working Group on Financial Markets: Over-the-Counter Derivatives Markets and the Commodity Exchange Act 4 (1999).

of information and transaction flow, and tools of risk management can increase not only the resiliency of world markets but also the speed at which problems are transferred from market to market. Regulators must be ready to react to global market changes quickly, 24 hours a day.

Global banking systems and international economies are more interconnected today than ever before. The improvements in communication and financial innovation have increased the effects of market disruptions anywhere in the world on the global economy. In 1997 and 1998, the tumultuous effects of events in Russia, Asia, and South America made this apparent. Risk managers must have the tools to deal with risks resulting from international market moves.

Risk managers must be able to engage in derivatives transactions without fear that legal uncertainty will impact their risk management decisions. A cloud of legal uncertainty has hung over the OTC derivatives markets in the United States in recent years, which, if not addressed, could discourage innovation and growth of these important markets and damage U.S. leadership in these arenas by driving transactions off-shore. Recognizing the important role that derivatives play in our financial markets, and the dangers of continued legal uncertainty, Congress is currently seeking to amend⁴ the Commodity Exchange Act⁵ to accommodate new financial innovation and market participation.

The Commodity Futures Modernization Act of 2000 would reauthorize the Commodity Exchange Act for five additional years and would reform the Commodity Exchange Act in three primary ways. First, it would incorporate the unanimous recommendations of the President's Working Group on Financial Markets on the proper legal and regulatory treatment of OTC derivatives. Second, it would codify the regulatory relief proposal of the Commodity Futures Trading Commission to ensure that futures exchanges are appropriately regulated and remain competitive. Lastly, this legislation would reform the Shad-Johnson jurisdictional accord, which banned single stock futures.⁶ The new Act's primary goal is to create legal certainty in the OTC derivatives market thereby fostering sound risk management practices.

As legislators in Washington recognize derivatives as a seamless part of sound risk management strategies, state regulators are expanding regulatory constructs to accommodate new market participants. For example, state legislatures across the country are granting expanded authority to insurers to engage in derivatives practices. This new authority is recognition of the need to trade in

4. See Commodity Futures Modernization Act, S 2697, 106th Cong. (2000).

5. 7 USC § 1 (1994).

6. See Testimony of Senator Richard Lugar at www.senate.gov/~agriculture/Legislation/106_Leg/ceaf1ste.htm

derivatives as part of overall investment activities. Use of derivatives by insurers has been increasing exponentially since the granting of this authority. Insurers now use derivatives to reduce risk on both sides of the balance sheet and to increase yield. The insurance departments play an increasing role in setting the parameters for derivatives practices.

In this issue, The Fordham Law Review memorializes the speech given by the Superintendent of Insurance of the State of New York at the Fordham International Symposium on Derivatives and Risk Management 2000. The publication of this speech is a part of the continuing effort⁷ by Fordham University School of Law to serve a leadership role in the evolution of derivatives and risk management regulation. Superintendent Levin's speech gives the reader unique insight into the future of state regulation of risk management practices.

In upcoming issues, speeches from Federal regulators, such as Governor Laurence Meyer, Member of the Board of Governors of the Federal Reserve System, will give the reader insights into the regulatory focus of Federal regulators and legislators. Fordham's Symposium plays an important role in the evolution of increasing market efficiency. By publishing the proceedings of this meeting, the Fordham Law Review continues a tradition of helping to preserve market integrity while helping industry attain greater efficiency.

7. Under the direction of Professor Rechtschaffen, Fordham Law School was one of the first schools in the country to offer a course on Derivatives & Risk Management.

Notes & Observations