

# THE FINANCIAL SERVICES ROUNDTABLE



## *Financing America's Economy*

To: Representatives of the Financial Services Roundtable, GAC, Public Affairs Council, Research Council, All Staff

### **Fast Facts: DERIVATIVES & THE DODD-FRANK ACT**

**FACT:** Thousands of American businesses use derivatives to hedge interest rate risk, foreign exchange risk, commodity price risk, etc.

- In testimony before the [House Financial Services Committee on February 15, 2011](#), Craig Reiners, Director of Risk Management for MillerCoors, spoke of the use of derivatives by end-user companies as “critical to reducing commercial risk and volatility in our day-to-day business operations, allowing us to create sustainable and prosperous businesses.”

**FACT:** There are two main categories of derivatives: (1) Over-the-counter (OTC) derivatives, which are traded directly between two parties without an intermediary; (2) Exchange-traded derivatives, which are publicly traded in a market setting with standardized contracts.

**FACT:** The Dodd-Frank Act mandates that most OTC derivatives to be cleared at a clearing house and traded on an exchange or a Swap Execution Facility (SEF) to bring transparency to the market.

**FACT:** There are over 50 rules that have to be made by the SEC and CFTC by July 2011 concerning derivatives as required by the Dodd-Frank Act. Thus far, the CFTC has issued 35 rules for comment that in the Federal Register.

**FACT:** On March 16, 2011, [CFTC Chairman Gary Gensler spoke](#) before the Futures Industry Association and described derivatives reform as occurring in three phases – early, middle, and late. Derivatives products will not be defined until the late phase, meaning that market participants will be asked to adhere to rules without knowing what products are impacted.

*Attached is a derivatives “cheat sheet” that describes the different types of derivatives and asset classes.*

As always, please do not hesitate to contact Abby McCloskey, Director of Research at the Financial Services Roundtable, at [Abby@fsround.org](mailto:Abby@fsround.org), or Scott Talbott, Senior Vice President of Government Affairs, at [Scott@fsround.org](mailto:Scott@fsround.org).

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March 2011



### Derivative Cheat Sheet

**Definition:** A derivative is an instrument whose value is based on or “derived” from one or more underlying assets or another financial instrument, such as currencies, commodities, indices, or published rates.

#### Basic types of derivatives

- **Forward:** An agreement entered into today to buy or sell a specified asset at a specified future date for an agreed ‘forward’ price.
  - Swaps are a series of forward contracts while futures are forward contracts with standardized terms that trade on an exchange.
- **Options:** Gives the holder the right to enter into a financial transaction at some point in the future at a predetermined level.
  - **Call** – Right to buy
  - **Put** - Right to sell

#### Major asset classes

- **Interest Rate** – “**Interest Rate Swap**” or “**Basis Swap**”- Used to cover interest rate exposure
- **Credit** – “**Credit Default Swap**” - Used to transfer credit risk of an asset without transferring ownership of the asset
- **Equity Swaps** – Used to transfer risk associated with equity exposure.
- **Foreign exchange** – “**FX Swap**” - Used to manage short-term and long-term exposure to foreign exchange rates.
- **Commodity** – e.g. “**Energy, Metal, or Agricultural Swaps**” – Used to transfer price risk associated with such markets as agricultural goods and products as well as energy and metals.

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