Prepared Remarks

of

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for

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Panel Two: Margin Considerations

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My name is James Cawley. I am Chief Executive Officer of Javelin Capital Markets, an "all to all" trade execution venue for interest rate and credit default swaps that expects to register as either a Swap Execution Facility or DCM once the rules are finalized.

Thank you for inviting me here to participate today.

Economic Equivalence

Swaps and futures on swaps are economically equivalent to each other and should be margined essentially the same way within the clearing house. Swaps and their futures cousins trade in the same currency, are benched off the same index, Libor, and are expected to be used interchangeably by market participants for hedging or speculative purposes.

To be sure, in certain instances, the Interest Rate Swap future accepts physical delivery of the underlying swap itself. In fact, such economic equivalence is confirmed by the fact that, to trade such a physical delivery swap, you must open and maintain a swaps clearing account and be prepared to accept it's delivery. That swaps and futures on swaps should be measured in the same way is underlined by the fact the margin calculation can flip from one day VAR calculation to a five day VAR —which is the VAR calculation of the underlying swap---upon

delivery. We argue then, that such a future on a swap might be nothing more than a forward swap agreement and thus both should be margined the same way.

There are those who argue that swaps and futures are swaps are different because futures represent fewer line items in the clearing house and swaps represent hundreds; or even thousands. Thus swaps could be more difficult to liquidate in a distress scenario.

This may be a red herring. It is well established that swaps trade and are risk managed—not widget like, where each swap is individually hedged using exactly similar swaps, but on a more holistic or portfolio basis where each swap is managed against the curve, where risk and liquidity are viewed on a more continuous or economically equivalent basis. It is expected that market practitioners will risk manage swap futures exactly the same way, irrespective of line count.

Moreover, as history has shown—moving portfolios from seller to buyer in distress scenarios has become more routine over time—whether it be Orange County in the mid 90's or most recently AIG and Lehman, irrespective of line count.

And if line count is the issue—shouldn't swaps that trade to specific IMM dates and have fixed coupons with upfront cash amounts, clear on the exact same margin as futures do? Both would, by definition, have the same reduced count of line items in the clearing house.

Additionally, there are those who argue that swaps and futures on swaps should clear on different margins, because futures are more liquid than swaps. But is this really the case? Consider this. Yesterday, the total notional traded in Libor based swaps futures was a combined $153 million. In the dollar swaps world, it is estimated that $200 Billion notional traded for the same day. Interest rate swaps are more liquid by a ratio of 1,300:1.

For swaps and futures on swaps to have different margin calculations, also has considerable policy implications. If for one product, the margin calculation is much lower than other, which is correct? What happens to the clearing house, in the distress scenario, if it becomes evident that not enough margin was collected against the lower margined product? Does the tax payer now enter the breach to cover the shortfall because DCOs have miscalculated and they been deemed systemically important?

Or consider the product with higher margin collected against it. Could it not be the case that users of such a product are being unfairly penalized, as too much margin is collected against their trades. As a consequence, does this not force market participants out towards the cheaper market unfairly?

In conclusion, the Javelin supports the open and fair development of both markets. In fact, the creation of a new product that adds liquidity to the market place should be welcomed. But it should be done –in such a way –that protects systemic integrity, competition and the end user.

The Commission should adopt a more flexible margin approach that more accurately considers the fact that both swaps and futures on swaps are economically equivalent; where their risk characteristics are the same, but may also change over time. Both products should clear on similar margin calculations. To be sure, liquidity should be a consideration. But it should also be recognized that liquidity will change for both products as the market democratizes and becomes more transparent and competitive. Swaps, already liquid, will increase in volume as more dealers compete and new liquidity providers enter the space along with new execution venues, such as all-to-all limit order books. The Commission should

immediately pass SEF rules, but as an interim step stall out further certification of swap futures until it has had time to consider their full implications.

Thank you and I look forward to answering any of your questions.