COMMISSIONER J. CARTER BEESE, JR.*
U.S. SECURITIES AND EXCHANGE COMMISSION

EXCERPTS FROM REMARKS BEFORE
1993 SIA GOVERNMENT RELATIONS CONFERENCE

WILLARD INTER-CONTINENTAL HOTEL
WASHINGTON, D.C.
MARCH 17, 1993

* The views expressed herein are those of Commissioner Beese and do not necessarily represent those of the Commission, other Commissioners, or the staff.

U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
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The OTC derivatives market. **This is not just an exclusive club of cutting-edge players anymore.** These customized products can:

-- provide businesses far more effective risk management tools than have been available in the past;
-- allow investors to create more perfect hedges against their portfolios than they can with standardized products; and
-- allow purchasers to use derivatives as surrogates for investment in underlying markets.

Skeptics dismiss the OTC derivatives market as just more financial hocus, pocus from Wall Street rocket scientists. But I think they miss the point: these products manage risk.

The most important issue for regulators and the market to confront is the risks these products present. They must be controlled and accounted for. Our goal should be to assure that we have innovative, but stable, markets and our challenge is to devise effective capital rules that are appropriate to this market. The SEC is now in the middle of a comprehensive examination of our capital rules for derivatives. **I hope that the Commission will release a concept release this Spring.**

The best thing that can come of this examination is a way to address the credit risk these transactions present. In addition, we will also very likely change the way we treat the market risk inherent in options and futures positions. We are very likely to shift away from a strategy-based approach toward a portfolio-based approach.

As for credit risk, it's less clear what our ultimate resolution will be. One approach that I'm intrigued with is applying a capital charge based on some percentage of the broker-dealer's total exposure to all counterparties. We could combine such a charge with a concentration charge based on the counterparty involved. Such a charge could be tiered in relation to the credit rating of various counterparties. In addition, I believe that we should give firms credit for mark-to-the-market and collateral arrangements.

I strongly encourage you to respond to the concept release when it is issued. **If we are going to arrive at a solution that <u>both</u> assures that broker-dealers are adequately capitalized <u>and</u> removes the disincentive to do this business in the broker-dealer, then we will need good, thoughtful comments from the industry.**