An Unfinished Mission: Making Wall Street Work for Us

AMERICANS FOR FINANCIAL REFORM and THE ROOSEVELT INSTITUTE

Toward an Understanding of the Use of Derivatives by End Users

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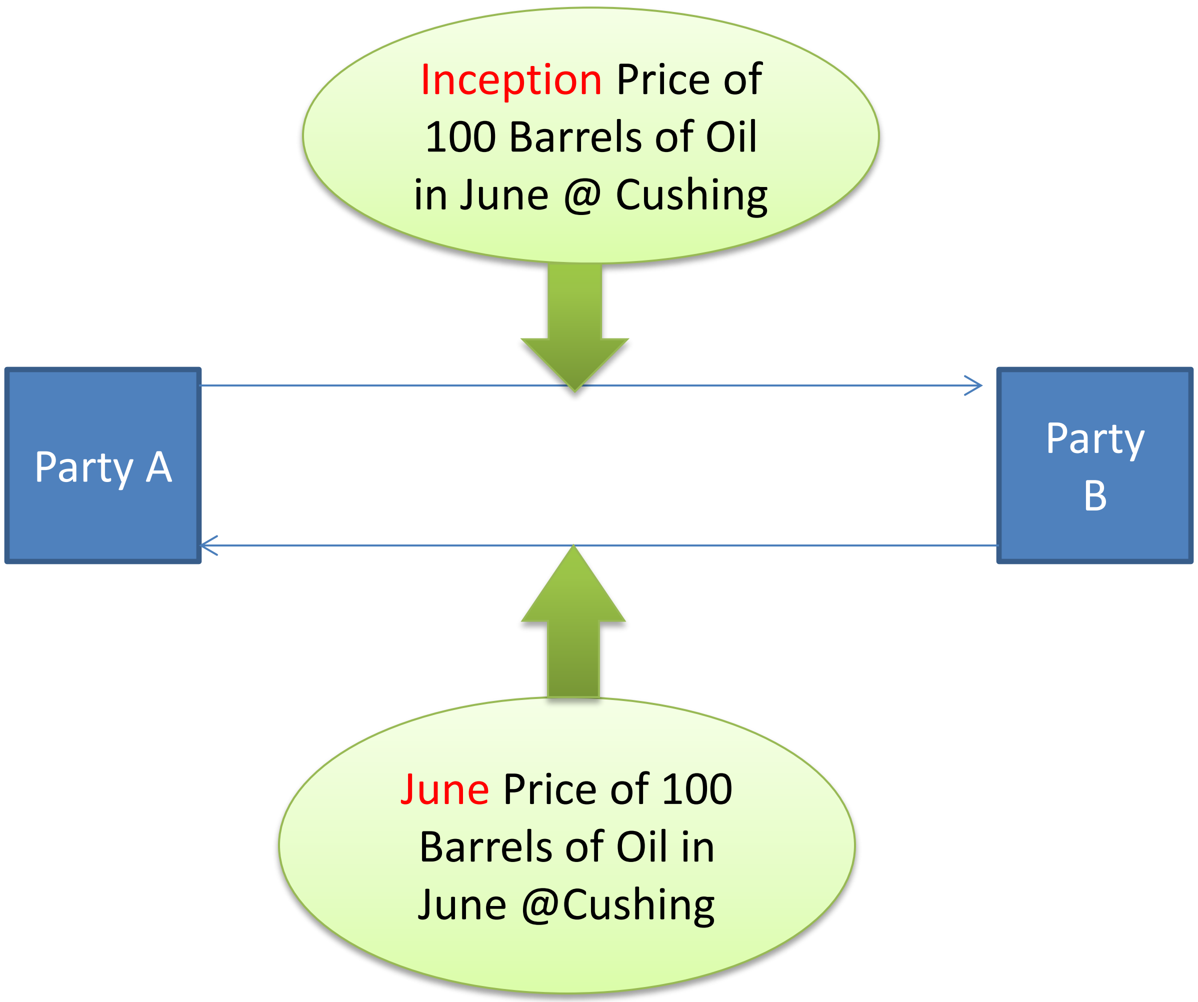
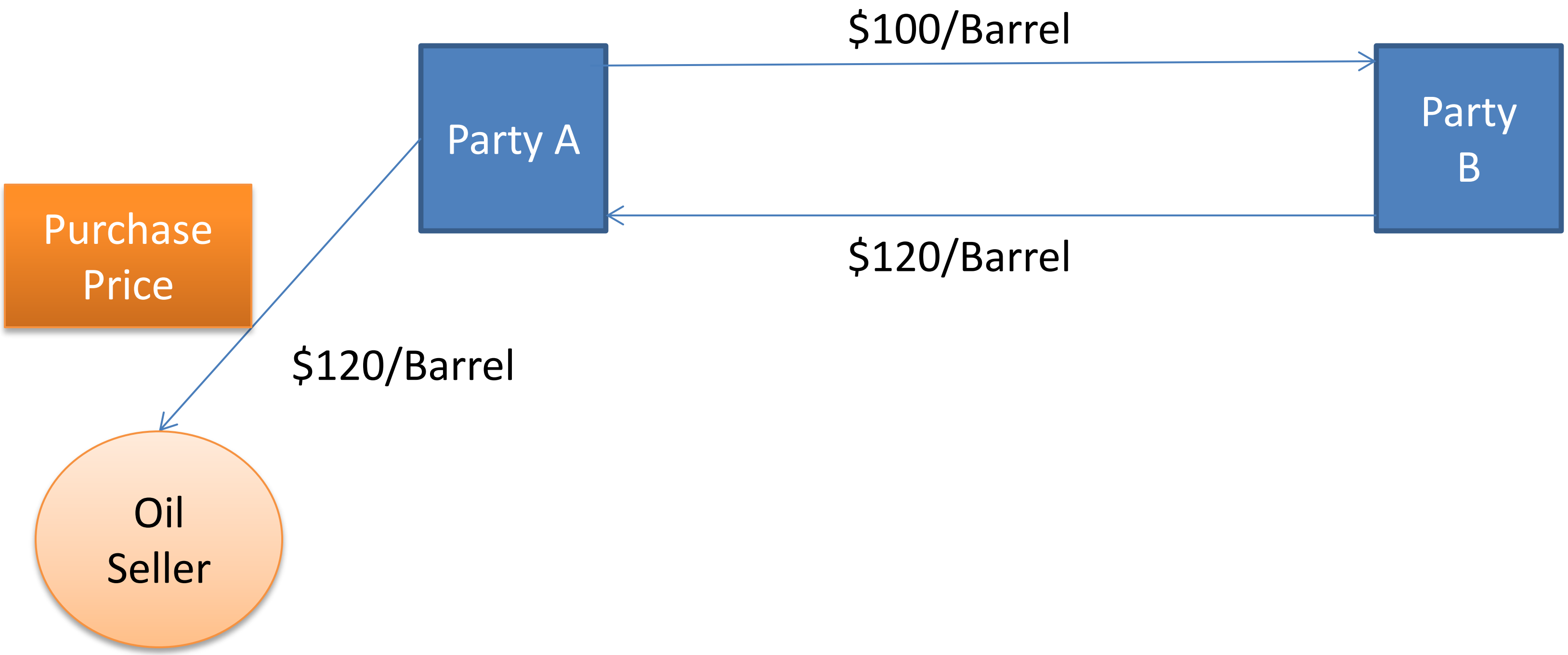
Basic Swap Configuration



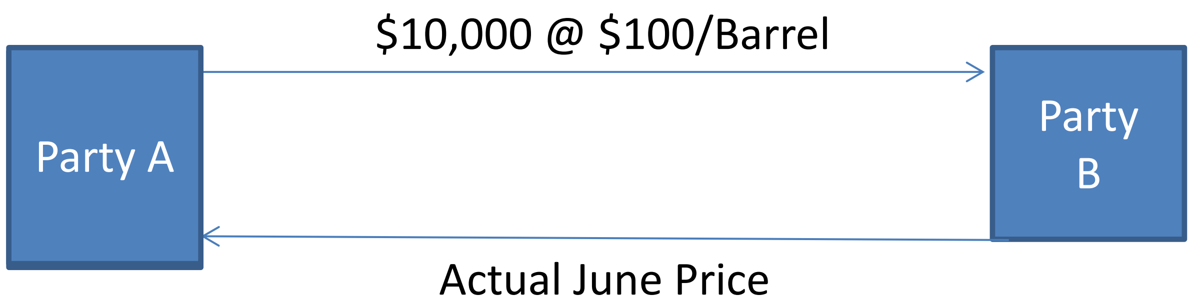
Swap as Hedge

Payments at Close of Swap Contract

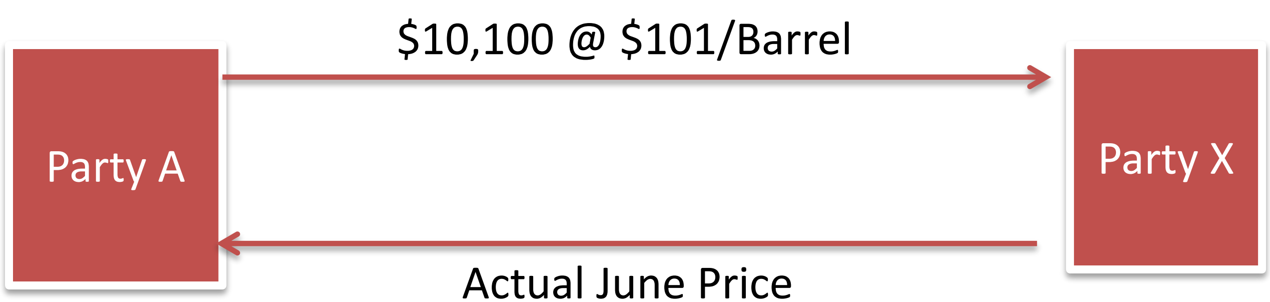


Credit Exposure on Swap

Swap Lost on Potential Default



Potential Replacement Swap



A has extended $1/barrel of Credit to B.

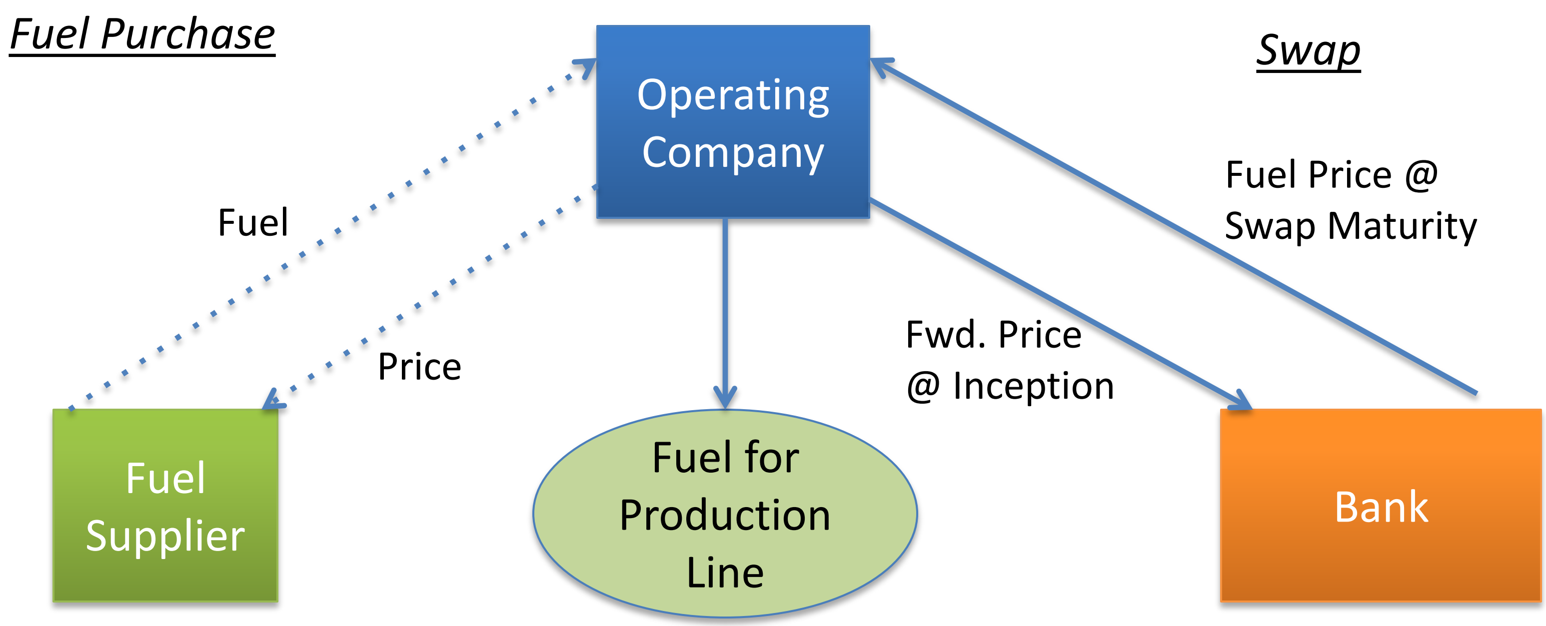
COMPARISON OF SWAP AND RESERVE FUND

	Reserve vs. Adverse Price Move	Swap Synthetically Fixing Price @ Today's Forward Price
Initial Cost	Cost of Capital to Fund Reserve	Charge for Potential Credit Exposure and Fee to Bank
Ongoing Potential Cost	Cost of Capital on Amounts Applied to Losses from Adverse Price Move	Cost of Funds for Required Margin Collateral
Risk	Inadequate Sizing of Reserve	Counterparty Non-Performance, Cash Liquidity, Operational Inflexibility
Upside From Advantageous Price Move	Retained	Lost

Valuation/Risk Issues

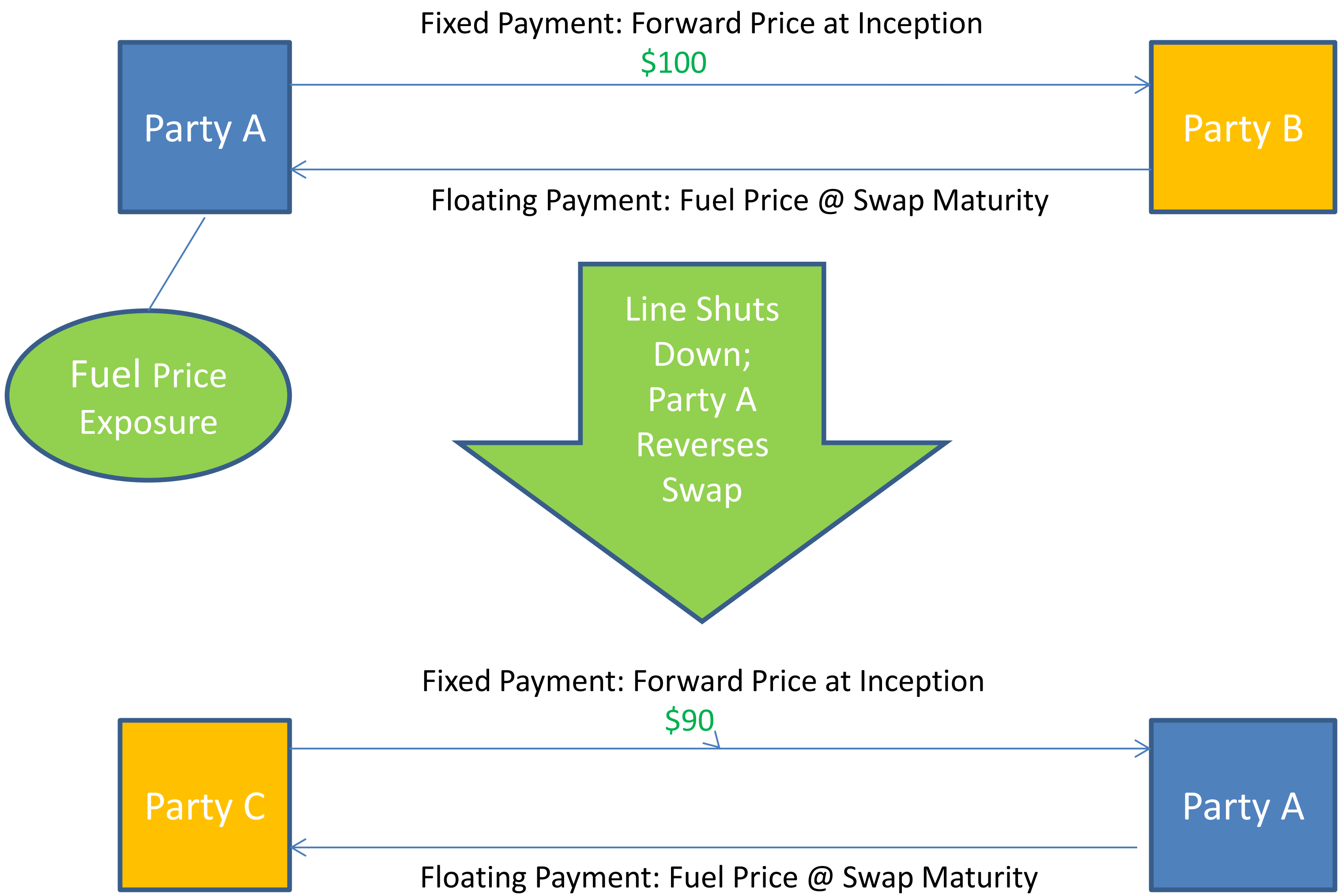
- Obscure Pricing, especially of Credit Extension
- Catastrophic Margin Call Risk
- Valuation of foregone Upside
- Inter-relationship with Operations

Operational Relationship



If the operating company shuts down the production line, it remains obligated on the swap. This would cause a loss if the price at maturity falls below the fixed payment

Operational Relationship



Loss to Party A: \$100 - \$90, or \$10.

Hidden Reasons Businesses and Governments Use Swaps

- Mis-perception/Obscuring of Risks and Costs
- Credit Rating Agencies
- Tax Consequences of Reserves
- Accounting Rules regarding Credit Exposures
- Safe decision for Executives
- Share Value Compensation Rules
- “Shadow” Debt