

U.S. COMMODITY FUTURES TRADING COMMISSION

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AGRICULTURAL ADVISORY COMMITTEE

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MEETING

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THURSDAY

JULY 25, 2013

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The Advisory Committee met in the Conference Center at Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C., at 9:30 a.m., Randall Fortenbery, Chairman, presiding.

MEMBERS PRESENT

RANDALL FORTENBERY, Chairman

M.J. ANDERSON, National Grain and Feed  
Association

JIM BAIR, North American Millers  
Association

SCOTT CORDES, National Council of Farmer

Cooperatives

NEIL DIERKS, National Pork Producers Council

CURTIS FRIESEN, National Corn Growers  
Association

EDWARD GALLAGHER, National Milk Producers  
Federation

JENNIFER HAN, Managed Funds Association

JOHN HAYS, Farm Credit Council

BRITTANY JABLONSKY, National Farmers Union

DWIGHT LANCLON, USDA-Risk Management Agency

LANCE KOTSCHWAR, Commodity Markets Council

ED LUTTRELL, National Grange

BILL MAY, American Cotton Shippers

Association

DAVID MILLER, American Farm Bureau

Federation

JOHN OWEN, USA Rice Federation

PAUL PENNER, National Association of Wheat

Growers

DIANA PRESTON, American Bankers Association

F. DON REYNOLDS, Independent Community

Bankers of America

DAVID SENTER, American Agricultural Movement

Inc.

STEPHEN STRONG, North American Export Grain

Association

STEVE WELLMAN, American Soybean Association

ROBERT YONKERS, International Dairy Foods

Association

COMMISSIONERS PRESENT

GARY GENSLER, Chairman and Sponsor of the

Advisory Committee

SCOTT O'MALIA, Commissioner

MARK WETJEN, Commissioner

CFTC STAFF PRESENT

CHRISTA LACHENMAYR, Designated Federal  
Officer

GARY BARNETT, Director, Division of Swap  
Dealer and Intermediary Oversight

LEE ANN DUFFY, Office of the General  
Counsel

WARD GRIFFIN, Division of Swap Dealer and  
Intermediary Oversight

LAURIE GUSSOW, Division of Market Oversight

VINCE MCGONAGLE, Division of Enforcement

SCOTT MIXON, Acting Chief Economist

KEVIN PICCOLI, Division of Swap Dealer and  
Intermediary Oversight

ANANDA RADHAKRISHNAN, Director, Division of  
Clearing and Risk

ROBERT WASSERMAN, Chief Counsel, Division of  
Clearing and Risk

ALSO PRESENT

ANNE BAGAN, Managing Director, Audits, CME  
Group

PHILLIP VERLEGER, PKVerleger LLC

A-G-E-N-D-A

Opening Remarks

Chairman Gary Gensler . . . . .6  
Commissioner Mark Wetjen. . . . . 11

Introductions . . . . . 12

Overview

Lee Ann Duffy . . . . . 17  
Laurie Gussow . . . . . 18

Member Questions/Discussion . . . . . 31

I. Customer Protection

Anne Bagan. . . . . 48  
Gary Barnett. . . . . 55  
Kevin Piccoli . . . . . 62

Member Questions/Discussion . . . . . 70

Panel II: Ethanol/RINS

Phillip Verleger. . . . .112  
Scott Mixon . . . . .121

Member Questions/Discussion . . . . .135

Panel III: Voice Recording (1.35)

Ward Griffin. . . . .147  
Vince McGonagle . . . . .157  
Scott Cordes. . . . .162

Member Questions/Discussion . . . . .168

Concluding Remarks. . . . .217

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22

P-R-O-C-E-E-D-I-N-G-S

9:31 a.m.

MR. FORTENBERY: Thank you very much for coming to the 36th meeting of the Agriculture Advisory Committee to the Commodity Futures Trading Commission.

My name is Randy FORTENBERY. I'm from the School of Economics at Washington State University so I'll be serving as the chairman. My primary job will be to try to keep us on topic and on time this morning. So that's why I'm trying to start it on time.

A couple of quick housekeeping items. If you haven't remembered to do so, please turn your cell phone either off or on vibrate.

When it's your turn to speak today there's a red button you'll need to push on the microphone. But when you're done speaking you need to turn it back off so somebody else can speak. So try to remember to both turn it on and turn it off.

1           I think as we get started today  
2 we'll first try to just be informal in terms  
3 of people speaking up when the opportunity  
4 arises to comment. If that gets a little  
5 crowded then maybe we'll start having to get  
6 people to signal me and we'll call on people.

7           I'd like to start the morning by  
8 introducing Chairman Gary Gensler who has a  
9 few comments for us to get us started.

10           CHAIRMAN GENSLER: Thank you. I'd  
11 like to thank the members of this committee  
12 for joining us today. And I specifically want  
13 to thank Randy who's decided to take on  
14 chairing this committee.

15           It's a little bit different  
16 format. It's really that we were working with  
17 our advisory committees and through the  
18 government processes that some other agencies  
19 in government said we maybe really should  
20 have, since it's an advisory committee, an  
21 outside chair. But I will be the sponsoring  
22 Commissioner. So there's a small shift in

1 that. But we're so delighted that Randy was  
2 willing to take on this chairmanship.

3 Also, Christa. Where's Christa?  
4 There. So if Christa stands up. Lachenmayr -  
5 -did I do that right? All right. She is  
6 serving officially as the Committee's  
7 Designated Federal Officer.

8 What does that mean? That means  
9 Christa is the person who if you need  
10 something, or you have a point of view, or you  
11 want to get some advice to us and you can't  
12 get me on the phone or Randy can't get us on  
13 the phone, Christa is, actually a term, the  
14 Designated Federal Officer, which is in the  
15 charter. Right, Christa? So she doesn't get  
16 to hide.

17 I also want to thank my fellow  
18 Commissioners, Commissioner Mark Wetjen who is  
19 here today. I know that Commissioner O'Malia  
20 will be joining us. I think that Commissioner  
21 Chilton is on the phone but I want to just  
22 pause to see if he is. Oh, he has a one-way

1 line.

2 And I also want to take a moment  
3 to recognize and thank former Commissioner  
4 Mike Dunn, who I see here today. But Mike  
5 chaired this group. He's chaired it so well  
6 that no Commissioner could stand in his shoes  
7 and we now have Randy standing in your shoes,  
8 Mike. But good to see you, Mike.

9 And this group and the advice and  
10 input of its members, not only as a full  
11 Committee but each of you and your membership,  
12 has really been critical to the CFTC's  
13 mission.

14 And this meeting comes at a  
15 particular time in our regulatory processes  
16 that your advice is critical. We are nearly  
17 done, all of this financial regulation called  
18 Dodd-Frank, but it's being implemented.

19 And today comes at a time that it  
20 would be really helpful just to hear your  
21 feedback. How is it going? What's going  
22 well? What's not going so well? What

1 adjustments or flexibility should we show,  
2 particularly as it relates to farmers and  
3 ranchers and producers and merchants and the  
4 agriculture interests that you know so well?

5 It also comes at a time that the  
6 Commission is looking at a process of  
7 finalizing some rules around enhancing  
8 customer protection. A lot has gone on, of  
9 course, as you know, in this field. A lot of  
10 good work by the self-regulatory  
11 organizations. A lot of good work here at the  
12 CFTC. But we are looking to possibly finalize  
13 some rules around this area in the fall, and  
14 your input at this critical time is very  
15 helpful.

16 With respect to swaps market  
17 reform, we'll update you and we'll hear your  
18 views. But it's really about making sure that  
19 farmers, ranchers, producers, merchants and  
20 others that use these complex products called  
21 derivatives work for you in the agricultural  
22 community.

1                   And though the vast part of the  
2 markets are in interest rates and credit  
3 derivatives and so forth, just peering into  
4 the data repositories that we now have, that  
5 you can see, there's actually -- and I was  
6 just handed these figures. And these may be  
7 rough, but to give you a sense of size.  
8 Agricultural swaps in the data repository is  
9 about \$200 billion in notional.

10                   So, you know, for most Americans  
11 that's not a small figure. It's not the large  
12 numbers in the interest rate swaps, but it's  
13 still a pretty relevant number.

14                   Energy swaps, or more broad  
15 commodity swaps, are about \$2 and a half  
16 trillion. I think these numbers will grow in  
17 size because key reporting dates are still in  
18 front of us. Come mid-August, a lot of new  
19 reporting will come into the data repository.  
20 So this is not a full picture yet.

21                   The overall swaps market, as you  
22 probably know, is greater than \$300 trillion

1 in size, but those numbers are significantly  
2 in the interest rate swap market.

3 And, again, I think the  
4 agricultural swaps, whether it's \$200 billion  
5 or \$1 trillion, it's really relevant to the  
6 hedging and lowering risk in your community.

7 So we look forward to hearing from  
8 you. And I turn it back to Randy, who I  
9 assume will let my fellow Commissioners say  
10 some things if they wish.

11 MR. FORTENBERY: Yes. So to my  
12 left is Commissioner Mark Wetjen who I think  
13 has a few comments for us as well.  
14 Commissioner Wetjen.

15 COMMISSIONER WETJEN: Thanks, Dr.  
16 FORTENBERY. Thanks, Mr. Chairman, and thanks  
17 to everyone who's here today for being part of  
18 this important first meeting of the Ag  
19 Advisory Committee, at least since I've been  
20 at the Commission. So it's great to have this  
21 group assembled.

22 And we've been spending, a lot of

1 us have been spending a good amount of time  
2 with folks from the ag sector this week. I  
3 was up in Congress and I think maybe some of  
4 the others around the table were also  
5 testifying this week in the House Ag  
6 Committee.

7 So I just want to thank those  
8 represented here for bringing a lot of good,  
9 useful attention to some key areas in our  
10 remaining rules where the ag interests in  
11 particular had a perspective that was  
12 important to understand.

13 The most important issue I would  
14 identify is this residual interest issue and  
15 our customer protection rulemaking that we  
16 hope to finalize very soon. So I think the  
17 Committee's done a very, very good job in  
18 highlighting this issue and making sure those  
19 of us here at the Commission fully understand  
20 it as we get through these next few weeks  
21 before considering a final draft and hopefully  
22 finalizing something very soon.

1                   So I just want to thank everyone  
2                   for being here. And thank you for your  
3                   advocacy on some of these important issues,  
4                   both in the customer protection space but also  
5                   with respect to some of our other rulemakings.  
6                   It's been very helpful, so thank you.

7                   MR. FORTENBERY: I think, like  
8                   myself, several of the Advisory Committee  
9                   members are new, maybe new to the process,  
10                  certainly new to this Committee. So perhaps  
11                  the place to start would be for us to  
12                  introduce ourselves to each other before we  
13                  get to the first topic. Can we start over  
14                  here on the left? Don't forget to push your  
15                  button.

16                  MR. LANCLÓS: Kent Lanclos, Risk  
17                  Management Agency.

18                  MR. OWEN: I'm John Owen. I'm a  
19                  rice, soybean and corn producer from northeast  
20                  Louisiana. I'm also incoming chairman of the  
21                  USA Rice Federation Producer's Group.

22                  MR. BAIR: Jim Bair, North

1 American Millers' Association.

2 MR. STRONG: Steve Strong with  
3 North American Export Grain Association. I'm  
4 also with Bunge in St. Louis in charge of corn  
5 risk for North America.

6 MR. DIERKS: I'm Neil Dierks. I'm  
7 the CEO of the National Pork Producers  
8 Council.

9 MR. GALLAGHER: Good morning, my  
10 name's Ed Gallagher. I'm representing  
11 National Milk Producers Federation today. I'm  
12 employed by Dairy Farmers of America and I'm  
13 the president of the DFA Risk Management  
14 Program.

15 MR. LUTTRELL: I'm Ed Luttrell.  
16 I'm the president of the National Grange.

17 MR. ANDERSON: M.J. Anderson with  
18 the Andersons in Maumee, Ohio, here  
19 representing National Grain and Feed  
20 Association.

21 MS. JABLONSKY: Hi, Brittany  
22 Jablonsky with the National Farmers Union.

1 MR. CORDES: Hi, good morning.  
2 Scott Cordes representing National Council of  
3 Farmer Cooperatives. And in my normal day job  
4 I'm president of CHS Hedging.

5 MR. FRIESEN: Curt Friesen from  
6 Nebraska. I'm representing National Corn  
7 Growers. I'm a producer who actively uses the  
8 CME for hedging. I raise corn and soybeans.

9 MR. PENNER: Paul Penner from  
10 Hillsboro, Kansas. A farmer from there, as  
11 well as first vice president of the National  
12 Association of Wheat Growers.

13 MS. HAN: Jennifer Han from  
14 Managed Funds Association.

15 MR. YONKERS: I'm Bob Yonkers with  
16 the International Dairy Foods Association.

17 MR. REYNOLDS: I'm Don Reynolds.  
18 I have a small rural bank in northern  
19 Missouri. I represent the Independent  
20 Community Bankers Association.

21 MR. HAYS: I'm John Hays with the  
22 Farm Credit Council here in Washington, D.C.

1 MR. WELLMAN: I'm Steve Wellman,  
2 chairman of the American Soybean Association.  
3 I farm in southeast Nebraska, soybeans, corn  
4 and some wheat.

5 MR. MILLER: Dave Miller, director  
6 of research with the Iowa Farm Bureau,  
7 representing the American Farm Bureau and also  
8 a producer of corn and soybeans in southern  
9 Iowa.

10 MR. MAY: Bill May, president and  
11 CEO of the American Cotton Shippers  
12 Association which represents U.S. cotton  
13 merchants.

14 MS. PRESTON: Diana Preston with  
15 the American Bankers Association.

16 MR. SENTER: David Senter with the  
17 American Agriculture Movement.

18 MR. FORTENBERY: Okay, thank you  
19 very much. What we're going to do -- we have  
20 a pretty full agenda today. We're going to  
21 start off with an overview of the Dodd-Frank  
22 legislation and the status of its

1 implementation. We have two presenters this  
2 morning. Okay, so there's going to be three  
3 presenters this morning. The Chairman's going  
4 to participate as well.

5 But we have Lee Ann Duffy from the  
6 Office of the General Counsel and Laurie  
7 Gussow from the Division of Market Oversight  
8 to sort of kick us off this morning. Take it  
9 away.

10 MS. DUFFY: I was going to make  
11 only the briefest of introductions. The Dodd-  
12 Frank Act established a comprehensive new  
13 regulatory framework for swaps. The  
14 legislation was enacted to reduce risk,  
15 increase transparency and promote market  
16 integrity within the financial system.

17 Under the Dodd-Frank Act, the CFTC  
18 now regulates swap dealers, requires  
19 standardized derivatives to be centrally  
20 cleared, requires standardized derivatives to  
21 be traded on regulated exchanges or swap  
22 execution facilities, and oversees a new swaps

1 reporting and record-keeping regime.

2 And Laurie's going to talk about  
3 reporting and record-keeping.

4 MS. GUSSOW: Thank you, Lee Ann.  
5 With the implementation of Dodd-Frank there  
6 was one area of transparency which I have been  
7 involved. And it is with respect to the  
8 reporting of swap data to the swap data  
9 repository. And in addition, the public  
10 dissemination of certain price and volume  
11 information regarding those transactions.

12 So, if you -- just as a general  
13 overview, I'm sure that all of you are quite  
14 familiar with the regulations that were passed  
15 back in July. Excuse me one second. My  
16 apologies. December of 2011 for Part 45 and  
17 Part 43. And then in June of 2012 for Part 46  
18 for the historical record-keeping.

19 In addition to having the  
20 regulations in place, which you guys have been  
21 involved in from the beginning, we've had  
22 those in place for about 18 months now with

1 respect to 43 and 45. We've also got the  
2 provisionally registered SDRs in CME, of  
3 course DTCC and ICE Trade Vault.

4 So we've got the players, we've  
5 got the rules. And so we have deadlines for  
6 reporting. And so with respect to the market  
7 participants, we have the implementation  
8 phased in based upon your status as the market  
9 participants.

10 So we have the swap dealers MSPs  
11 reporting with the first phase-in. Then of  
12 course we have the financial entities. And  
13 now we've had the first round of reporting for  
14 the non-registered entities. As some of you  
15 may have already begun reporting on July 1  
16 with respect to your interest rate and credit  
17 default swap transactions.

18 And then we have our last phase of  
19 the implementation with respect to reporting  
20 going live August 19 with respect to the other  
21 three asset classes, other commodities,  
22 equities, and foreign exchange. So in

1 addition to those basic time frames, we have  
2 some additional time to report the historic  
3 data and some other backloading if you've been  
4 relying on No-Action relief for reporting  
5 between the compliance date of April 10 and  
6 these delayed time frames that we just  
7 discussed.

8 And when we talked about  
9 reporting, we have of course the Part 45,  
10 which is the regulatory reporting. The data  
11 goes to the SDR. That's confidential data  
12 available for the regulators.

13 And then, in addition, if the swap  
14 is a publicly reportable swap transaction,  
15 there are certain price and volume information  
16 that is sent to the SDR which the SDR publicly  
17 disseminates on its website. So you can see  
18 transaction-by-transaction information about  
19 basically whatever has been sent to the SDR  
20 that is publicly reportable.

21 And like I said, that information  
22 is on each SDR's website. It's currently --

1 you know, those websites are currently in  
2 effect. The data is currently being publicly  
3 disseminated. So if you haven't had the  
4 opportunity to review it you might want to  
5 check out and see what is available.

6 Okay, so one common question is  
7 who reports? So the reporting hierarchy is  
8 set forth in Part 45. And again we start with  
9 the swap dealer. And then if there's no swap  
10 dealer in the transaction, the major swap  
11 participant would be the next reporting  
12 counterparty.

13 If there's neither a swap dealer  
14 nor major market participant then the  
15 financial entity, a financial entity, would be  
16 the reporting counterparty. If none of those  
17 entities are involved, or shall we say if  
18 there's two swap dealers, two MSPs, or two  
19 financial entities, there's a tie-breaker  
20 provision that sets forth how the decision  
21 will be made.

22 And then of course we also have to

1 look at whether it's a U.S. person versus a  
2 non-U.S. person. And in these instances of  
3 the tie-breaker situation or transactions with  
4 non-U.S. persons we have to look at where the  
5 transaction is executed, whether it was on a  
6 platform or bilaterally. So, again, this is  
7 set forth in the rule.

8 And at the end you will see all  
9 these resources are available online. So  
10 we've been really careful and diligent about  
11 providing this information so that it's easily  
12 accessible to you and anybody else that's  
13 interested in looking.

14 Another common question we get is  
15 with respect to reporting and record-keeping  
16 which Part 45 requires both reporting and  
17 record-keeping as you're aware. There's a  
18 unique identifier to which each counterparty  
19 to a swap must be identified. That identifier  
20 is called the Legal Entity Identifier, or an  
21 LEI. Right now we're in the phase-in process  
22 and we're using an interim identifier called

1 the CICI.

2 And if you have not yet checked it  
3 out you may want to go to the CICI utility,  
4 which is a publicly available website, to  
5 register for a CICI identifier. And there's  
6 a wealth of information on that website  
7 including frequently asked questions.

8 And so that should be able to  
9 assist you in the registration process. It's  
10 a very quick process, very easy. And so  
11 again, each counterparty to a swap that is  
12 reportable must obtain an LEI, or in the  
13 interim a CICI.

14 And, again, another very active  
15 area of conversation is what relief is  
16 available? We understand the end user or the  
17 non-registered entity is coming late to this.  
18 The swap dealers and MSPs have been involved  
19 and preparing for this for awhile now, so we  
20 are trying to provide the end users with as  
21 much information as possible.

22 And so I've provided on the screen

1 just a general list of No-Action relief  
2 letters that are currently available on the  
3 website that provide -- you know, that address  
4 several different reporting scenarios, and who  
5 the eligible participants are for relief and  
6 the relief involved. And again this is on the  
7 website and easily accessible.

8 And like I said, all this  
9 information is available to the public. I've  
10 given the Commission's website. All the rules  
11 are up there. The registered SDRs, which  
12 asset classes they support. We have  
13 frequently asked questions, Q&As, we've got  
14 fact sheets about reporting. And again, the  
15 reporting relief.

16 And so just to walk you through it  
17 at a very high level because I have received  
18 calls from outside counsel that haven't gotten  
19 here yet so maybe this would be helpful. So  
20 if you just go to Law and Regulation, and  
21 Dodd-Frank, one of our favorite places to  
22 look, there's a list of rulemaking areas, if

1 you go there. And then you can find under  
2 these tabs all the information that we've  
3 provided to you today in addition to  
4 information that I haven't even touched upon.

5 So, we're here to answer questions  
6 and we're here to help you remain and come  
7 into compliance with the reporting rules. And  
8 hopefully we're providing the information for  
9 you to do so. Thank you.

10 CHAIRMAN GENSLER: I'm going to  
11 take it to maybe just a little higher level  
12 than that detail as Lee Ann did. There are  
13 really three broad areas that have all been  
14 implemented in this financial reform. And  
15 then there's so much detail in 50 to 60  
16 finalized rules.

17 The financial crisis was such that  
18 Congress asked to bring commonsense rules of  
19 the road to this esoteric and complex market  
20 called swaps.

21 Transparency. We've completed our  
22 various rule sets on transparency and now

1 there is transparency in this marketplace. To  
2 the regulators, as I indicated earlier and as  
3 Laurie has put in a more detailed tone, that  
4 there are data repositories. There are three  
5 of them now, but there are data repositories  
6 that collect data from market participants so  
7 that the regulators can see the full scale and  
8 scope of the marketplace.

9           There's always more work to be  
10 done but that is now in place and it's been  
11 phased from last December through the last  
12 phasing date is I think as Laurie just put  
13 out, August 19.

14           The second part of transparency is  
15 public market transparency. You all can  
16 actually see the price and volume of  
17 transactions as they flow through the system.  
18 They're time-delayed and they've been being  
19 reported since last December and again phasing  
20 through this August 19 various time delays and  
21 so forth. But you can see the price and  
22 volume with the counterparty information

1 masked of course, similar to a modern-day  
2 ticker tape.

3           And a third part of transparency  
4 is that if you wish to, starting shortly you  
5 could actually go onto a centralized market  
6 structure. Whether that's called a designated  
7 contract market like you've used in the  
8 futures world, but shortly a platform called  
9 swap execution facilities.

10           Now you might think that primarily  
11 this will be for interest rate swaps and  
12 credit swaps and some of the high-volume swaps  
13 like that. But if a trading platform wishes  
14 to offer agricultural swaps there are rules of  
15 the road in place that they'll have to offer  
16 you various ways to transact and they'll have  
17 to send that information on your behalf to the  
18 data repository.

19           So it might even be that you want  
20 to transact an agricultural swap or an energy  
21 swap on one of these swap execution  
22 facilities. They will start registering and

1 being up and alive as soon as -- I think it's  
2 about 2 weeks from now, August 5. And they  
3 need to register by early October.

4 That's all in place already but  
5 there's a lot to come ahead on this  
6 transparency initiative as these swap  
7 execution facilities come alive later this  
8 year.

9 A second main piece of Dodd-Frank  
10 was lowering risk. And it's lowering risk  
11 through central clearing as well as lowering  
12 risk through the oversight of dealers.

13 Central clearing was a commitment  
14 of the futures industry for about 120 years.  
15 But now it's come to the swap marketplace for  
16 financial enterprises.

17 So most of you have a choice. You  
18 don't have to involve yourself in central  
19 clearing. What Congress pointed out and we've  
20 really kept in mind is that non-financial  
21 parties, farmers and ranchers and producers  
22 and millers like yourselves, but retail

1 companies and software companies and  
2 manufacturing companies, get a choice whether  
3 to use central clearing.

4 But for financial entities that  
5 make up about 90 percent of this derivatives  
6 market -- truly about 90 percent of the  
7 derivatives market are financial companies --  
8 that they use central clearing to lower the  
9 risk of an interconnected financial system.

10 And that, this Commission  
11 finalized rules, robust risk management rules  
12 for the clearinghouses, finalized rules on key  
13 interest rate swaps and key credit derivative  
14 swaps that they must be brought to the  
15 clearinghouse. And that phasing has been  
16 since March of this year through September of  
17 this year.

18 But as I say, as end users, if  
19 you're using an interest rate swap or using a  
20 credit derivative swap I would find it pretty  
21 unlikely that you would have to involve  
22 yourself in central clearing. I think there

1 is one information thing that you have to file  
2 in an SDR just that you are an end user. And  
3 that might be by September of some date. I  
4 can't remember the date in September.

5 And then the other way we're  
6 lowering risk is regulating the dealers, the  
7 large banks here in the U.S., the large banks  
8 around the globe. They started registering  
9 with us in December of last year.

10 But it means as you face a large  
11 bank, their registration means they are now  
12 subject to various business conduct rules on  
13 their sales practice, various rules that we  
14 have in place about making the markets fair  
15 and less subject to abuse. But also business  
16 conduct rules to make sure that they manage  
17 their risk better, that they confirm their  
18 trades, that they have various documentation  
19 for their trades and so forth. So those are  
20 the main things that have occurred.

21 And throughout the process we've  
22 been listening. We've worked with the

1 agricultural cooperatives and others around  
2 this table to ensure that you don't get caught  
3 up in maybe the swap dealer definitions and so  
4 forth. But it would be really helpful to get  
5 your advice on how you've seen this reform.

6 Because as I said, we're well past  
7 90 percent finished, the various regulatory  
8 issues. We're probably well past halfway in  
9 terms of implementation. And this meeting  
10 couldn't come at a more timely moment to just  
11 hear from you as to what's working, what's not  
12 working, what tweaks or adjustments are  
13 appropriate.

14 And I think this Commission and  
15 any Commission really needs to be adjusting  
16 over time. I see Mike Dunn again. Mike said  
17 as we were voting for these rules that we  
18 should always stand ready to adjust. And I  
19 share Mike's view on that.

20 MR. FORTENBERY: Thanks very much,  
21 Lee Ann, Laurie and Chairman Gensler.

22 Before I throw it open for

1 questions or comments let me just ask can  
2 everybody hear okay? Any problems there?

3 Please make sure when you're  
4 speaking, you speak into the microphone for  
5 two reasons. One so the rest of the Committee  
6 can hear, but also we're recording this for  
7 the purposes of constructing minutes of the  
8 meeting later. So it would help if we  
9 actually knew what was said when it's said.

10 Any questions or comments about  
11 the Dodd-Frank implementation, the Act itself?  
12 For any of the three presenters. Yes?

13 MR. CORDES: Just one comment.  
14 I'd give some feedback. You asked how things  
15 are going, that kind of thing. Some of the  
16 things that we're seeing in the industry is  
17 there's some confusion about what applies to  
18 who and where.

19 Sometimes with some of the swap  
20 dealers that the co-ops are dealing with, some  
21 are saying, okay, you've got to clear it, you  
22 don't, end user. So there's just some

1 confusion that needs to be worked through and  
2 a better understanding of what applies to who  
3 and when and where.

4 CHAIRMAN GENSLER: That's helpful.  
5 And if you do have specifics, particularly as  
6 it relates to agriculture interests, please  
7 don't hesitate to let us know.

8 The clearing mandate is of course  
9 just these four big interest rate curves and  
10 some credit derivatives. I doubt many people  
11 around this table use credit derivatives, but  
12 maybe.

13 But please do. If there's an  
14 issue, don't hesitate to let us know.

15 MR. FORTENBERY: Other comments or  
16 questions?

17 COMMISSIONER WETJEN: I just want  
18 to follow up with the last question. Does it  
19 seem as though that's -- and I don't ask this  
20 question suggesting any skepticism on my part.  
21 I'm just trying to better understand things.  
22 Does it seem like that's more a function of

1 people starting to comply for the first time.  
2 And so are these questions anything out of the  
3 ordinary? Or is it more of a reflection of  
4 the rules being not as clear as they should  
5 be, or market participants seeking answers  
6 from the agency and they're not getting  
7 answers either soon enough, or the answers  
8 aren't sufficient? Or is it a combination of  
9 those two things, would you say?

10 MR. CORDES: I think it's probably  
11 a combination. I think probably the biggest  
12 challenge is there's so many things coming so  
13 fast that as these milestone dates hit, people  
14 aren't quite up to speed on what's required  
15 and trying to get that understanding. So I  
16 think maybe some clearer time lines back, or  
17 clarification on some of the things to help  
18 the participants would be helpful.

19 MR. FORTENBERY: Yes, sir.

20 MR. FRIESEN: When I have visited  
21 with my local grain elevator in my hedging,  
22 what they're doing is -- they are very

1 confused about who is required to report and  
2 things like that. They don't know if they're  
3 a swap dealer or not.

4 But one thing that they did bring  
5 up, and as farmers get more adept at using  
6 more risk management tools these elevators are  
7 trying to develop products that help us market  
8 grain. And some of those they feel are  
9 considered swaps.

10 So I mean the dollar amounts  
11 they're talking about are so small, could  
12 there be a floor in there where anything below  
13 that would not need to be reported? Because  
14 they're coming out with new products all the  
15 time and in order to use some of these tools,  
16 I do think some of them are going to be  
17 considered swaps the way they describe them.

18 So if something could be done to -  
19 - I guess we need all the risk management  
20 tools we can get. I appreciate their efforts  
21 to try and make it easier to market but they  
22 need to be clarified, I guess.

1                   MR. GALLAGHER: I'd like to follow  
2 up on that because we've seen some of the same  
3 in the dairy industry. And certainly some of  
4 the swaps we contemplate writing are going to  
5 be pretty small, notional amounts that are not  
6 going to be any type of an issue in any way,  
7 shape, or form in the security of the economy  
8 of the United States.

9                   The other thing that we're finding  
10 is that we've built this house, we've all got  
11 this new house that we're getting used to  
12 living in. And some of us have some special  
13 needs because our industry is a little bit  
14 different.

15                   And we've got these new utilities,  
16 say. And the operating instructions are a  
17 little bit vague and we're not quite sure how  
18 to operate them.

19                   And in some cases, one particular  
20 issue that we're running across as a dairy  
21 cooperative is that we have a lot of marketing  
22 contracts that have volumetric optionality in

1       them. In order to -- we're kind of like the -  
2       - we're the dairy grid, like the electric  
3       grid. We make sure that whoever wants milk  
4       can get their milk and we move milk around so  
5       that everybody gets what they need when they  
6       need it. And so we have a lot of volumetric  
7       optionality into our contracts.

8                       My reading of those is that they  
9       are not swaps. But it's not important what my  
10      reading is; it's important what yours is. And  
11      it's vague enough that it gives us some  
12      concern. And so we'd like to at some point  
13      have some more dialogue about just better  
14      understanding what would fit into probably the  
15      seventh part of that particular set of rules.  
16      So just continued dialogue.

17                      We appreciate the dialogue that  
18      we've had to date and we really appreciate the  
19      flexibility that you've shown the agricultural  
20      industry.

21                      COMMISSIONER WETJEN: I just had a  
22      quick response to that. I appreciate the

1 question and raising this.

2 That was part of our swap  
3 definition rule about a year ago. And that  
4 volumetric optionality test that you referred  
5 to was something that we did on an interim  
6 basis which is to say we sought additional  
7 comment on the seven-part test that you  
8 referred to.

9 So I guess my first question is,  
10 has your group filed a comment letter in  
11 response to that. Because I think when we  
12 were working through that at the time most of  
13 the focus was on the electrical utility space  
14 and less so on the dairy space. So I'm kind  
15 of interested to hear you say it might impact  
16 you.

17 And then secondly, in regards to  
18 whether -- well, if you didn't file a comment  
19 letter, I would urge you to do that.

20 And then secondly, that's probably  
21 something, since it's been out for comment for  
22 some time maybe we can think about redressing

1 that at some point soon.

2 CHAIRMAN GENSLER: I would share  
3 Commissioner Wetjen's thoughts that, Ed, if --  
4 even if you filed one because now you have a  
5 year of experience, you might want to re-file  
6 something because it may change. It would  
7 just be helpful. Or if you feel that you want  
8 to just set up a meeting, I'd look forward to  
9 it and I'd certainly take the meeting.

10 MR. GALLAGHER: Thank you.

11 MS. DUFFY: I also want to add the  
12 team, the staff team that worked on the  
13 products definition still consults on  
14 questions of the products definitions. So you  
15 can contact me or Dave Aron and we'd be happy  
16 to speak with you as well.

17 CHAIRMAN GENSLER: I think that  
18 Lee Ann raises a very good point that staff  
19 stands ready even at our small agency, time  
20 permitted, to deal with frankly the hundreds  
21 of questions that come up.

22 And as Commissioner Wetjen said on

1 the volumetric options it has generally been  
2 questions from the electric utility field.  
3 But whether it's Lee Ann herself -- Lee Ann  
4 helped write some of those provisions. And  
5 Dave Aron who she mentioned in our Office of  
6 General Counsel. But often it can be  
7 addressed through staff interpretation as  
8 well.

9 MR. FORTENBERY: Any other  
10 comments or questions? Yes.

11 MS. PRESTON: As the American  
12 Bankers Association, I would have to say we  
13 represent interests on all sides of the  
14 equation here.

15 I think we're often seen as the  
16 largest, most active players. We also  
17 encompass the smallest players that do swaps,  
18 in some cases once every 5 years.

19 So I would have to say I  
20 appreciate the dialogue that we have had with  
21 the Commission. I have found the staff  
22 extremely responsive and willing to listen.

1                   And I think some of what you were  
2 asking about, Commissioner Wetjen, you know,  
3 what are the challenges here. Some of them  
4 are new market players that have come in.

5                   For example, we dealt with new  
6 trade affirmation platforms which the dealers  
7 and the end user banks and the banks in the  
8 middle all had to deal with and it was very  
9 challenging.

10                   We appreciated the staff's time in  
11 listening to us. We appreciate the  
12 accommodation in terms of saying that there  
13 will be some accommodation in terms of  
14 enforcement actions while this all sorts  
15 itself out. Because we really do represent  
16 banks on all sides of this equation.

17                   MR. GALLAGHER: An issue that I  
18 had the opportunity to speak to your staff  
19 about relative to our members. But I'm  
20 curious if it goes beyond our members. So I'd  
21 like to ask the group a question about the LEI  
22 CICIs.

1                   So one of the things that I've  
2                   seen is that for a dairy farmer they're  
3                   invested in their operation for decades and  
4                   they're not moving anywhere.

5                   And so my question was why would a  
6                   dairy farmer need to have an annual re-  
7                   submission and an annual re-payment for an LEI  
8                   CICI when they're going to have the same  
9                   address for decades. So that we know where  
10                  they're going to be.

11                  And I was just curious if there  
12                  were other agricultural, other farm-based  
13                  groups that had the same thought or the same  
14                  idea. As opposed to having to have a farmer  
15                  pay an annual fee for an LEI when they're in  
16                  the same place all the time.

17                  Any comments?

18                  MR. FORTENBERY: Any responses to  
19                  that? Any more discussion? Yes, sir.

20                  MR. DIERKS: Just to Ed's  
21                  question, I would suggest that I think there's  
22                  a lot of sense in that from the producers'

1 perspective. I know some of our members that  
2 have started to use swaps in agriculture, it's  
3 the same kind of thing. I mean they're pretty  
4 identifiable. They've been there forever.

5 And as you sign up if there's some  
6 way of just you're in -- you do the LEI CICI  
7 and it just doesn't need to be renewed. It  
8 just should -- until maybe it's either -- or  
9 a longer period of time might work better for  
10 renewal.

11 CHAIRMAN GENSLER: I'm not close  
12 enough to it and a lot of this is also at the  
13 data repositories themselves. But for data  
14 integrity, I think the best technologist once  
15 told me that you want to have some time,  
16 whether it's once a year, in some  
17 circumstances you have to do it more often or  
18 less often. But some time just to make sure  
19 that you still have the right party and the  
20 right number. It's sort of like telephone  
21 numbers change and cell phone addresses  
22 change.

1                   But I believe that's why the  
2 international regime, and when you use the  
3 term LEI, legal identifier, that's an  
4 international regime that's -- so even at a  
5 Morgan Stanley or Goldman Sachs they're --  
6 well, they'd like to think they'll be in  
7 existence a long time, too. But there's some  
8 need to refresh for data integrity. But I  
9 don't know why it landed on once a year and  
10 that may be some international arrangement.

11                   MS. HAN: Along the lines of I  
12 guess the LEIs and CICIs. So we've been in  
13 the futures markets, our members, for a long  
14 time. And so -- in the swaps markets. And so  
15 we appreciate all the work the Commission is  
16 doing. We know it's been a lot of rulemaking.

17                   One thing that we would like to  
18 make sure is that with -- as we are moving  
19 into this new house as you've raised it, this  
20 new framework, and just making sure everything  
21 is working correctly.

22                   We want to make sure that all of

1 the information kept at the swap data  
2 repositories are maintained in a confidential  
3 manner. Our members have been aware of  
4 instances when trade data has been released to  
5 the counterparty. And so we're quite  
6 concerned about that.

7 The futures markets have been  
8 working and so there haven't been problems.  
9 But here I think at this initial phase, we  
10 have seen issues. And so we would like for  
11 the Commission to ensure that swap data  
12 repositories maintain the data confidentially  
13 and make sure that both sides of the  
14 transaction, that they're not aware of who  
15 their counterparty is. And so that's  
16 something we'd like to emphasize.

17 MS. PRESTON: Since we are in the  
18 agricultural forum, I would be remiss in not  
19 pointing out that we have a clearing mandate  
20 that has gone and been implemented through  
21 many parts of the marketplace, but that there  
22 is a proposed exemption from clearing for

1 cooperatives, for Farm Credit.

2 And while we appreciate that  
3 farmers need access to agriculture, I again  
4 reiterate that we represent banks of all sizes  
5 and all different marketplaces, and do have  
6 some serious concerns about a proposed  
7 exemption for cooperatives. Farm Credit in  
8 particular has a swaps portfolio of \$26  
9 billion and it seems like there is something  
10 that contradicts the mandate that the  
11 Commission has for central clearing. I just  
12 want to point that out.

13 MR. FORTENBERY: Time for one more  
14 comment or question before we take a quick  
15 break. Anybody else? Anything they'd like to  
16 get on the table? Okay, thank you, Lee Ann  
17 and Laurie for your time.

18 One thing I failed to mention is  
19 the slides that you see presented today will  
20 all be available to you after the meeting. So  
21 anything that pops up on the screen, you will  
22 have access to at a later time.

1                   Why don't we take about a 15-  
2                   minute recess. We'll return at 10:30. So  
3                   there's coffee in the back, water. Feel free  
4                   to introduce yourself to the rest of the  
5                   Committee members and I'll see you in about 15  
6                   minutes. The next subject is customer  
7                   protection. Thank you.

8                   (Whereupon, the above-entitled  
9                   matter went off the record at 10:14 a.m. and  
10                  resumed at 10:30 a.m.)

11                  MR. FORTENBERY: Thank you. We  
12                  have two more topics that we're going to  
13                  discuss before lunch. The first one is on  
14                  customer protection this morning and then  
15                  we'll have a short session on ethanol and  
16                  RINs. More specifically, RINs, Renewable  
17                  Identification Numbers.

18                  But the first thing we're going to  
19                  do this morning is talk about customer  
20                  protection. We have a panel to address the  
21                  issue for us.

22                  Anne Bagan who's the managing

1 director of the CME Group is going to be on  
2 the panel. She'll speak first. Gary Barnett,  
3 director of the Division of Swap Dealer and  
4 Intermediary Oversight. I'm tripping over the  
5 word. And Kevin Piccoli, Division of Swap  
6 Dealer and Intermediary Oversight. So Ms.  
7 Bagan.

8 MS. BAGAN: Good morning,  
9 everybody. As I'm sure you're aware, after  
10 the unhappy events in our industry over the  
11 past couple of years a number of industry  
12 groups were put together to look at whether  
13 there were ways that we could enhance customer  
14 protections.

15 I believe the FIA put together I  
16 think they were called the Financial  
17 Management Group. One thing they did that I  
18 would highly recommend you read if you have  
19 not, they put a FAQ together on how customer  
20 segregation works. It's an excellent document  
21 and it's very good for customers I think. So  
22 they put a group together to look at potential

1       enhancements.

2                   The NFA also put a group together  
3       for self-regulatory organizations and  
4       participating on that were CME, Minneapolis,  
5       Kansas City and ICE. And we also were looking  
6       at ways that we could suggest enhancements to  
7       customer protection.

8                   Those two groups actually came up  
9       with many of the same ideas. And so we have  
10      put those in place and I'll go through what  
11      some of those are real quickly. But these  
12      suggestions and rules that we've put in place  
13      have also been proposed by the CFTC in their  
14      recent rulemaking. So the whole industry I  
15      think is on board together.

16                  So our goal here was to have  
17      greater transparency, increased detection and  
18      increased deterrence from situations where  
19      customer funds could be potentially lost.

20                  And one thing that we put in was  
21      that all FCMs now must report all customer  
22      segregation computations to their designated

1 self-regulatory organization which would be  
2 either CME or NFA on a daily basis.

3 NFA had been doing that. CME did  
4 it on a for-cause basis. But now we're  
5 requiring all of our FCMs to submit those  
6 reports to us. To date for just 2013 CME has  
7 received approximately 15,000 of those reports  
8 which need to be reviewed every single day.

9 We also are now getting semi-  
10 monthly detailed reports of where the FCMs are  
11 investing their customer funds. To date for  
12 2013 we've received about 1,500 of those which  
13 also have to be reviewed immediately.

14 We also have a rule in place now  
15 that if an FCM is going to decrease their  
16 excess segregated funds in any of the  
17 categories. So when I say segregated I mean  
18 trading U.S., trading foreign, or trading  
19 cleared swaps.

20 And if that excess decreases by 25  
21 percent on any given day they must notify  
22 their DSRO and it must be approved by a senior

1 executive at the firm. And so for 2013 we  
2 have received approximately 80 of those  
3 notifications.

4 This is something that we will  
5 look at when we get the daily reports from  
6 firms. So if a firm does not report that to  
7 us on the day that it happens they will get a  
8 call from our management team and there's  
9 potential disciplinary action if they don't  
10 notify us. So the firms have been keeping on  
11 top of that.

12 We've also begun, about a year ago  
13 we started using Confirmation.com which  
14 allowed us to get direct confirmations from  
15 banks of balances that they were holding. And  
16 we could use that then on our regulatory  
17 examinations.

18 But besides that, and one thing  
19 that we're probably even more excited about,  
20 we -- "we" meaning NFA and CME have engaged an  
21 outside vendor called AlphaMetrix 360. And  
22 they actually aggregate balances for us at

1 banks, all cash and securities held on behalf  
2 of customers. And they report that to us for  
3 every single account at every one of our FCMS  
4 every day. And we use that as a measure  
5 against what the firms are reporting to make  
6 sure that they are in line and we know the  
7 funds are there. So we have been using that.

8 Now right now that's just with  
9 banks. We are in phase II right now,  
10 programming, that will also get those balances  
11 from carrying brokers and clearing  
12 organizations. And we hope to have that up  
13 and running still this year. The carrying  
14 brokers have to be in by September.

15 Also, FIA, NFA, the Institute for  
16 Financial Markets and CME have been engaged in  
17 a study on whether insurance is a potential  
18 that we could have. We've received  
19 information from several different FCMS, both  
20 collateral and positions, and our consultants  
21 are now reviewing and analyzing all of that  
22 information.

1           Once they get done with that, and  
2 they are in the process. And we do expect it  
3 will take some time for them to do all the  
4 analytics. But once they do that then we'll  
5 go out for quotes on how much insurance will  
6 cost. So that's in process and I know that  
7 that's been something that a lot of people  
8 have been asking about the potential for that.

9           And then finally from CME's  
10 perspective we put together what we called the  
11 farmer fund which was a fund we put together  
12 to be able to pay customers back perhaps on a  
13 more timely basis than they would get through  
14 the whole bankruptcy situation if there was a  
15 shortage in the customer funds that were being  
16 held. We used it for PFG and paid out  
17 approximately \$2 million, a little bit more  
18 than that, to their customers. So that's all  
19 been paid out as of this point.

20           One other thing I should say. We  
21 do regulatory examinations on our firms -- and  
22 if you're an FCM you know that -- every 9 to

1 15 months. But one other thing we are now  
2 doing -- and I should also point out those are  
3 done on a surprise basis. So the firms are  
4 not supposed to know when we are coming in.  
5 We just show up.

6 But now we're also going in  
7 intramonth just to look at the customer  
8 balances to make sure that what they're doing  
9 during the month is also in compliance with  
10 all the regulations. And so far to date we  
11 have not had any -- noted any problems with  
12 those.

13 But we go in intramonth again on a  
14 completely surprise basis and we tie out where  
15 the balances are. We can use the AlphaMetrix  
16 balances that we get on a daily basis to make  
17 sure that the funds are where they're supposed  
18 to be. And again we haven't had any  
19 significant problems noted at all with any of  
20 those reviews.

21 I don't know if you want me to go  
22 into any more detail on any of that?

1                   MR. FORTENBERY: Why don't we go  
2 on to the other two presentations and then we  
3 can come back for questions or discussion.  
4 Thank you.

5                   MR. BARNETT: Great. Thank you,  
6 Anne. Okay. I want to talk to you a little  
7 bit about where we are with our customer  
8 protection rule set.

9                   As you know, our mission is to  
10 help ensure the integrity of the futures and  
11 swaps market, and as part of that we must do  
12 everything we can to protect customers and  
13 their funds. And as Anne mentioned, in the  
14 aftermath of the FCM crises we saw in late  
15 2011-2012 we saw weaknesses that needed to be  
16 dealt with.

17                   And we reached out broadly on ways  
18 to enhance customer protections. We had three  
19 roundtables. We had multiple consultations  
20 with the SROs, many industry participants from  
21 the FIA, CME, NFA, the FCMs, the buy side  
22 customers, as well as many discussions with

1 fellow regulators, the accounting and auditing  
2 industry. We've considered comments on many,  
3 many comment letters, over 125 comment  
4 letters.

5 And in fact before we came out  
6 with our proposed rule set which I'll talk to  
7 you about a little bit we had already adopted  
8 some important improvements to protect  
9 customer funds. I'll just quickly tick  
10 through those.

11 We had completed amendments to  
12 Rule 125 regarding the investment of funds to  
13 prevent the use of customer funds for in-house  
14 lending through repurchase agreements. We  
15 required clearinghouses to collect margin on  
16 a gross basis so that FCMs would not be  
17 offsetting one customer's collateral against  
18 another and then sending only the net to the  
19 clearinghouse.

20 We had adopted the so-called LSOC  
21 rule for swaps to help ensure customer money  
22 was being protected individually all the way

1 to the clearinghouse. We had adopted customer  
2 protection enhancements for designated  
3 contract markets, basically codifying staff  
4 guidance on minimum requirements for SROs.

5 And then as Anne mentioned in July  
6 2012 the CFTC approved the National Futures  
7 Association's proposal that stemmed from a  
8 coordinated effort as Anne mentioned with the  
9 CFTC, the SROs, other financial regulators and  
10 market participants to address some of the  
11 issues raised in MF Global. And then we  
12 proposed the rule set November 14, 2012.

13 Now, because the customer  
14 protection rule set, and Anne mentioned it so  
15 I'm going to just tick through it very  
16 quickly. But it's in the rule set. And it's  
17 there so that we can directly enforce those  
18 rules. Let me just quickly click through some  
19 of those requirements.

20 The first one is fixing Part 30,  
21 requiring that sufficient funds were held in  
22 the Part 30 accounts to meet the FCM's total

1 obligations to customers under the net  
2 liquidating equity method and no longer  
3 holding just what was needed for margin  
4 offshore with the rest being subject to risk.

5 Maintaining written policies and  
6 procedures governing the maintenance of excess  
7 funds as Anne just described. And then also  
8 making the additional reports available, the  
9 daily computations of seg and secured and so  
10 forth.

11 But our rule package then goes on.  
12 And let me tick through some of those for you  
13 as well.

14 As mentioned the daily information  
15 for bank and custodial accounts is very, very  
16 important. The proposed rule set included --  
17 we wanted to get direct access which came up  
18 before AlphaMetrix was out. So we support the  
19 aggregator method.

20 We do need and we're continuing to  
21 -- staff is continuing to recommend that we  
22 have in times of crisis when data is not being

1 pushed to us, that we have some kind of  
2 mechanism to allow us to have direct  
3 electronic access to bank and custodial  
4 account information in times of crisis, to be  
5 able to turn it on at that point.

6 We think also increasing  
7 disclosure to customers regarding the risks  
8 associated with futures trading and also  
9 requiring FCMs to provide current and  
10 potential customers with specific information,  
11 firm-specific information about the  
12 institution.

13 We think greater enhanced controls  
14 at FCMs regarding how customer accounts are  
15 handled is important. And that's included in  
16 the proposed rule set.

17 We have requirements regarding  
18 standards for SRO examinations and the annual  
19 certification, the annual certified financial  
20 statement audits, including raising the  
21 minimum standards for independent public  
22 accountants.

1           We want and we proposed additional  
2 filings that would give us an effective early  
3 warning system to allow us to get ahead of  
4 problems, to try to see around the corner  
5 where possible. More than we had done. Kevin  
6 frequently discusses it as sort of in the past  
7 we had been driving with a look in the rear  
8 view mirror and we're trying to look forward  
9 more.

10           And then seventh, we had  
11 instituted a liquidity requirement for FCMS or  
12 proposed to do so to better detect FCMS that  
13 had become distressed and may put customer  
14 funds at risk.

15           All of these points of course are  
16 about ensuring that customers can have  
17 confidence that the funds they post as margin  
18 or collateral are fully segregated and  
19 protected.

20           The comment period on the proposed  
21 rule set closed on February 15 of this year.  
22 We've continued to take comments. A number of

1 you in the room we've met with recently. We  
2 have now prepared a comment summary with  
3 proposals on the final rules which are now  
4 with Commissioners. And we're working  
5 together again with these additional comments,  
6 with staff of the Commissioners and so on to  
7 finalize a draft, pens-down rule package for  
8 Commission consideration.

9 So in general we still think that  
10 the basic direction, and I'm loath to talk too  
11 much about where we are changing some things  
12 because it's part of the rulemaking process.  
13 But in general we still think basically fix  
14 Part 30, require more effective risk  
15 management, require the delivery of more  
16 forward-looking information to allow us to get  
17 ahead of issues, help assure better  
18 examinations by outside CPAs, SROs, and  
19 ourselves frankly, provide more information  
20 and disclosure for customers and implement  
21 some changes around capital and liquidity.

22 That's it in a nutshell. We're

1 going to turn it to you and try to get your  
2 input and reaction to those things. But first  
3 Kevin's going to say some words about the exam  
4 process.

5 MR. PICCOLI: Sure. Thanks, Gary.  
6 So I thought I'd just spend a second on  
7 talking about the oversight process and how we  
8 put the pieces together.

9 So when I look at oversight  
10 there's three legs to the stool. The first is  
11 the CPA, the person who's coming in every year  
12 doing an annual audit of the intermediary.

13 The purpose of that CPA is really  
14 twofold. One, to provide us with a level of  
15 comfort that the financials that we get on a  
16 daily and monthly basis, we have an element of  
17 reliance on those because the CPA has gone  
18 through and they've looked at the controls,  
19 they looked at the process and the procedures  
20 that the firm has used in preparing their  
21 financials.

22 The other element that's critical

1 from the CPA is what we call the material  
2 inadequacy letter. So the CPA is charged with  
3 providing an opinion on the financial and  
4 regulatory reporting control.

5 So it's just reporting, it's not  
6 operating controls, it's not risk, but it's  
7 just for financial and regulatory reporting.  
8 But that also provides us with a level of  
9 comfort that during the year we have an  
10 element of relying on the CPAs when we get the  
11 monthly numbers.

12 I will say though that as we  
13 discover errors -- Let's say we're in the  
14 month of June. We get their financials and we  
15 find out there was material error -- We will  
16 go back to the year end and find out whether  
17 the CPA identified that error. And if not  
18 we'll challenge the CPA and say why did you  
19 not pick up this error. So we're trying to  
20 use that as an important leg in our oversight  
21 function.

22 The second leg is the DSROs

1 themselves. And with the CME and the NFA as  
2 the two primary ones. They as Anne mentioned  
3 perform a risk-based internal controls review  
4 every 9 to 15 months at the firms. And  
5 they're in there and getting into the detail  
6 on the firms themselves. As Anne also  
7 mentioned they receive the daily and the  
8 monthly filings as well that they review, as  
9 well as the notices coming in.

10 And then of course in the event of  
11 a crisis we will coordinate with Anne, the  
12 CME, the NFA on any particular issue, whether  
13 that's business continuity in Hurricane Sandy  
14 or a firm-related issue.

15 From the CFTC perspective, so the  
16 third leg to the stool, you know there we have  
17 obviously less staff, not as much as I would  
18 like, but that's the cards I'm dealt. But our  
19 focus is a couple fold. One, oversight of the  
20 DSROs, making sure the CME and the NFA are  
21 doing what has been asked of them and they're  
22 doing it appropriately.

1           We also perform what we call for-  
2           cause exams. So if we see a firm is having  
3           particular problems, they're filing a lot of  
4           notices, or a lot of amended financial  
5           statements, that may indicate a control  
6           problem. We'll go in and look for it  
7           specifically. So a very targeted approach at  
8           the particular problem.

9           Our scope is very narrow because  
10          we just don't have the staffing to do full-  
11          scope exams and that's the role of the CME and  
12          the NFA. So we'll go in on a for-cause basis.

13          We'll also do horizontal or sweep-  
14          type examinations. And by that we've done a  
15          few of them so far, one on liquidity where we  
16          go out to the firms and look at their  
17          liquidity, what are their sources of  
18          liquidity, do we think they're adequate, are  
19          they -- do they have enough committed lines.  
20          Does the firm have the proper governance over  
21          their asset liability management process. To  
22          ensure that if there is a liquidity problem

1 you've got the right folks looking at it,  
2 they've got the right banking relationships  
3 and committed lines or uncommitted lines to  
4 help shore up their capital and their excess.

5           Because there's basically three  
6 levels. You have the excess customer  
7 protection, the excess customer reserve, the  
8 residual interest. You have the excess net  
9 capital. So those two are very effective at  
10 providing an element of liquidity.

11           But on top of that there's the  
12 third piece and that's just banking liquidity,  
13 making sure -- because sometimes -- just  
14 because you have excess net capital doesn't  
15 mean that's liquid net capital. So we like to  
16 see what liquidity do they have in the market.  
17 So if there is a time when there's a large  
18 customer, big margin call that the customer  
19 can't make, the deficit in the account, the  
20 firm has the ability to have the cash to cover  
21 that call.

22           So the others that we have looked

1 at, we're looking at anti-money laundering  
2 processes. Their business continuity process.  
3 And that was in the wake of Hurricane Sandy.  
4 We did a joint review with the SEC and FINRA.  
5 And then targeted residuals is another one  
6 that we looked at recently.

7 And then just finally, we also do  
8 the daily monitoring, the monthly monitoring  
9 of the financials that come in. They go  
10 through our system and we do regression  
11 analysis, trend analysis and comparative  
12 analysis on the financials to see if there's  
13 anything that pops out from that standpoint.

14 So that's sort of the oversight  
15 function in a nutshell. Gary?

16 MR. BARNETT: Thank you very much.  
17 Why don't we turn it over. The real function  
18 here of course is to tell you a little bit  
19 about what we're doing, but to get your  
20 reactions too and your advice about what we're  
21 doing. So I'm going to just turn it over and  
22 open to comments, please.

1                   CHAIRMAN GENSLER: I would say  
2                   that's really critical because what we're  
3                   trying to do is get in front of Commissioners  
4                   a final document. We use this term in the  
5                   CFTC folklore "pens down" meaning the staff  
6                   has put their pens down and then Commissioners  
7                   are weighing in. But that's a little  
8                   misleading because Commissioners weigh in all  
9                   the time before the staff gets to "pens down".

10                   But this input, it comes at a  
11                   really critical time because Gary and his team  
12                   are trying to get something to the  
13                   Commissioners in the next, you know, few weeks  
14                   to 6 weeks.

15                   COMMISSIONER O'MALIA: Mr.  
16                   Chairman? Will the comments here be included  
17                   in the comment file for the rule?

18                   CHAIRMAN GENSLER: I think they  
19                   most definitely need to be. You know, we have  
20                   a whole transcript so we can just put the  
21                   whole transcript of this section into the  
22                   administrative procedures record.

1                   COMMISSIONER WETJEN: I wanted to  
2                   add something too because Kevin in his  
3                   presentation mentioned this. And this came up  
4                   earlier in the week when Commissioner O'Malia  
5                   and I were up in the House.

6                   Kevin mentioned the importance of  
7                   doing examinations of FCMS. Those  
8                   examinations require people. And so I wanted  
9                   to make this point to this group because I  
10                  think this group might be uniquely positioned  
11                  to help the agency on this front.

12                  After MF Global, after Peregrine,  
13                  it's fair to say none of us want to have to go  
14                  through that again. And one of the best ways  
15                  to ensure against that in addition to some of  
16                  these policy changes are routine, substantive,  
17                  deep examinations of FCMS.

18                  And in order to do that we need  
19                  personnel, we need staff to do that. This  
20                  Agency is underfunded. We have more  
21                  responsibilities now than we did 3 years ago  
22                  and we need the staff to do the job. We need

1 the staff to make sure something like MF  
2 Global, something like Peregrine doesn't  
3 happen again.

4 None of us want to see confidence  
5 in the markets we oversee shaken in the way it  
6 was. And one of the easiest ways we can do  
7 that is to advocate to the Congress to ensure  
8 that we have sufficient resources here. I  
9 can't say how important that is, or I can't  
10 overstate it rather. And as I said, I think  
11 this group here is probably uniquely  
12 positioned to help us on that front.

13 The rules are essentially  
14 finalized as Chairman Gensler said. We're 90  
15 percent done. We're now in the next phase of  
16 this which is implementation. Not only do we  
17 need to do examinations, we need to get  
18 questions to folks -- or answers to questions  
19 rather when people bring issues to us which is  
20 all the more reason for additional resources,  
21 additional staff and personnel here that can  
22 provide those answers to questions and

1 undertake these examinations that are going to  
2 be very, very important.

3 MR. FORTENBERY: Who would like to  
4 start off the discussion? Questions or  
5 responses? Yes.

6 MR. GALLAGHER: So I appreciate  
7 everything that you folks are working on on  
8 this topic, but the totality of this and how  
9 it all fits together is a little bit beyond  
10 what I can comprehend.

11 I was curious, is there a way we  
12 could do a bit of a case study? And maybe use  
13 MF Global and Peregrine, and go back and show  
14 how these changes that you have made would  
15 have created a red flag or an alert that would  
16 have identified the issue sooner. And then  
17 what you would have done to alert those that  
18 had accounts with those two entities to be  
19 able to transition something that didn't  
20 create another issue. Any opportunity for  
21 that?

22 MR. BARNETT: We can't really use

1 Peregrine or MF Global until it's sufficiently  
2 history and everything's public. So I don't  
3 think we should speak to them. But the  
4 concept, the principle that you're talking  
5 about, our rules till now have largely, the  
6 principles are right. And we were talking  
7 about this yesterday. Rules that say, you  
8 know, you will not commingle customer funds.  
9 You will not use customer funds improperly.

10 That's kind of like, in a way  
11 that's kind of like a speed limit that says  
12 you won't go faster than X miles an hour. And  
13 if you don't have cops there to catch people  
14 you're not going to have sufficient  
15 deterrence. If you don't have sufficient risk  
16 management you can't self-police, a separation  
17 of duties and things that will mitigate the  
18 risk that people will violate things, or act  
19 out of conflicts of interest.

20 So, and if you have our  
21 orientation, if the only things you deal with  
22 are violations and you look at them after

1 they've occurred, and they're either big  
2 enough to send to enforcement, or you fix them  
3 and move on, then you haven't dealt with  
4 trends and problems and so on.

5           So if you look at this, the main  
6 core idea of seg and its importance is there.  
7 And it's how to minimize, how to mitigate the  
8 risk to seg.

9           And one thing we did learn is that  
10 company risk, when people get -- you know,  
11 that failing to have sufficient internal  
12 review or risk management can be an issue.  
13 And also operating company risk can put  
14 customer funds at risk. And so if you look at  
15 these different proposals around that, they're  
16 trying to bolster the seg system.

17           So I know there are people --  
18 we've talked about alternative seg systems  
19 that are being looked at by the industry. We  
20 support that consideration. Whether it's  
21 insurance, whether it's some kind of perfect  
22 seg or alternative seg system. Those all have

1 gating and timing issues to it.

2 So when we have the system we have  
3 right now, and the industry has proposed this  
4 as well about the need to increase risk  
5 management, not management of risk. So,  
6 that's how I would say if you look at the  
7 orientation, it's like greater risk management  
8 to help mitigate human problem, misfeasance or  
9 malfeasance. Allow us to do a better job.  
10 Don't just look in the window at something  
11 that's gone wrong. Try to look at what's  
12 going on, risk. So we need more forward-  
13 looking information. Make sure that our  
14 examination and oversight has got that  
15 orientation to it as well.

16 Make sure we're keeping up with  
17 the rest of the world. FINRA and the SEC went  
18 to a more risk-based orientation 6-7 years  
19 ago. We've lagged. How do we catch up with  
20 that? How do we stay current with other best  
21 practices?

22 We tried to address all of those

1 sorts of things in this rule set. And that's  
2 kind of an organizing principle around the  
3 different pieces of it.

4 CHAIRMAN GENSLER: Gary, I'm going  
5 to answer the question directly. Peregrine.  
6 Lots of bad actors, you know, basically  
7 doctoring books and everything like that.  
8 That's well out there.

9 The system of the self-regulatory  
10 organizations and the CFTC being able to  
11 directly through modern technology means see  
12 what's in the bank account, see what's in the  
13 custodial account and have a confirmation, an  
14 online affirmative confirmation of those  
15 accounts is something that I think directly  
16 addresses those issues -- not all of the  
17 Peregrine issues, but directly addresses.

18 And I think what already, and Anne  
19 went through some of this, but already the NFA  
20 and CME and others have started to use, I'm  
21 trying to remember what's the outside service?

22 MS. BAGAN: AlphaMetrix.

1                   CHAIRMAN GENSLER: AlphaMetrix to  
2 have those direct electronic views daily into  
3 the cash and custodial accounts.

4                   I'm not participating in the  
5 specific matters around MF Global but more  
6 generically about the public policy issues,  
7 ensuring that a futures commission merchant  
8 keeps its books and records in a stronger way.  
9 And nobody can pull out more than 25 percent  
10 of what's called the excess without a CEO  
11 signature or senior officer signature I think  
12 addresses some of that. But that's my short  
13 version of what I think your question was.

14                  MR. GALLAGHER: Thank you. So if  
15 you do find an issue then what do you do? So  
16 do you alert the account-holders of the FCM  
17 that there may be an issue? Because that  
18 could create some sort of a dysfunctional  
19 system too.

20                  CHAIRMAN GENSLER: Well, Kevin  
21 could briefly tell you. But if some futures  
22 commission merchant is using customer money at

1 any point in a day, intra-day, end of day, it  
2 doesn't matter, any point in the day that's a  
3 violation. And that's when Kevin and Gary and  
4 sometimes the full Commission, I mean we're  
5 alerted to these things as well. And it  
6 becomes a very intense discussion with the  
7 futures commission merchant. I guess that's -  
8 - I'd like to leave it there maybe.

9 MR. PICCOLI: Yes, I think very  
10 intense is probably an understatement. Yes.

11 But whenever there are any issues  
12 that we see, whether they're at the CFTC, at  
13 the SEC, FINRA, or any other international  
14 regulator that we become aware of we always  
15 take a retrospective look and do a post mortem  
16 and say okay, could this happen with our  
17 registrants. Is there something we should  
18 change either in our internal examination  
19 process or should we send out what we call  
20 "Dear FCM" letters that go out to the FCMs and  
21 say by the way, we saw this, and just want to  
22 give you a heads up on it.

1 MS. BAGAN: And I would just like  
2 to add that as an SRO we have an assortment of  
3 emergency actions that we can take. In a  
4 situation where an FCM was not holding the  
5 customer funds that they told us they had we  
6 would be in there immediately and looking to  
7 transfer customers. And find out where did  
8 that money go.

9 COMMISSIONER O'MALIA: Mr.  
10 Chairman? Maybe we could answer -- I think  
11 you asked a very good question about when does  
12 the customer know. When will the customer be  
13 notified if something has gone wrong with his  
14 account. How will we address that? How does  
15 -- I think we know how using the SRO enhanced  
16 oversight responsibilities, but specifically  
17 how will we interface with the customer on  
18 these individual things under the new customer  
19 protection -- proposed customer protection  
20 rules.

21 MR. BARNETT: Okay. My answer may  
22 be too technical and you'll have to jump back

1 in.

2 We have struggled with some of the  
3 -- we get additional information. And what do  
4 we do when we have early warning issues? I  
5 mean it's one thing if we're talking about  
6 seg's been violated, but you know, early  
7 warning on capital or something like that. Or  
8 other stress problems that come up.

9 There is a real tension between  
10 having the forward-looking information as a  
11 regulatory tool and then accelerating the  
12 problem by making it public. We have provided  
13 that there should be more fulsome disclosure  
14 to customers about the markets and futures  
15 trading and so on and so forth. And from  
16 specific disclosure.

17 But at some point the information,  
18 the realtime information about problems at the  
19 FCM start to create -- if you disseminate that  
20 information it accelerates the problem. And  
21 you can't help resolve it. So there's a real  
22 issue there.

1                   We struggle with that all the  
2                   time. There have been situations we've been  
3                   stuck in when we couldn't provide information  
4                   we would have liked to. And then we turned to  
5                   CME, for instance, with their powers to help  
6                   protect, maybe stop allowing new people to  
7                   come in, dealing with certain accounts, things  
8                   like that. So it's a little bit of a  
9                   balancing when things get really tough.

10                   COMMISSIONER O'MALIA: Does that  
11                   help or hurt?

12                   MR. GALLAGHER: I appreciate that.  
13                   That was helpful. Thank you.

14                   COMMISSIONER O'MALIA: Gary, could  
15                   you also mention maybe some of the Know Your  
16                   FCM changes we made over a year ago? That  
17                   might help people understand who they're  
18                   commingled with, what they've been set up with  
19                   in terms of -- I think those were done at  
20                   least a year ago if not longer. It'll at  
21                   least help customers understand where they're  
22                   putting their money and who they're investing

1 with in a FCM.

2 MR. PICCOLI: So yes, there were a  
3 few things that we were able to get out very  
4 quickly. Financial information on the firms  
5 themselves. So the segregation amounts,  
6 excess amounts, net capital, where funds are  
7 invested. That information, through the NFA  
8 they were able to get that out very quickly on  
9 their website and it's right there for all  
10 investors to look at. Anyone wanting to do  
11 due diligence on their FCM can look at it and  
12 get a lot of useful financial data.

13 It's on a monthly basis right now  
14 where the information is updated. But that is  
15 all there as well. So that was I think very  
16 helpful to get out quickly.

17 MS. HAN: So we have looked at the  
18 customer protection rules. And one thing I  
19 think along these lines that we would advocate  
20 is that -- we support all the information that  
21 you propose to require FCMs to disclose to  
22 you. But we think that there should be some

1 more information disclosed to customers.

2 Some of those would be schedules  
3 for the segregation amount, the secured amount  
4 in cleared swaps, cleared swaps and customer  
5 seg amount for the customer seg amounts as  
6 well as the summary balance sheet and some of  
7 the income statements monthly. So we think  
8 that that would be very helpful information to  
9 provide to customers. And so that way  
10 customers, you know, all the while can kind of  
11 make their own assessments too.

12 MR. FRIESEN: I guess as a small  
13 producer who uses Chicago Board of Trade and  
14 then the CME for the last 30 years, I've never  
15 had a problem. I was not involved in MF  
16 Global or any of those so I've been very  
17 fortunate.

18 But I use those products for risk  
19 management. And when we talk about margin  
20 call and things like that, and I've read some  
21 things and I don't know if they're up to date,  
22 what I'm seeing, or not.

1           But if you increase the amount of  
2 money that I have to place on margin right  
3 now, I mean I have 3 business days I think to  
4 send money in. And that works for me. You  
5 make that any tighter and at some point in  
6 time I'll probably quit using the Exchange.  
7 I just can't stay on top of it that much as a  
8 producer. As a small businessman you might  
9 say, it's too much of a requirement.

10           And on top of that if I see that  
11 correctly, I mean it would put more money of  
12 mine at risk to a MF Global because I'd have  
13 more margin money there. So it puts me at  
14 higher risk.

15           As far as insurance, I guess that  
16 would all be nice if they could buy insurance  
17 but they're going to pass that cost on to me  
18 too. So I guess I don't see a use for it.

19           I guess the only thing I can see  
20 from the MF Global bankruptcy that I think  
21 could be done differently is if my funds were  
22 put at the top of the list for bankruptcy.

1 But otherwise when you have bad actors that  
2 break the law I think they're going to  
3 continuously look for ways around your  
4 regulations and your rules. And it's  
5 unfortunate. So I expect it to still happen.

6 So I sweep my fund regularly now  
7 which I don't like to do. I used to keep  
8 quite a bit of money there so we didn't have  
9 to send money back and forth. But now it's  
10 different. So I mean some of that trust is  
11 gone.

12 But for you to send information  
13 for my FCM, that's of no use to me whatsoever.  
14 I'm not sophisticated enough to analyze that  
15 data. I hope I know my FCM but it does me no  
16 good.

17 MR. BARNETT: Understood. The  
18 margin deficit residual interest issues that  
19 you were talking about is a very important  
20 question and one that we're looking at  
21 internally very carefully.

22 MR. ANDERSON: The NGFA represents

1 over 1,000 member companies encompassing all  
2 aspects of the agribusiness in the USA. We've  
3 been on record already similar to what you  
4 were saying.

5 First, we appreciate the effort  
6 that you guys made into some of the insurance  
7 funds. And we're anxiously awaiting to see  
8 your results on cost.

9 We do take issues with two things  
10 that we feel could greatly increase customer  
11 risks. First was the timing of when an FCM  
12 takes a capital charge. We've urged you to  
13 stay at the 3-day window, again similar.

14 And also the concept of the  
15 residual interest where the FCM can kind of  
16 top up the account until the margin call is  
17 received. We feel if we change that that  
18 there is a strong likelihood that we see FCMs  
19 requiring pre-funding of the margin accounts  
20 to exactly your same point.

21 Now if I'm an elevator and I have  
22 \$2 million on deposit with my FCM I have to

1 have an additional \$1 million there. So  
2 there's more money potentially at risk in case  
3 someone does get around the regulations again  
4 and we have a situation similar to an MF  
5 Global.

6 CHAIRMAN GENSLER: Can I ask a  
7 follow-up of both of the last commenters? One  
8 of the challenges we have is the law itself.  
9 It's a law that's been in place for some time.

10 And I'm not a lawyer, but I'll  
11 paraphrase as I understand it, that thou shall  
12 not use one customer's money to secure or  
13 guarantee another customer's position or  
14 deficit. Roughly speaking.

15 And so what we put out in this  
16 proposal was a rule that basically said that.  
17 The futures commission merchants highlighted  
18 to us, "Well actually there's been a practice  
19 for some time, maybe years whereby if you had  
20 a deficit as you said." Is your first name?  
21 What's that?

22 MR. ANDERSON: M.J.

1                   CHAIRMAN GENSLER: M.J., okay. As  
2 M.J. said, that you'd like to still have 3  
3 days. So if they made a call on you on a  
4 Tuesday because you were in deficit you want  
5 until maybe Friday, 3 days or Thursday.

6                   But what the futures commission  
7 merchants are doing is during those 3 days is  
8 possibly using somebody else's money to secure  
9 your deficit.

10                  Now, the futures commission  
11 merchant itself might have enough of their own  
12 money, and it's totally appropriate that they  
13 would put some of their capital, their money  
14 in to secure your deficit.

15                  What we did in this proposed rule  
16 is what if the futures commission merchant  
17 isn't putting their money in to secure your  
18 deficit but they're using who wants to  
19 volunteer their money to be used for M.J.

20                  Can I see by a show of hands who  
21 wants their surplus to be used for M.J.'s  
22 deficit? I haven't seen any raised hands.

1 That's the challenge that we have. That's the  
2 challenge that we have. Ed, you want your  
3 money to be used for M.J.'s deficit?

4 MR. GALLAGHER: At the right  
5 interest rate I may take that.

6 (Laughter)

7 CHAIRMAN GENSLER: All right. But  
8 that's -- I'm trying to frame this public  
9 policy and legal issue and what we are -- and  
10 this is the challenge that we have. And I  
11 don't know what the right answer is.

12 But M.J.'s got a deficit. He  
13 wants 3 days because -- and I'm sorry, I don't  
14 remember the gentleman's name who was so  
15 articulate.

16 MR. FRIESEN: Curt.

17 CHAIRMAN GENSLER: Curt. Curt  
18 says I'm a small producer and businessman and  
19 I don't have the books to sort of keep up with  
20 this. That all sounded -- I mean I grew up,  
21 my dad had a small business with 30-35  
22 employees and if he didn't make payroll on

1 Friday, he shut down. And my mom was the  
2 bookkeeper. So I identify with what Curt  
3 said.

4 But then there's this issue, does  
5 Curt's deficit or M.J.'s deficit get funded by  
6 Ed.

7 MR. GALLAGHER: I think that's a  
8 good question. We have no intention of  
9 wanting one for the other. As you mentioned,  
10 may fund it with another customer's as opposed  
11 to may put up their own capital for it as  
12 well.

13 Many FCMS are already down to one  
14 day. So where that money is trued up the next  
15 day. Again, we would support the idea that  
16 there's no -- one customer's funds is not used  
17 for another customer's deficit as well.

18 The concern we have is more the  
19 dollars that I need to margin my account, is  
20 that going to increase dramatically and  
21 therefore perhaps put more money at risk in  
22 the case of a default.

1                   MR. MILLER: The question -- I  
2 might almost be ready to raise my hand and say  
3 customer to customer if it's at some level of  
4 -- again, we're not talking deficits  
5 necessarily, we're talking under margined.

6                   I have a much bigger problem with  
7 the FCM using my excess funds for their  
8 internal investments that are not subject to  
9 margining rules. That was the creation of an  
10 MF Global, not the inter-transfer among  
11 customer segregated accounts.

12                   So I think we need to make sure we  
13 understand in some regards this movement to  
14 the one day versus the industry practice if  
15 you will, particularly with small customer  
16 accounts.

17                   I've been on both sides of having  
18 reportable positions and been relatively a  
19 small customer. My FCM had me on a much  
20 tighter leash when I was on reportable  
21 positions than when I was trading one contract  
22 of corn or two contracts of corn. And the

1 ability for me to use -- to satisfy it by  
2 bringing in a check the next morning which  
3 probably was not going to clear in the FCM's  
4 account for 2 days, I don't really want that  
5 to go away. As opposed to me having to come  
6 off the tractor, figure out how to get a wire  
7 transfer for a \$200 margin call.

8 So I think there's a difference  
9 between when I was on a call with reportable  
10 positions as opposed to on a call that might  
11 be a \$100 call, a \$200 call, and the ability  
12 of a FCM to manage that internally.

13 And the movement of segregated  
14 funds at the margin, you know, being a net  
15 margining was not the result that resulted in  
16 either Peregrine or MF Global. And let's make  
17 sure we're not causing problems for  
18 functionality, particularly in the ag  
19 community to solve -- and none of this would  
20 have solved Peregrine or MF Global.

21 And I think that's the concern  
22 that's being raised is we're applying a

1 bandage to the wrong sore. You know, we're  
2 putting something on and we're trying to fix  
3 something that wasn't the problem, it wasn't  
4 the causality.

5           And I understand there may be  
6 issues with law that have to be clearly  
7 addressed by the Commission. But on the other  
8 hand, let's make sure we're not creating  
9 problems at the farm level, at the elevator  
10 level, et cetera, that in fact makes us  
11 riskier. In the name of customer protection,  
12 may make us all riskier.

13           And that I think is the concern  
14 that has been raised by Grain and Feed, been  
15 raised by American Farm Bureau, and I think a  
16 number of other institutions that represent  
17 the farmer interest.

18           MR. CORDES: I'd like to add just  
19 a few comments. And maybe staff can  
20 elaborate. Or maybe, Commissioner Wetjen, you  
21 mentioned earlier this is under review. And  
22 I know there's been a lot of testimony on

1 this. And I've made some comments as well.

2 I think part of our discussion  
3 here is how we interpret the new rules or the  
4 laws. We're not talking so much deficits,  
5 we're talking potential margin calls. I think  
6 there's a difference.

7 I mean nobody's asking anybody to  
8 cover someone else's deficit. The way the  
9 rules are written or proposed is as an FCM  
10 you're going to have to make sure your  
11 customer has enough money to meet a potential  
12 margin call, which means look at the market  
13 right now. If you've got a short position on  
14 corn and it's up 30 cents, do you have that  
15 additional money there?

16 The way the rules are written  
17 today I'm seeing it's going to be we're going  
18 to ask the customer to basically double-fund  
19 their margin call. You're going to have the  
20 initial margin call and you're going to have  
21 money in your account to fund the one day's  
22 move. That's the fallout or what it's looking

1       like at this point.

2                       So I'd be curious if staff or one  
3       of the Commissioners would like to comment on  
4       how you're looking at handling those revised  
5       interpretations or rules.

6                       CHAIRMAN GENSLER:  You know, I see  
7       Bob Wasserman and Ananda here as well.  I  
8       don't know if either of you wanted to --  
9       Ananda is the head of our Division of Clearing  
10      and Risk.  And I don't mean to take it away  
11      from you, Gary, but since he's maybe --

12                      MS. BAGAN:  Can I add something  
13      just before you start?  And Scott is right,  
14      it's not deficits meaning a negative account  
15      balance.  That's already covered by the  
16      regulations today.  Firms have to put their  
17      own money in to cover those today.

18                      It is the margin call issue that  
19      we're talking about.  That's the change.

20                      MR. RADHAKRISHNAN:  Scott, you're  
21      both with the same FCM.  You're both with the  
22      same FCM and you both put on positions that

1       require a margin of \$100 each. Okay? And  
2       your -- and that's the margin of the CME,  
3       \$200. So the FCM gives your \$100 and Curt's  
4       \$100 to the CME, right? Fine.

5               Next day your margin requirement  
6       drops to \$80. Curt's margin requirement goes  
7       up to \$120. As far as the CME is concerned  
8       it's still \$200. But what we're saying is  
9       that the FCM cannot use your \$20 to fund his  
10      margin call. That's all we're saying.

11              So would you like that?

12              MR. CORDES: I'm not disagreeing  
13      with that. The way it's proposed today is you  
14      don't even have the next day to collect the  
15      \$200 as an FCM from him to get to the CME.  
16      You're saying it's realtime right now.

17              MR. RADHAKRISHNAN: Right, but  
18      then the issue is -- the issue, and maybe this  
19      is something, you know, the staff can clarify.  
20      The issue is when the CME makes the margin  
21      call, that's the point in time when the  
22      clearing member has to pony up, right?

1                   So at the time in which the  
2                   obligation of the FCM arises to meet margin  
3                   requirements that's the time at which the FCM  
4                   has to make sure that it is not using one  
5                   customer's funds to margin, secure, or  
6                   guarantee another customer's obligations.

7                   MS. BAGAN: But keep in mind too  
8                   that if Scott's margin goes down to \$80 he can  
9                   take that \$20 out immediately. The firm has  
10                  to give that to him immediately. In which  
11                  case now they do have to put up their own  
12                  money.

13                  MR. RADHAKRISHNAN: That's right.

14                  MS. BAGAN: Or until Curt pays up.

15                  MR. RADHAKRISHNAN: But what we  
16                  want to say is we don't want -- we don't want  
17                  a situation where the FCM uses its own funds.  
18                  I'll speak for staff. We don't think it's  
19                  right that the FCM puts its own capital into  
20                  the seg account. Only at a point in time when  
21                  Scott wants to withdraw his \$20. I mean, at  
22                  all times his money should not be used to

1 margin, secure, or guarantee the obligations  
2 of another customer. That's the point.

3 MR. WASSERMAN: I think the issue  
4 we're trying to balance is this. There's some  
5 very real practicalities and you've pointed  
6 them out.

7 There's also the fact that if the  
8 FCM goes bust and you find out that your \$20  
9 isn't there because actually they were using  
10 it to margin Curt's positions, and Curt as  
11 well had a bit of a problem, you'd be very  
12 upset. And among other things you'd be upset  
13 with, well, us.

14 On the other hand, you're right,  
15 there are practical issues. And we don't want  
16 to put folks in a position where there needs  
17 to be double margining.

18 So as Ananda said, the first issue  
19 is you put your position on, say, Monday  
20 morning. And there's an increase in margin  
21 requirements. Or let's say Curt does, rather.  
22 Your money isn't actually getting used until

1 the FCM moves money upstream, say, to the CME.  
2 So it's not an immediate matter. In other  
3 words, he has to be in the right place at all  
4 times.

5 COMMISSIONER O'MALIA: Bob, can I  
6 ask a question?

7 MR. WASSERMAN: Sure.

8 COMMISSIONER O'MALIA: You raised  
9 -- at a point in bankruptcy we've got this pro  
10 rata distribution rule well outside of our  
11 ability to fix it in a rulemaking. So when it  
12 goes to bankruptcy it doesn't matter,  
13 everybody's money freezes. It doesn't matter  
14 whether he's \$20 up or \$20 down. If there's  
15 a hole everybody is frozen and that hole is  
16 distributed evenly. So it doesn't -- he can  
17 be mad but the Bankruptcy Code is the problem.  
18 How do you resolve a hole in bankruptcy under  
19 pro rata distribution?

20 MR. WASSERMAN: So the purpose of  
21 the -- there's two levels.

22 COMMISSIONER O'MALIA: Unless it

1 takes 3 years like it's taking in MF Global.

2 MR. WASSERMAN: Well, again, I  
3 will note in MF Global most of the money did  
4 go out in a much shorter period of time,  
5 albeit it is only now that we're getting  
6 towards the very good result of hopefully  
7 getting close on 100 percent.

8 That said, MF Global is an example  
9 of where the rules were not followed and at a  
10 certain level if the rules are not followed  
11 there's problems there.

12 If the rules are followed and the  
13 question is what the rules are and we try to  
14 make sure that they are followed. We want to  
15 make sure that if the rules are followed and  
16 someone loses money because that does happen -  
17 -

18 COMMISSIONER O'MALIA: Can we come  
19 back to the specific example?

20 MR. WASSERMAN: Sure.

21 COMMISSIONER O'MALIA: So how does  
22 this daily margin true-up rule protect you in

1 a pro rata distribution under bankruptcy if  
2 there's a hole in somebody's account?

3 MR. WASSERMAN: Forgive me, but  
4 the idea is that this is ensuring -- this is  
5 to reduce the likelihood of that hole  
6 occurring in the first place.

7 In other words, if Curt has a  
8 margin requirement of \$120 we want to make  
9 sure that there's \$120 of Curt's money there  
10 to meet that margin requirement so that if  
11 Curt defaults when there is a margin -- when  
12 there is an actual loss there's enough money  
13 there.

14 COMMISSIONER O'MALIA: Okay, but  
15 in the case of a default, somebody defaults.  
16 Somebody has a hole, blows themselves up. How  
17 does this rule -- would this rule change  
18 anything about the pro rata distribution in  
19 bankruptcy?

20 MR. WASSERMAN: This rule is not  
21 intended to change the pro rata distribution  
22 in bankruptcy.

1                   CHAIRMAN GENSLER: Can I use the  
2                   example? The Advisory Committee is seeing us  
3                   deliberate with our staff.

4                   But Curt has a \$120 now margin  
5                   requirement under the example but he only has  
6                   \$100 in. And Scott has \$100 in but no longer  
7                   -- he wants, you know, he might have wanted  
8                   his \$20 back.

9                   But before Scott got his \$20 back  
10                  either the FCM goes bankrupt or, sorry Curt,  
11                  Curt goes bankrupt. Just as an example.

12                  Back to Commissioner O'Malia's  
13                  question. Will Scott get his \$100 or not? I  
14                  mean, I know that on Tuesday \$20 of Scott's  
15                  dollars are being used to margin Curt. Curt  
16                  only put \$100 in. Now Curt goes belly up.  
17                  What happens? I don't know the answer. This  
18                  is not a setup. I'm trying to understand.

19                  MR. WASSERMAN: Let's assume for  
20                  the moment these are the only two customers.  
21                  So if Curt loses \$120. Because let's say  
22                  indeed maybe -- Curt loses \$120. The margin

1 being a measure of --

2 MR. RADHAKRISHNAN: Let's answer  
3 the question. If Curt goes bankrupt, the FCM  
4 is fine, then Ed's fine. He can go away if he  
5 wants but there's no FCM insolvency. So if  
6 Curt goes -- and I hope you don't go bankrupt.

7 The issue is what happens if on  
8 that same day, the FCM is insolvent because of  
9 Curt's inability to fund the margin. That's  
10 the specific question.

11 So the issue then is whether there  
12 is a shortfall in segregation. Being -- if  
13 all the customers who have credit balances or  
14 equity show up and say give me my money back  
15 does the FCM have enough money to give it  
16 back.

17 Because Curt cannot get more than  
18 what he's entitled to. So I think what will  
19 happen is that there will be an attempt. And  
20 you know, and correct me if I'm wrong, but an  
21 attempt to freeze out Curt and try and move  
22 all of the positions and the money on the non-

1 defaulting customers to the extent possible.

2 CHAIRMAN GENSLER: And if the loss  
3 is big enough, won't it be pro rata --

4 MR. RADHAKRISHNAN: If the loss is  
5 big enough and there is a shortfall in  
6 segregation as a whole then the -- and there's  
7 a bankruptcy filing then the pro rata  
8 distribution rules come into effect.

9 But the objective of this rule is  
10 to make sure, one, to be faithful to the  
11 statute.

12 MR. FORTENBERY: We have about 5  
13 minutes left on the topic. Let me throw it  
14 back to the Committee and see if -- David, do  
15 you have a comment you'd like to make?

16 MR. MILLER: Again, it strikes me  
17 as part of the conversation. We're trying to  
18 solve a bankruptcy problem with a CFTC ruling  
19 with regard to the pro rata distributions.

20 We are still talking margin.  
21 We're not talking deficit. The account is not  
22 deficit. The account may be under-margined,

1 and in an under-margined that doesn't mean  
2 there isn't sufficient -- if the position is  
3 liquidated for everyone to be made whole.  
4 Because you're still on a margin position.

5 It is a totally different thing if  
6 we're talking using my funds to cover  
7 somebody's deficit position. Then I am at  
8 risk because there is not sufficient funds in  
9 segregated accounts to make everyone whole.

10 But if it is simply a margin  
11 position that is under-funded for a very short  
12 period of transactional time I'm not at risk.  
13 I only become at risk if the other person goes  
14 deficit, not if they're under-margined.

15 And I think we're mistaking the  
16 ability to do transactional lubricity I'll  
17 call it to make the system work with markets  
18 that are moving constantly during the day.  
19 And we hit a settlement point at one time and  
20 this, I can tell you, I've been both a broker,  
21 I've been on, like I said, been on multiple  
22 sides of this. If it's a significant risk I'm

1 in contact with them. Or they're in contact  
2 with me.

3 If it is this minor piece and I  
4 know the customer will send me the check  
5 tomorrow. But I'm not putting someone else at  
6 risk.

7 Now, if my account goes deficit  
8 because I've got \$5,000 in there and the  
9 market moves \$10,000 against me, that's a  
10 whole different situation than if my account  
11 went deficit.

12 I think we really are trying to  
13 solve something that's a bankruptcy issue with  
14 a rule that really takes and puts sand in the  
15 gears of functionality. And I think we need  
16 to be very, very careful about doing it.

17 CHAIRMAN GENSLER: It's David,  
18 right? Yes, I assure you we're trying to be  
19 very, very careful.

20 I think that there's two issues.  
21 One is the law, thou shall not use, secure,  
22 guarantee, you know, with one customer's money

1 other people. So that's this intra-day or  
2 intra 3-day what was the word you used?

3 MR. MILLER: I used transactional  
4 lubricity.

5 CHAIRMAN GENSLER: Lubricity.  
6 I'll look it up later. But it sounds good.

7 That transactional lubricity  
8 intra-day or for 3 days, is that consistent or  
9 conflicting that thou shall not use, secure  
10 customer money, et cetera. That's a legal  
11 question. I'm not a lawyer but that's an  
12 important piece.

13 But I do think that there is some  
14 risk even if it's using somebody's margin  
15 because if the music stops and the FCM goes  
16 default and Curt's not there -- sorry Curt.  
17 And in liquidating the position CME has to  
18 move his position or liquidate the position,  
19 they needed the \$120. If they liquidated and  
20 only needed \$5 then that's all right. But the  
21 risk would probably come if they have to  
22 liquidate it and his initial margin wasn't

1       enough.

2                       So I'm just saying there is some  
3 risk. How you measure that, I'm not saying,  
4 but there is some risk I think. And so it's  
5 a legal question and then there is some risk.  
6 And I do share -- it's not what Peregrine and  
7 the others were about.

8                       COMMISSIONER O'MALIA: Can I ask  
9 Bob and Ananda maybe so we don't avoid  
10 Commissioner discussion here. But if it's the  
11 law how have we not interpreted it this way  
12 previously? What was our standard before?

13                      MR. RADHAKRISHNAN: I think we,  
14 staff, I'll speak for staff, assumed that  
15 people knew what the law was and were  
16 complying with the law the way that the law  
17 said they had to comply.

18                      And then it was through, you know,  
19 our activities as a result of these two  
20 unfortunate events that we realized that  
21 people had a different view of the law. In my  
22 view a wrong view of the law.

1 MS. BAGAN: But Ananda, I don't  
2 know that that's entirely true in that at the  
3 FCM level itself this is one of the things we  
4 look for on our regulatory examinations is to  
5 make sure that they are following the law at  
6 the FCM.

7 I'm not talking about what they  
8 put up at the clearinghouse, I'm talking about  
9 making sure they hold the funds they need to  
10 hold. And they are doing that. And they  
11 always have been doing that. That's different  
12 than what was going on at the clearinghouses.

13 MR. RADHAKRISHNAN: So what we're  
14 saying is let's clarify the law. This is the  
15 law. It's, you know, as Chairman has said,  
16 the statute is very clear. You cannot use one  
17 customer's money, funds, or property to  
18 margin, secure, or guarantee the obligations  
19 of another.

20 So, nobody's been able to make the  
21 argument with all due respect that what we're  
22 suggesting is not what the law says it is.

1 The arguments we've heard through all the  
2 comment letters is it's going to be expensive,  
3 the Earth's going to fall, so on and so forth.  
4 But nobody has said, nobody has done to my  
5 view a legal analysis saying your analysis is  
6 wrong. Right?

7 I mean the gentleman over there  
8 said, you know, it's a difference between  
9 deficit and margin. But the point is that if  
10 the example that I gave takes place the FCM is  
11 using one customer's property to margin  
12 somebody else's requirement.

13 MR. FORTENBERY: We need to move  
14 on to the next topic. Let's have just one  
15 more comment if you'd like and then we'll --

16 MR. FRIESEN: Well, from my  
17 perspective, I mean I guess I was always more  
18 concerned when I had excess margin there. I  
19 kind of knew they were using my money to do  
20 something, I didn't know what, because  
21 somebody always uses it. Whether they invest  
22 it wisely or not, I was always hoping I'd get

1       it back.

2                   But I guess my biggest concern as  
3 a user of the CME right now is that if I have  
4 excess margin there and my FCM goes bankrupt  
5 why can't I get all my money back if customer  
6 accounts are segregated. Or how can we do  
7 that to protect my excess margin there.

8                   The rest of it is just positions  
9 that, yes, they're frozen, that's unfortunate  
10 and that's taking a long time in some cases.  
11 But it puts me at risk. And I don't mind  
12 leaving those excess funds there if I know  
13 they're protected somehow.

14                   MR. FORTENBERY: Thank you very  
15 much. Scott, one more?

16                   MR. CORDES: Can I? Just one last  
17 comment. I'll keep it brief.

18                   You talked about the practicality  
19 and what goes on. And I think one thing that  
20 needs to be considered is you've got wire  
21 transfers in, wire transfers out. They don't  
22 always necessarily go in the order you want.

1 So what is the practicality of how that works  
2 on a day's transaction, whether it's between  
3 you and your FCM, or the FCM and the  
4 clearinghouse.

5 MR. FORTENBERY: Okay, thank you  
6 very much. Thank you, Anne and Kevin and  
7 Gary.

8 We're going to change --

9 COMMISSIONER O'MALIA: Mr.  
10 Chairman, can I make one last comment?

11 MR. FORTENBERY: Okay. This is  
12 the last last comment.

13 COMMISSIONER O'MALIA: That's  
14 fine. Make sure you wish Anne a happy  
15 birthday. It was yesterday. And 25 years of  
16 CME service today. So this is how she spends  
17 her day.

18 (Applause.)

19 MS. BAGAN: Thank you.

20 MR. FORTENBERY: Okay, that was a  
21 good comment.

22 We're going to change direction

1 just a little bit and talk about renewable  
2 identification numbers, RINs. As you may know  
3 maybe eight or 10 weeks ago futures contracts  
4 were initiated to actually trade RINs  
5 explicitly.

6 We have two members of a panel  
7 today to talk to us about those. The first  
8 one is Phillip Verleger who's the principal of  
9 PKVerleger who's going to talk to us a little  
10 bit about the background of RINs.

11 And then also the Chief Economist,  
12 the interim Chief Economist here at the  
13 Commission, Scott Nixon, is also going to  
14 speak to us. So we'll go from there.

15 MR. VERLEGER: First, I have  
16 submitted a paper which will be also on our  
17 website.

18 Second, let me just summarize it.  
19 Ethanol has been used as a fuel additive for  
20 many years in the oil business. It has a high  
21 octane that makes it popular with refiners,  
22 especially when the price is low because it

1 cuts the cost of producing gasoline.

2 Other things being equal today  
3 refiners would blend as much ethanol as they  
4 could into gasoline. As you can see from this  
5 first chart the price of ethanol which is the  
6 black line is below the price of RBOB which is  
7 a refining blending stock for gasoline.

8 I might add that if you blend more  
9 ethanol you can make a lower-octane gasoline  
10 which is lower cost to manufacture.

11 Second point. Existing  
12 infrastructure within the petroleum industry  
13 distribution limits the amount of ethanol in  
14 gasoline to 10 percent. This is a regulation  
15 having to do with fire hazards and the rules  
16 that are established by UL Laboratories. You  
17 can install separate pumps for higher ethanol.  
18 They are very expensive. And so companies  
19 tend not to do that. Marketers tend not to do  
20 that.

21 Third point. Congress dictated a  
22 specific volume of ethanol that had to be

1 blended into motor fuels when it passed the  
2 Energy Act of 2004, more recently the Energy  
3 Independence and Security Act of 2007. EPA  
4 implements that act.

5 Today, this year, 20 billion  
6 gallons of renewable fuels must be blended in  
7 gasoline and other motor fuels; 16.5 billion  
8 of those are ethanol. The projected gasoline  
9 and diesel use is 183 billion gallons, that  
10 was the projection made by EIA last year.  
11 That means you have to blend about 11 percent.

12 Now, you know, the traditional way  
13 of working in Washington would be to require  
14 a specific number of gallons or specific  
15 percentage in every gallon. EPA has  
16 introduced tradable credits called Renewable  
17 Identification Numbers. They are 18-digit  
18 long numbers which EPA tracks and can be  
19 traded like pollution credits or any other.

20 EPA has encountered significant  
21 difficulties with enforcement of the law,  
22 particularly as to biodiesel RINs. Several

1 people are in jail now.

2 Buyers of fraudulently created  
3 RINs were required to replace them. That is  
4 EPA, if they find they're fraudulent goes to  
5 the buyer, say Valero, and says you bought it  
6 from Sam, you have to buy some more. EPA has  
7 cleared some of that up now with the  
8 certification program.

9 There are six types of RINs. My  
10 focus today is going to be the D6 RIN as EPA  
11 calls it which is the ethanol RIN which is  
12 what CME trades. That is what's blended in  
13 gasoline.

14 Until -- if you look for a second,  
15 the table just shows in the second column the  
16 requirements.

17 Until this year the prices of RINs  
18 were essentially negligible. The reason was  
19 that essentially we were well below the 10  
20 percent blend rate and companies were happy to  
21 move ahead. They were using more ethanol than  
22 required so the price was free.

1                   But what has happened is gasoline  
2 demand has failed to keep up with the  
3 projected levels that were used by Congress  
4 when they passed the act.

5                   If you look at this chart what we  
6 show is the trend in gasoline that was  
7 expected by Congress from EIA when the law was  
8 passed in 2006 as compared to what has  
9 actually happened. And we are now seeing  
10 roughly a 20 percent shortfall in gasoline  
11 consumption with an absolute fixed requirement  
12 for blending gasoline.

13                  Now, the decline has come because  
14 consumers finally figured out after 30 years  
15 that energy prices were high and they ought to  
16 consume. And so if you look at Bureau of  
17 Economic Data on gasoline consumption which is  
18 probably the most accurate by month what you  
19 see is a trend line, the red line, of gasoline  
20 as a percentage of total consumption. That  
21 broke in 2005 and we are now again about 20  
22 percent short and we're going further.

1                   So what has happened is the price  
2 of RINs have risen dramatically. At the  
3 beginning of the year they were zero. Last  
4 week they were \$1.40. This morning I was  
5 informed by Tom Kloza, editor of OPIS, they  
6 dropped to 90 cents. They have since risen  
7 back to \$1.10.

8                   This is a problem because Valero,  
9 one of the largest refiners, a company that I  
10 was a member of the board of directors 20  
11 years ago has said it's going to spend between  
12 \$600 and \$800 million this year for RINs.  
13 This is not a trivial subject. And so  
14 refiners have been pushing on Congress to  
15 change the law which would reduce their  
16 obligation.

17                   All of the discussion so far has  
18 ignored though E85 which is a 15 percent blend  
19 of gasoline and an 85 percent blend of  
20 ethanol. Those of you from the Midwest will  
21 be familiar with it. It has been available  
22 for years but the price has not been

1 attractive. Consumers have been able to --  
2 could see it at the pump selling for less, in  
3 this case on the graph this comes from the  
4 AAA. The average price of E10 which is  
5 regular gasoline and E85, you can see it's  
6 below. But you don't get as much energy. So  
7 -- and my chart has reversed the colors. The  
8 price has tended to be well above the price of  
9 E10 and nobody's used it.

10 Well, recently as prices of RINs  
11 have increased the price of E85 has been  
12 falling. Because E85 is essentially a tool  
13 for manufacturing a RINs. You get 0.75 RIN  
14 extra which you can sell. So you get -- if I  
15 sell Mr. Friesen a gallon of E85 I get a  
16 dollar back from somebody else. And some  
17 marketers are passing this on.

18 We have seen an experiment in  
19 Minnesota and what has happened is sales have  
20 tripled. We're seeing sales in other parts of  
21 the country. And we're actually seeing now if  
22 you look at the average price of gasoline from

1       January at a price -- the green line is 20  
2       percent -- 80 percent of E10. And below that  
3       we show the energy equivalent price of E85.  
4       It has dropped just in July to a point where  
5       it pays. And we are now seeing very large  
6       volumetric sales.

7                If the program continues as it is,  
8       and if EPA does not show flexibility I think  
9       the E85 if you do the numbers will work out  
10      and we will see essentially the RIN problem  
11      that the oil refiners keep identifying go  
12      away. The market will clear.

13               It will help if there is active  
14      trade in the CME contract. When I checked  
15      their website last week there were 70  
16      contracts open. Now I helped introduce the  
17      NYMEX crude contract many years ago so it  
18      takes awhile for a new contract to work, but  
19      we have yet to see significant activity.

20               There remain, however, some  
21      significant problems. The oil industry, part  
22      of the oil industry does not like it. And we

1 keep seeing -- we saw this week hearings in  
2 Congress calling for repeal of the Renewable  
3 Fuels Act. I think the consensus of Congress  
4 is that's not going to happen. The  
5 Republicans told the people, oil and ethanol  
6 people to go back and renegotiate it.

7           We have seen inability of EPA to  
8 issue rules in a timely fashion. Now, that  
9 shouldn't come as a surprise to anybody at  
10 this agency because Congress quite frequently  
11 imposes regulations which are far too  
12 complicated to be implemented in a timely  
13 fashion.

14           EPA is supposed to issue the final  
15 rules for a current year on the November of  
16 the previous years. They have not. And that  
17 creates uncertainty. It makes it difficult to  
18 trade.

19           And in fact today's drop in the  
20 price and then the rebound may have come  
21 because if you look at the timing of it from  
22 a report on Bloomberg where some of the

1 renewable fuels producers said well maybe  
2 we'll compromise on the agreement.

3 The basic facts though are that  
4 the program is basically sound. It's going to  
5 take some adjustment. But the flexibility is  
6 there, it's just being ignored. Thank you.

7 MR. FORTENBERY: Thank you,  
8 Phillip. Scott?

9 MR. MIXON: Okay. Well thank you  
10 for that. Okay, first I'd like to say just I  
11 appreciate the opportunity to address this  
12 Committee and importantly to hear the comments  
13 back. Our economic research at the Commission  
14 clearly benefits from hearing the inputs of  
15 market participants. It helps us to focus the  
16 research in impactful directions that help us  
17 to develop appropriate and thoughtful  
18 regulations which is of course one of our key  
19 jobs.

20 I'll say that I'm particularly  
21 proud to be addressing issues of agricultural  
22 interest today. As Chairman Gensler said this

1 is not the largest space in the markets that  
2 we regulate but it is key in terms of the  
3 history and the mission of the CFTC.

4 And I'll say I'm personally  
5 mindful of this having grown up on a farm in  
6 Alabama myself. And if you go upstairs you'll  
7 see the toy farm machinery that I played with  
8 as a child up on my bookshelves. It's a  
9 constant reminder about the end users and the  
10 importance that they have in this market.

11 So with that in mind part of our  
12 motivation here to think about the RIN market,  
13 this Renewable Identification Number market,  
14 is to understand some of the details, both  
15 from that top-down perspective in terms of the  
16 fundamental forces of supply and demand that  
17 these markets are supposed to reflect, as well  
18 as some of those micro issues. We're very  
19 mindful always of how markets trade and the  
20 structure of these markets.

21 And this is a particularly  
22 interesting market. It's one frankly that we

1 haven't focused on as much as we have our  
2 traditional agricultural markets. And that's  
3 because this market has only existed for a few  
4 years. So perhaps we can be forgiven for  
5 that.

6           The thing that caught everyone's  
7 attention of course was the fact that as we  
8 just heard the price of these RINs, these  
9 tradable credits that refiners have to produce  
10 to show compliance with the EPA law spiked up  
11 from about a nickel to a dollar within the  
12 span of a couple of months towards the end of  
13 2012.

14           This caught everyone's attention.  
15 And what we've seen recently is even though  
16 those prices came off a bit, down to 60-70  
17 cents, they've trended back up. But they've  
18 continued to show the volatility. And again  
19 they've gone from \$1.40 a few days ago back to  
20 much lower levels.

21           So actually I'll just go back for  
22 a second. This is the D6 RIN which we were

1 just talking about which is a corn-based  
2 ethanol. There are some different flavors of  
3 these RINs if you'll allow me that pun.

4 The D4 and D5, they represent  
5 different types. So the D4 biodiesel, that's  
6 more of a soybean-based type product. And the  
7 D5 is another type, more advanced biofuel.

8 The main point from this is those  
9 prices did seem to be moving in line with the  
10 regulation. So we didn't observe on the face  
11 of it these prices at least being out of line  
12 with each other and their relative levels  
13 whenever we evaluated them to just see what  
14 the prices looked like.

15 Because from the regulations,  
16 which are in fact a bit complex relative to  
17 what you might think, the obligated parties  
18 who have to deliver these RINs to the EPA can  
19 deliver D4 or D5 RINs as well as D6 RINs. So  
20 if they have to deliver D6 they could  
21 substitute D4 or D5.

22 Substitution only works one way

1       though.  So these D6 RINs have to be less than  
2       or equal to the D4 or D5 RINs.  So at least we  
3       observed that.

4                       We started to dig a little  
5       further.  We understood exactly the same  
6       story, that given the status quo the  
7       regulations impose requirements on the  
8       blending which given the status quo for  
9       marketing, for shares of the different types  
10      of products, for the amounts that have to be  
11      blended, that you would see the amount that  
12      had to be blended exceeding the amount that  
13      the market could contain with the current  
14      technology.

15                    CHAIRMAN GENSLER:  Scott, can you  
16      go back to the prior page?  I'm sorry.

17                    MR. MIXON:  Yes.

18                    CHAIRMAN GENSLER:  So, the mandate  
19      is a governmental set of actors, the  
20      Environmental Protection Agency that says you  
21      must have this much biofuel.  Is that what the  
22      blue is?

1 MR. MIXON: That's correct, that  
2 many gallons.

3 CHAIRMAN GENSLER: And the red,  
4 what is a blend wall?

5 MR. MIXON: So this represents a  
6 number of assumptions, but it's basically what  
7 industry says they -- that's the maximum  
8 amount they can blend given the gasoline  
9 they're expecting to sell. So at a 10 percent  
10 ethanol rate that's as much as they can put  
11 in. That's as much as they can use in a given  
12 year of ethanol.

13 CHAIRMAN GENSLER: So when the  
14 government says you only need the blue, the  
15 value of the RINs was small.

16 MR. MIXON: Negligible.

17 CHAIRMAN GENSLER: But is it as  
18 simple as when the blue passed the red, 2013,  
19 all of a sudden everybody, there's like a  
20 chase around the market, almost like a squeeze  
21 to buy these?

22 MR. MIXON: I wouldn't use the

1 word "squeeze" but --

2 CHAIRMAN GENSLER: Yes, okay.

3 MR. MIXON: But effectively, yes.

4 And that's -- on this next slide that's what  
5 the analysts have said is the fundamental  
6 explanation, that the only way that given this  
7 technology and the infrastructure that this  
8 difference will be made up is by buying RINs,  
9 buying these credits. Even if you don't use  
10 them, buying the credits to deliver to the  
11 EPA.

12 And the assumptions in the models,  
13 the assumptions that they're using is that the  
14 supply of RINs that they've been building up  
15 over the past couple of years will be  
16 completely depleted sometime in 2014. So they  
17 become valuable as this constraint becomes  
18 fairly binding.

19 And this was something that had  
20 been identified by some analysts. Some of  
21 these papers you see at the bottom, some of  
22 the ag economists had started identifying this

1 issue as a real barrier that you'd have to get  
2 through.

3 And you can see some of the  
4 titles. "Something Has to Give," "Why Isn't  
5 the Conventional RIN Price Higher?" So the  
6 fact they were at a nickel, the analysts were  
7 saying the value really should be much higher.  
8 So we started to see it much higher.

9 Doesn't say as much about the  
10 volatility or the exact level, but it does  
11 give that fundamental based explanation of  
12 some of the issues that are out there in the  
13 market.

14 So, you know, at that level we  
15 understood a little bit about that top-down  
16 issue, the set of policies, the set of market  
17 structures that were giving rise to these  
18 issues that were causing people to put a lot  
19 of attention on these markets.

20 And then the next step is to  
21 really think about the bottom-up part. So  
22 we're very mindful about the way that these

1 things trade. This, as I said, it's not a  
2 traditional commodity derivative until  
3 recently whenever the exchanges launched  
4 futures contracts on RINs.

5 And so we did the research. This  
6 is our preliminary due diligence and I can  
7 share some of it with you. We talked to  
8 market participants to understand what they  
9 were doing. We talked to some of the brokers  
10 of RINs.

11 These products have only existed  
12 for a few years and prior to 2010 it was  
13 really a spreadsheet-based market. You can  
14 imagine if these things are 38-digit strings  
15 of numbers reflecting gallons of ethanol, you  
16 can imagine that might lead to some sort of  
17 transcription errors, fat fingers errors,  
18 difficulties in terms of dealing with the  
19 market.

20 And so the EPA set up the  
21 Moderated Transaction System. So this is not  
22 a traditional market, it's not a centralized

1 limit order book when you think about an  
2 exchange. It's really more of a back office  
3 type accounting system as we understand it.

4           So transactions occur, they occur  
5 outside of the system but then they are  
6 basically booked into this EPA system. So the  
7 participants can see what they've done, they  
8 see the transactions they've done, but they  
9 don't see the entire marketplace. So this is  
10 something they get from their brokers. They  
11 talk to brokers who are in this market. So  
12 there is some post trade transparency that the  
13 EPA gets.

14           The transactions have to be booked  
15 into this system generally within a few days.  
16 And then there are reports that are due at the  
17 end of a quarter.

18           As we talk to the brokers we get a  
19 little bit more color. Really they're just  
20 estimates by the brokers, guesses about what  
21 they see in the marketplace. They obviously  
22 see their own slice of the market. They can

1 give us ideas about what might be out there.

2 But the guesses we've heard were  
3 perhaps 20 to 25 different brokers who dealt  
4 in these markets, send out market sheets.  
5 They give an idea about the prices they're  
6 seeing in the market, the interest they're  
7 seeing.

8 The numbers they suggest are that  
9 out of the 2.6 billion RINs that were  
10 available at the end of 2012 on a slow day you  
11 might have seen 5 or 10 million RINs trade.  
12 On a much more active day when there was a lot  
13 more volatility you might have seen maybe 100  
14 million RINs trade.

15 In terms of the bid and the ask  
16 prices that they seem to see in the market  
17 they indicate that back in 2012 when these  
18 RINs were not particularly valuable, when they  
19 were trading around a nickel, you saw the  
20 spread effectively be around two-tenths of a  
21 penny. So that's about three or four percent  
22 wide which sounds reasonably wide.

1                   Two thousand thirteen, middle of  
2                   the year -- or sorry, maybe middle of the  
3                   spring you saw them around 70 cents. Spreads  
4                   still tended to be about three or four percent  
5                   wide.

6                   Recently, it's not obvious to us  
7                   exactly why it might be a little bit smaller  
8                   except the numbers are a bit larger. It seems  
9                   like the spreads might be slightly smaller  
10                  than they were before, but you still see  
11                  spreads that are one and a half or two  
12                  percentage points wide.

13                  That's very large compared to what  
14                  we think about typically in, say, futures  
15                  markets. But you know, it might be what you  
16                  might see in a more traditional cash market.

17                  So this was certainly some of the  
18                  color we were interested in understanding  
19                  partly again because we saw the futures market  
20                  starting to overlay derivatives contracts on  
21                  top of these RIN instruments.

22                  And then as we also heard alluded

1 before there were some difficulties in the  
2 market. It's an evolving market, it's a young  
3 market, and so one of the difficulties that  
4 was observed was from 2010 and 2011 there were  
5 some fraudulent trades that were entered for  
6 D5 RINs.

7 CHAIRMAN GENSLER: Can I just  
8 caution? These are alleged frauds. These are  
9 not frauds by the CFTC's Division of  
10 Enforcement or anything like that.

11 MR. MIXON: The CFTC Division of  
12 Enforcement has had no connection with this.

13 CHAIRMAN GENSLER: This is just  
14 what some market people were saying.

15 MR. MIXON: Color from market  
16 participants. Although we have had trials and  
17 people have -- and convictions, violations of  
18 the Environmental Protection Act as I  
19 understand it.

20 The impact of this was that we  
21 saw, according to the market participants,  
22 liquidity drying up for some of the smaller

1 plants, some of the smaller refiners if they  
2 weren't well known to some of the potential  
3 purchasers of RINs that they had -- the  
4 counterparty credit risk the purchasers were  
5 very mindful of since they bore it completely.

6 There have been some fixes as I  
7 understand. There's a proposed rule from 2013  
8 to validate these RINs. The EPA is not a  
9 validation entity for these RINs.

10 And the story again that the  
11 market participants have told us is that we  
12 have seen some financial institutions enter  
13 the market. But they have had difficulties  
14 establishing some of those relationships.  
15 They're not refiners, they're not in those  
16 markets, they don't know the same people.

17 So even if they're well known  
18 financial entities within those circles  
19 they're not that well known within these  
20 particular circles. And so trading desks who  
21 might bring liquidity to these markets have  
22 not had as much traction as you might hope

1 because their counterparty credit risk issues  
2 are still perceived to be issues for them.

3 So this again says to us this is a  
4 very young market. It's an evolving market.  
5 It's one that only very recently over the last  
6 couple of months had futures markets that were  
7 introduced on it. They haven't gotten a lot  
8 of traction. The number of contracts is quite  
9 small. Open interest is quite small.

10 But it's one that we're watching  
11 very mindfully because it is connected with a  
12 number of the other products and commodities  
13 that we're interested in at the Commission,  
14 corn, soybeans, gasoline, ethanol, and so  
15 forth. And so this is an active area for us  
16 to be considering in terms of thinking about  
17 it in the research side.

18 MR. FORTENBERY: Thank you,  
19 Phillip and Scott. Any discussion about the  
20 RINs markets or the activities currently going  
21 on?

22 MR. FRIESEN: I think if I would

1 have been a wise investor I would have bought  
2 RINs about five years ago or four years ago.

3 MR. VERLEGER: Well, a couple of  
4 points. When the RIN market was created by  
5 Congress. And the standard, if you go back to  
6 your graph that shows the blend wall, the  
7 Congress very carefully decided that RINs  
8 accumulated two years ago would become  
9 invalid. So if you had gone and bought those  
10 RINs five years ago they would have become  
11 worthless.

12 I've been living as an economist  
13 with environmental regulations for years and  
14 one of the things they try to do is block  
15 every opportunity. So that a RIN that was  
16 generated in 2011 from selling gasoline with  
17 10 percent ethanol which had no value in 2011  
18 could have been used to meet a 2012  
19 obligation. But it could not be used to meet  
20 a 2013 obligation.

21 Similarly, you have 2012  
22 obligations that can be used, RINs accumulated

1 in 2012 that are being used for 2013. That's  
2 why both of our graphs show prices for 2012  
3 and 2013.

4 But those 2012 RINs expire at the  
5 end of the year. They cannot be used for  
6 2014.

7 To make things even more  
8 complicated, the regulations say you can only  
9 carry 20 percent of your 2012 RINs forward to  
10 2013. And if you're deficit in 2014 you can  
11 use 2015 up to a certain point.

12 But the environmental regulations  
13 are roughly five times as long in terms of  
14 Federal Register pages for an economic impact  
15 as a CFTC regulation. So you think Dodd-Frank  
16 is bad, EPA is worse, or more complicated.

17 The situation is even more  
18 complicated because if that blend wall weren't  
19 reached the EPA Administrator now in office  
20 has the right to change it or to relax the  
21 standard so that the situation can be changed.  
22 Which makes trading of any kind of a financial

1 instrument of something like this even more  
2 difficult.

3 Last year they changed the D1, D2  
4 for cellulosic ethanol because there was no  
5 cellulosic ethanol there. So this is  
6 extremely complicated.

7 I know the CFTC has had  
8 difficulties. You've managed to work with the  
9 FERC but it's difficult. It's going to be  
10 even more difficult in trying to work with the  
11 Environmental Protection Agency given the  
12 authorities the Administrator of the  
13 Environmental Protection Agency has to change  
14 the rules unilaterally.

15 CHAIRMAN GENSLER: I just have a  
16 question for the Committee, not the presenters  
17 with all respect. How is this affecting the  
18 markets for corn and soy and what are you  
19 seeing? And secondly, what issues for this  
20 agency?

21 MR. FRIESEN: Well, I think --  
22 we've been following the RIN price pretty

1       closely in Nebraska. We're I think the second  
2       largest ethanol producer in the country.

3               We've seen petroleum marketers in  
4       our area that are making around a \$1.20 per  
5       gallon profit on the 85 because of the RIN  
6       price currently. They're not passing it on to  
7       their customers. The customers don't realize  
8       this because they don't understand the RIN  
9       market.

10              But from what we've seen at least  
11       if you had -- the petroleum industry has  
12       blocked E15 from use even though stations that  
13       have chosen to market E15 have come under  
14       contract disputes with the petroleum industry.  
15       So essentially they're blocking E15 use which  
16       would lower the price of RINs. It's a  
17       conscious choice of theirs.

18              And I think the RIN market is  
19       going to be extremely volatile, and especially  
20       if suddenly we start using more E85 and the  
21       demand for those RINs drops. Because I think  
22       looking at the mandates that we can use that

1 amount if we choose to. But right now there's  
2 a conscious effort not to.

3 COMMISSIONER O'MALIA: There was,  
4 before I came down here kind of a wire story  
5 that said RINs dropped 50 cents over the last  
6 week. Any sense of what contributes to this  
7 immediate volatility? Do you have any sense  
8 at all, any thoughts on it?

9 MR. VERLEGER: In the paper I  
10 tried, I think I've made the first real hard  
11 attempt to figure out what an equilibrium  
12 price for a RIN is this year. And if you work  
13 at it two or three different ways you come out  
14 with about 90 cents.

15 Now, this is a commodity and so as  
16 Scott said the price had gone to \$1.40. You  
17 expect markets to overshoot.

18 But if you work through carefully  
19 and look at the limited information that's  
20 available. I've been working with a firm in  
21 Minnesota that markets a lot of gasoline and  
22 we have been passing through the benefit to

1 see. Our goal is to see what the consumer  
2 response is. How much -- what the price  
3 elasticity and substitution is.

4 And when you work through this and  
5 you look at the substitution 80 to 90 cents,  
6 maybe \$1 is about the right price this year.  
7 But markets overshoot. They've been  
8 overshooting for 200 years.

9 The largest problem here is  
10 uncertainty on regulation. The lack of data.  
11 The Energy Information Agency provides no  
12 information on the volumes of E10, E15, or E85  
13 sold. So we don't know the quantities. All  
14 you can see is the prices.

15 You have the Bloomberg. I rely on  
16 Argus Media. So the prices are uncertain.  
17 This is really -- what do they call them in  
18 the Wall Street? A pink sheet market. So  
19 you're going to see a huge amount of  
20 volatility.

21 But the market clearing mechanisms  
22 are there, they're just not as transparent as

1 in many of our other bonds. If I were going  
2 to draw an analogy to financial markets I'd  
3 say this is a little more obscure than the  
4 municipal bond market where the margins tend  
5 to be very large.

6 CHAIRMAN GENSLER: I'm just back  
7 to the Committee again with all respect.  
8 M.J.? I mean I'm not familiar with this RIN  
9 market. I'm just looking what's happening on  
10 the ground for farmers. Or is this not in  
11 their thoughts?

12 MR. MILLER: They're aware of it.  
13 But it's one of those where it's a complex  
14 market.

15 And the comments have been right  
16 on target. The value of RINs does have a  
17 connection to the value of corn but it's an  
18 indirect valuation, not a direct valuation.  
19 Because it has to do with ultimately the  
20 incentives that you might have for particular  
21 types of ethanol, not only production but  
22 blending and opportunities that come with

1 that.

2 But the substitution effect also  
3 brings in the soybean oil market in biodiesel.  
4 And you've had a recent drop, some would call  
5 it a collapse in the soybean market, the spot  
6 soybean market of \$1.50 in the last three  
7 days.

8 CHAIRMAN GENSLER: Let me ask this  
9 simple question. Do farmers -- does somebody  
10 who's planting corn or soy benefit if the RIN  
11 price is high or low? I mean I'm just trying  
12 to understand.

13 MR. MILLER: The higher the RIN  
14 price, the more incentive there is to produce  
15 ethanol.

16 CHAIRMAN GENSLER: And does that  
17 in any way then feed back to somebody on the  
18 farm? I guess I'm seeing no.

19 MR. FRIESEN: I guess from my  
20 standpoint I don't think the RINs price has  
21 had a lot of impact on ethanol production.  
22 The RIN transfers with the gallon of ethanol

1 so it's whoever uses that ethanol to blend  
2 with who can use that RIN in their marketing  
3 ability.

4 MR. FORTENBERY: We're about just  
5 a couple of minutes into our lunch period. Is  
6 there one more comment from the Committee or  
7 question? Yes, go ahead.

8 MR. WELLMAN: Yes. Direct effect  
9 to the farmer and the price, I don't believe  
10 that it's tracked that well by the farmer back  
11 down to the farm. Now, if they have  
12 investments in an ethanol facility and things  
13 like that, yes, they might be more in tune  
14 with the RIN value.

15 But a quick question. Besides the  
16 D6 can you comment a little bit more about the  
17 comparison and the valuations between the D5  
18 and D4? Is there any -- when the D6 value  
19 changes is there any correlation between the  
20 D4, 5's, and 6?

21 MR. MIXON: Well, my first comment  
22 of course is that we are not a price-setting

1 agency. So I just want to get that out there.

2 But you can look at the chart  
3 here. And based on my understanding of the  
4 regulations because that deliverability of the  
5 D4 or D5 to satisfy the D6 obligation, you  
6 will see them have at least as much value as  
7 the D6.

8 And so prior to the D6 RINs having  
9 much value, having a value of about a nickel  
10 the D4 and D5, so the second generation  
11 biofuels, for example, they were more  
12 valuable. There are different constraints  
13 that the EPA has put out for them.

14 And then as the D6 constraint  
15 became more binding they seem just from the  
16 picture to be more closely related. But those  
17 are just observations from this particular  
18 chart.

19 MR. FORTENBERY: I'm going to  
20 suggest we go ahead and break for lunch. We  
21 can continue this discussion at lunch.

22 All the speakers and the Committee

1 members are invited to lunch up on the ninth  
2 floor. I think it takes a secret handshake to  
3 get to the ninth floor so there's staff by the  
4 elevators that can help you facilitate your  
5 transportation up there.

6 Phillip, you're going to be able  
7 to join us for a little bit for lunch. So  
8 feel free to continue the discussion at lunch.  
9 And we will reconvene at 1:00 o'clock. Thank  
10 you.

11 (Whereupon, the foregoing matter  
12 went off the record at 12:08 p.m. and went  
13 back on the record at 1:06 p.m.)

14 MR. FORTENBERY: What we're going  
15 to do this afternoon is talk about the issue  
16 of voice recording and the voice recording  
17 requirements.

18 We have three different panel  
19 members and then as always we'll hear their  
20 presentations and then throw it open for  
21 comments or questions.

22 The first speaker is Ward Griffin

1 who is Division of Swap Dealer and  
2 Intermediary Oversight, Vince McGonagle who's  
3 with the Division of Enforcement and Scott  
4 Cordes with CHS Hedging. I think we're going  
5 to start with Ward. So go ahead.

6 MR. MCGONAGLE: It's Vince  
7 McGonagle.

8 MR. FORTENBERY: Sorry. What did  
9 I say?

10 MR. MCGONAGLE: Don't worry about  
11 it.

12 (Laughter.)

13 MR. FORTENBERY: Okay. Wrong  
14 glasses.

15 MR. GRIFFIN: Good afternoon. My  
16 name is Ward Griffin and I am the associate  
17 chief counsel of the CFTC's Division of Swap  
18 Dealer and Intermediary Oversight.

19 I'd like to take a moment to thank  
20 Dr. FORTENBERY and the members of the  
21 Agriculture Advisory Committee for allowing us  
22 the opportunity to discuss the new oral

1 record-keeping requirements under Regulation  
2 1.35.

3 On December 21, 2012 the  
4 Commission published in the Federal Register  
5 final rule amendments to Regulations 1.31 and  
6 1.35 that will require futures commission  
7 merchants, retail foreign exchange dealers,  
8 certain introducing brokers and certain  
9 members of designated contract markets or swap  
10 execution facilities to record and retain  
11 records of oral communications.

12 The Commission noted that the  
13 overarching purpose of the final rule  
14 amendments was to promote market integrity and  
15 protect customers. And the Commission  
16 believes that the collection of and access to  
17 searchable records, both oral and written, are  
18 indispensable tools the Commission needs to  
19 ensure market integrity and to protect  
20 customers.

21 As noted by the Commission in the  
22 preamble of the final rule release the markets

1 have undergone a significant transformation  
2 over the last few decades, and in particular  
3 over the last few years.

4 Technological advances have  
5 contributed to tremendous growth including  
6 significant numbers of retail customers as  
7 well as greater interconnectedness with order  
8 flow distributed across multiple trading  
9 centers. These changes have required the  
10 Commission to adapt and these rules are part  
11 of that adaptation.

12 The Commission sought through the  
13 proposed rule amendments to conform the  
14 existing record-keeping requirements of  
15 Regulation 1.35(a) to the record-keeping  
16 requirements for swap dealers and major swap  
17 participants as set forth in Regulation 23.202  
18 which were finalized by the Commission in the  
19 spring of 2012.

20 The Commission published the final  
21 rule amendments in the Federal Register and  
22 solicited comments. The Commission received

1 many comments in response to the proposal.  
2 The Commission considered those comments prior  
3 to issuing the final rule amendments and the  
4 Commission narrowed the proposed amendments in  
5 several significant areas in response to those  
6 comments.

7           Comments to these proposed  
8 amendments to Regulation 1.35 primarily  
9 focused on a handful of key areas each of  
10 which was discussed by the Commission in the  
11 preamble of the final rule.

12           First, commenters addressed the  
13 oral record-keeping requirement generally.  
14 Such commenters discussed the costs involved  
15 in such requirements as well as the necessity  
16 and feasibility of such a requirement.

17           Second, commenters addressed the  
18 applicability of the proposed rule amendments  
19 to members of DCMs and SEFs including  
20 commercial end users and non-intermediaries  
21 who are not registered with the Commission to  
22 keep records of their cash commodity

1 transactions.

2 Third, commenters addressed the  
3 proposed requirement that each record be  
4 maintained in a separately identifiable  
5 electronic file, also known as tagging.

6 Additional other issues were  
7 raised by commenters. We need not go through  
8 the full range of comments here today, but to  
9 point out three such comments. Number one,  
10 there were requests for a significant  
11 compliance time table. Two, there were  
12 requests for alternative treatment for smaller  
13 firms. And three, there were requests for a  
14 shorter record retention period than what had  
15 been proposed.

16 As noted by the Commission in the  
17 final rule release the final rules will  
18 significantly advance the Commission's efforts  
19 to detect and defer abusive, disruptive,  
20 fraudulent and manipulative acts and practices  
21 that seriously harm market integrity and  
22 customers.

1           The information will benefit the  
2 Commission in its market analysis efforts such  
3 as investigating and preparing market  
4 reconstructions, and understanding causes of  
5 unusual market activity. Plus, the  
6 requirement that records be kept current and  
7 readily available facilitates the timely  
8 pursuit of potential violations which can be  
9 vitally important in seeking to freeze and  
10 recover any profits received from illegal  
11 activity.

12           However, to address comments  
13 received from the public the Commission  
14 incorporated several changes to what had  
15 originally been proposed. Again, these  
16 changes reduce the burden in several  
17 significant ways from what had been proposed.

18           First, the oral record-keeping  
19 requirement will be limited to those oral  
20 communications that lead to a transaction in  
21 a commodity interest and related cash or  
22 forward transactions. This represents a

1 reduction from the proposal which would have  
2 applied the requirement to commodity interests  
3 and cash commodity transactions.

4 Second, acknowledging that  
5 implementing and maintaining an oral  
6 communication recording system would be overly  
7 burdensome for small entities and the  
8 commercial end user non-intermediary members  
9 of a DCM or SEF the Commission excluded from  
10 the new requirement small introducing brokers,  
11 oral communications of a floor broker who is  
12 a member of a DCM or SEF that do not lead to  
13 the purchase or sale for any person other than  
14 the floor broker, and certain members of the  
15 DCM or SEF including floor traders, commodity  
16 pool operators, and members that are not  
17 registered or required to be registered with  
18 the Commission in any capacity.

19 The Commission also permitted  
20 covered persons to contract with other  
21 Commission registrants to retain the required  
22 records provided that the records retained by

1 the contractor registrant are the same  
2 records, thus allowing covered persons to  
3 avoid retaining the same records as other  
4 Commission registrants.

5 Third, the Commission removed the  
6 requirement that each transaction be  
7 maintained as a separate electronic file.  
8 Instead, the final rule requires that such  
9 records be kept in a form and manner  
10 identifiable and searchable by transaction.  
11 This eliminated the so-called tagging  
12 requirement.

13 Fourth, the Commission  
14 significantly reduced the retention period for  
15 the oral records from five years as had been  
16 proposed to one year.

17 The Commission also significantly  
18 extended the amount of time that affected  
19 entities would be afforded to come into  
20 compliance with the final rule with respect to  
21 the recording of oral communications. In  
22 doing so the entities subject to this

1 rulemaking were afforded approximately the  
2 same amount of time as had been given to swap  
3 dealers and major swap participants to come  
4 into compliance with their requirements under  
5 Regulation 23.202.

6 All affected CFTC registrants must  
7 be in compliance with the oral record-keeping  
8 requirements of regulation 1.35 by December  
9 21, 2013 which will mark the one year  
10 anniversary of the publication of the final  
11 rule in the Federal Register.

12 Likewise, similar to the treatment  
13 afforded to swap dealers and major swap  
14 participants, the Commission delegated to the  
15 director of the Division of Swap Dealer and  
16 Intermediary Oversight the authority to grant  
17 alternative compliance schedules to affected  
18 registrants.

19 Specifically, the Commission  
20 delegated to the director of DSIO the  
21 authority to establish an alternative  
22 compliance schedule for a firm that requests

1 one provided that the firm establishes that it  
2 is technologically or economically  
3 impracticable for the firm acting in good  
4 faith to comply with the oral record-keeping  
5 requirement within a reasonable time period  
6 beyond December 21, 2013.

7 Because the rule requires the  
8 director of DSIO to make findings on this  
9 issue the burden is on the firm to produce  
10 sufficient documentation showing that  
11 notwithstanding the good faith efforts to  
12 achieve full compliance prior to December 21,  
13 2013, full compliance is technologically or  
14 economically impracticable.

15 The division has learned from the  
16 experiences over the past several months in  
17 terms of the compliance efforts of swap  
18 dealers and major swap participants concerning  
19 the oral record-keeping requirement.

20 One point that I would like to  
21 stress is that time is of the essence. The  
22 final rule was published over seven months ago

1 and affected firms already should be well  
2 underway in working towards full compliance.

3 With less than five months  
4 remaining until the compliance date affected  
5 firms that have not yet initiated the process  
6 should do so immediately. Although vendors  
7 have informed us of the existence of cost-  
8 effective, off-the-shelf applications firms  
9 should allow themselves plenty of time to  
10 allow for the installation and testing of such  
11 applications.

12 That concludes my prepared remarks  
13 today. With that I will hand the microphone  
14 over to Vince McGonagle with the Commission's  
15 Division of Enforcement.

16 MR. MCGONAGLE: Hi, good  
17 afternoon, everyone. Thank you, Ward. I'm  
18 just going to briefly touch on a couple of  
19 topics, the purpose for the audio taping rule.

20 I became involved in the issue on  
21 a more formal basis several years ago. There  
22 was an inter-divisional group that was

1 established that I referred to as the Record-  
2 keeping Task Force.

3 And at that time we along with  
4 representatives from then DMO, DCIO and OGC  
5 talked about where we thought record-keeping  
6 should go in the future and what we thought  
7 needed to have changed. We followed closely  
8 what other regulators were doing, what SEC had  
9 on the books, FINRA, FCA came out with an  
10 audio taping rule just a few years ago in  
11 2009.

12 And so we sort of have this  
13 backdrop of we know that entities out there  
14 that are interested in following the  
15 transactions that they're entering into, that  
16 a good number of those entities were already  
17 taping their conversations. And we though  
18 from an enforcement standpoint audio tapes of  
19 those conversations is an important component  
20 of the enforcement program.

21 The rule made clear that the  
22 purpose of the audio taping rule is to promote

1 market integrity and protect customers. And  
2 Ward's talked about that pretty extensively.

3 Some of the enforcement matters,  
4 without delving into any specifics, but I can  
5 say generally and to the extent that anyone  
6 has been looking at our web page for the past  
7 year will see a number of actions that  
8 reference evidence as part of either the  
9 findings of the Commission or in allegations  
10 of the complaint that are based on audio taped  
11 conversations.

12 The types of cases that I'm  
13 referring to include the following:  
14 allegations involving disclosures of material  
15 non-public customer information; segregation;  
16 failure to supervise; speculative limits; wash  
17 sales; non-bona fide prices; fraud; false  
18 reporting; and manipulation.

19 And so literally just over the  
20 course of the past few years from enforcement  
21 actions you see a broad range of activity,  
22 enforcement-related activity that relies on

1 and uses audio taped information.

2 In reviewing comments to the  
3 proposed rule we were cognizant of concerns  
4 that individuals had with respect to how that  
5 might affect them as small players potentially  
6 in the market versus the larger market  
7 interests that they thought that enforcement  
8 was focused on, particularly manipulative  
9 activity. But as I've talked about here we  
10 are looking at broad customer protection  
11 relief as well as market integrity issues.

12 We did, however, narrow the scope  
13 of the rule to focus on entities that deal  
14 only with customers. And we think in doing  
15 that we tried to hopefully strike a balance  
16 that preserves for the division information  
17 that is most likely to be of concern with  
18 respect to an enforcement investigation.

19 I can tell you though my personal  
20 feeling with respect to taping transactions,  
21 more is better. However, I think that the  
22 rule here is a great approach and I am very

1 thankful that the Commission considered and  
2 passed it.

3 With respect to searchability we  
4 received of course a number of questions  
5 following the rule coming out this past  
6 December concerning how entities should  
7 prepare themselves with respect to  
8 searchability.

9 In the rule guidance it sets forth  
10 some information that I think is helpful. The  
11 record-keeper should be able to readily access  
12 and identify records pertaining to a  
13 transaction or a counterparty by running a  
14 search of the raw data.

15 So what does that mean? Well,  
16 basically if you have off-the-shelf data  
17 analytics those analytics should have the  
18 ability, for example, if the Division of  
19 Enforcement sends a subpoena or a request for  
20 information where we're looking for trading  
21 information on a particular date, or on a  
22 particular line, or by a particular

1 individual, that those individuals who are  
2 responding to our request should be able to  
3 run the analytics available currently from  
4 these software programs and start a production  
5 that's focused on responding to those  
6 requests.

7 Compliance with searchability as I  
8 said can happen through the use of  
9 commercially available products capable of  
10 conducting speech analytics on recordings.

11 Both land lines and mobile  
12 telephones should be recorded. Covered  
13 persons must ensure that covered  
14 communications do not occur on personal phones  
15 that lack the recording capability.

16 The Commission also indicated that  
17 it did not adopt any explicit safe harbors.  
18 However, the Commission recognized that it  
19 will consider good faith compliance with  
20 policies and procedures that are reasonably  
21 designed to comply with the oral  
22 communications component. Thank you.

1 MR. CORDES: Thank you for  
2 allowing me the opportunity to speak. I'm  
3 going to talk to this rule a little bit. And  
4 I want to add some color and a little bit of  
5 clarity on some of the issues that I see as an  
6 FCM and maybe some of the other folks in the  
7 agricultural industry. I know there's others  
8 within our National Council of Farmer  
9 Cooperatives group that have this issue as  
10 well.

11 And really what I want to talk to  
12 a little bit is how you comply with some of  
13 this stuff and some of the challenges we have.  
14 And we have one example that I want to walk  
15 through just a little bit here that I think  
16 impacts some of the folks in the room here in  
17 how we look at that.

18 What I want to talk about is  
19 within CHS Hedging, we have branch offices  
20 around the countryside. And you'll see on the  
21 screen I've got just some dots where they are.

22 They represent 64 different branch

1 offices that we have around. They're branch  
2 offices of the FCM. They operate and act a  
3 lot like an introducing broker but they are a  
4 branch office.

5 Just to give you a little idea  
6 what the profile of these branch offices are,  
7 most of these are a relationship with I would  
8 say is the local cooperative or the local  
9 entity. And we have the individual that is  
10 licensed and registered there. We have  
11 oversight. We have auditing. But they're an  
12 employee of that local organization. And  
13 they're offering these commodity brokerage  
14 services as something ancillary to their other  
15 daytime activities.

16 Most of these branch offices  
17 you'll see range in a revenue stream of maybe  
18 \$5,000 a year to \$250,000. Probably an  
19 average of \$20,000. They'll handle trades of  
20 maybe a total of 100 for the year up to 4,000.  
21 Most of them are dealt around commodities such  
22 as the grain and the livestocks.

1                   Lots of times what happens is this  
2 individual that's registered there and  
3 licensed is also maybe the person that's  
4 buying grain from farmers to that location.  
5 And what will happen lots of times is the  
6 farmer might come in and say you know what?  
7 I'd like to talk about the markets. I want to  
8 protect my crop but I'm maybe not ready to  
9 sell you grain. Is there another way that I  
10 can manage my risk, i.e., can I use my futures  
11 account. So there's that education ongoing  
12 that goes there.

13                   Once trades take place they  
14 probably will call us or they will have an  
15 electronic order entry on their screen in  
16 their office that they can place the trade.

17                   From there as the FCM in the home  
18 office we will manage that order flow. We'll  
19 have oversight to that order flow. We'll  
20 handle the margin calls, the money moving back  
21 and forth, that sort of thing.

22                   You might ask a little bit, you

1 know, what's the value here if there's not a  
2 high-volume flow that's taking place at these  
3 branch offices. Lots of times it gets down to  
4 that farmer, that rancher at that local level.  
5 They have a trusted local contact they can  
6 deal with. There's easy access. They can  
7 come in and see them. They can call them on  
8 the phone. There's an education process that  
9 takes place. There's market intelligence,  
10 consultation. And really it offers them  
11 another risk management choice.

12 So with what I've described about  
13 what the profile and what these branch offices  
14 look like, today the way the rule is written  
15 these branch offices would have to comply with  
16 oral taping requirements. Because technically  
17 they are part of the FCM as a branch office  
18 and as an FCM we're required to tape.

19 Now we do that already today in  
20 our home office. We also do it in our two  
21 major other offices that I have employees at,  
22 Kansas City and Indianapolis. So we have that

1       searchable record type thing there.

2                   But it gets into these branch  
3 offices. It comes down to what is  
4 economically and what is technically feasible  
5 to do. So we have this question about  
6 recording cost and benefits.

7                   If we go forward with compliance  
8 will these branch offices drop off because you  
9 can't comply with it? Then what happens to  
10 the risk management choices at that local  
11 level to the farmer?

12                   We also run a little bit of a  
13 challenge around cell phones being searchable  
14 and how you can tag, that kind of thing. So  
15 with there I wanted to give the rest of the  
16 Committee an opportunity to see some of the  
17 things that we see out there.

18                   I know there's other firms in  
19 other situations probably some similar things.  
20 I would say maybe some solutions going forward  
21 outside of a No-Action letter is maybe looking  
22 at the rule a little bit and say can it be

1 looked at in a similar fashion to the IB you  
2 carved out for the smaller type thing. Is  
3 there a revenue stream by location? Is it a  
4 physical location? Is it specific  
5 commodities?

6 I would also point out these  
7 branch offices don't deal in over-the-counter  
8 transactions. It's all exchange-traded type  
9 products. So there's probably some solutions  
10 that can be had if you want to identify in  
11 those ways. But hopefully my presentation  
12 here is helpful to give the rest of the  
13 Committee and the Commission here some insight  
14 to what's taking place.

15 MR. FORTENBERY: Thanks, Ward,  
16 Vince and Scott. Go ahead.

17 CHAIRMAN GENSLER: Scott, if I  
18 could just ask just as an example because  
19 you're in the field and you have a sense of  
20 this. So three of your 64 offices you tape  
21 and this oral recording -- just focused on  
22 those 3 offices -- this oral recording rule is

1 at least aligned enough with what you already  
2 do. That's not where the issue is coming.  
3 It's coming from possibly the other 61  
4 offices?

5 MR. CORDES: Yes, that's correct.  
6 It would be the other ancillary offices that  
7 we don't have the size and scale, yet they're  
8 adding a valuable service to the local  
9 agriculture community.

10 CHAIRMAN GENSLER: So of those 60  
11 odd other offices how many of them have, you  
12 know, these wonderful pictures. But how many  
13 of them are just like the one-person office?  
14 I just don't have a sense.

15 MR. CORDES: Yes, I would have to  
16 think right off the top of my head. It would  
17 be the majority of them. There might be I  
18 think one or two where there might be two  
19 people licensed, but neither one of them is it  
20 a full-time job for them. It's ancillary to  
21 their other duties that they maintain at that  
22 location.

1                   CHAIRMAN GENSLER: So you're  
2 saying there's like your 3 hubs and then  
3 there's 60 others that either have 1 or 2  
4 people in them.

5                   MR. CORDES: That would be  
6 correct.

7                   CHAIRMAN GENSLER: And they're  
8 only doing futures only.

9                   MR. CORDES: Only doing futures.

10                  CHAIRMAN GENSLER: All right,  
11 thanks. That's helpful.

12                  MR. FORTENBERY: Discussion? Yes.

13                  MR. DIERKS: Just as a further  
14 clarification of that, Scott. When you talk  
15 about that one licensed person in that  
16 location, he might or she might only have  
17 maybe 15 or 20 minutes a day maybe dealing  
18 with the futures. They're also running the  
19 scale or taking delivery of corn that farmers  
20 bring in to sell or whatever. Is that  
21 correct?

22                  MR. CORDES: Yes, it could be that

1 simple. Some might be 15 minutes a day. Some  
2 might not look at it for a day or two.

3 The nice thing they have with  
4 being a branch is we give them intel and  
5 information that they can pass down to the  
6 local. But as far as their time requirement  
7 it could vary. I mean some would do more but  
8 a lot of them it's not a -- it's a smaller  
9 part of their daily duties.

10 MR. ANDERSON: Could maybe either  
11 of you guys clarify a little bit? I know  
12 there's a distinction between what's required  
13 for a member of an exchange versus someone  
14 who's not a member of an exchange.

15 MR. GRIFFIN: If you'll bear with  
16 me I'll pull the exact language up.

17 MR. CORDES: Could you also expand  
18 -- you know, there's a little talk about -- it  
19 talks about cash transactions. I think some  
20 people think if they're dealing in cash  
21 commodities that they would have to tape as  
22 well, but I don't think that's --

1 MR. GRIFFIN: No, no, no. Right.  
2 There are two components and Scott was  
3 pointing out a second component. And I'll  
4 deal with that very quickly first.

5 There were a number of concerns  
6 with how the proposed rule had been phrased,  
7 that it would include cash commodity  
8 transactions which if you're a non-registrant  
9 member of a contract market that -- and you  
10 engage in these cash commodity transactions  
11 that are not related to a commodity interest  
12 transaction that it was going to -- it would  
13 expand the burden into an area where the  
14 Commission hasn't traditionally had any  
15 jurisdictional interest to get into.

16 There was a legitimate cost-  
17 benefit question there that is the burden  
18 that's being placed there, is it appropriate  
19 and/or is it from a cost-benefit perspective  
20 a good idea? And the Commission looked at  
21 that and said well, no, it's not.

22 And so to deal with that first

1 component the Commission had changed the  
2 language from the proposed rule to the final  
3 rule so that those cash commodity  
4 transactions, that that is out. So that  
5 addressed a fair amount of the concern with  
6 respect to the commodity markets. Go ahead.

7 MR. ANDERSON: And is that only if  
8 you're not a member of an exchange? Or what  
9 if you're doing cash contracting but are also  
10 a member of an exchange?

11 MR. GRIFFIN: There are two  
12 components. So first you have, if you're just  
13 engaging in cash commodity transactions,  
14 you're a member but you're not an FCM, you're  
15 not another registrant above a certain  
16 threshold or within certain parameters.

17 I don't want to mix the two  
18 categories up too much. On the one hand  
19 you're talking about types of transactions  
20 that would trigger the requirement, right?

21 Then the second component is the  
22 nature of who the registrant is. And there

1 the Commission got in -- and again, this  
2 pertains specifically to the oral record-  
3 keeping requirement alone. It does not  
4 pertain to written records and things of that  
5 nature.

6 But it's spelled out and I'll give  
7 you the exact cite. It's Regulation 1.35(a) -  
8 - excuse me. Well, it's at the end of (a)(1)  
9 but it's enumerated out romanettes (i) through  
10 (viii). And if you give me a second I'll walk  
11 through those very quickly.

12 Again, the rule --

13 CHAIRMAN GENSLER: You can send it  
14 to the Committee.

15 MR. GRIFFIN: Or I can send it to  
16 the Committee, whatever you like.

17 CHAIRMAN GENSLER: Just give the  
18 best oral answer.

19 MR. GRIFFIN: That would be fine.  
20 Yes. Essentially it carves out a number of  
21 folks. It carves out, again, oral  
22 communications that led solely to the

1 execution of a cash or forward transaction  
2 just as we discussed.

3 It carves out transactions by  
4 floor brokers who are transacting for  
5 themselves, if there isn't communication with  
6 a customer out there.

7 It carves out what we call small  
8 IBs which are introducing brokers that have an  
9 aggregate revenue from their IB business of  
10 not more than \$5 million total over the  
11 preceding 3-year period.

12 And others as well, floor traders,  
13 members of DCMs or SEFs that are not  
14 registered or required to be registered by the  
15 Commission. I mean all those persons are  
16 strictly carved out. So it is not applicable.  
17 The oral record-keeping requirement is not  
18 applicable to them.

19 CHAIRMAN GENSLER: And this was --  
20 I mean hopefully we got the right balance.  
21 Scott raises the branch issue that we need to  
22 take a close look at.

1                   But what we tried to do is when we  
2                   proposed this I want to say a year and a half,  
3                   maybe 2 years ago, I think we got it too wide.  
4                   It think it was too inclusive. And we got a  
5                   lot of comments back from your interests and  
6                   other interests as well, the FCM community,  
7                   and we narrowed it as probably not completely  
8                   to Vince's liking. But we -- he's in the  
9                   Division of Enforcement so you can imagine  
10                  where he'd come from.

11                  But the Commissioners working  
12                  together with the staff narrowed it and with  
13                  these various exceptions and carve-outs to  
14                  really principally be members of exchanges,  
15                  FCMs that are members, and then these  
16                  introducing brokers that are over a certain  
17                  size as I remember. Is that?

18                  MR. GRIFFIN: That's correct.

19                  MR. STRONG: Scott, does this  
20                  carving out of the cash transaction from the  
21                  recording requirement, doesn't this take care  
22                  of the 60-some branch offices? Or did I miss

1 something there?

2 MR. CORDES: There are other  
3 activities that they're doing around cash --  
4 it does. But the activities they would do  
5 around exchange-traded products as a branch  
6 does not because that's a futures transaction.  
7 Today the way the rule is written that would  
8 still bring them under that review.

9 MR. KOTSCHWAR: The Commodity  
10 Markets Council has been very interested in  
11 this issue for quite awhile and we in fact  
12 commented on it. And we were happy to get the  
13 relief that we got on the oral recording.

14 Unfortunately, we feel like we've  
15 been a little bit duped and weren't paying  
16 close attention because at the same time we  
17 were getting relief on that the definition of  
18 an electronic record was being expanded to the  
19 point of including a lot of 21st century  
20 analogues for phone calls.

21 Today, great, we have a lot of --  
22 you know, a lot of grain is at least bought

1 and sold initially with a phone call. But  
2 more and more it's with a text or an instant  
3 message that has completely replaced the whole  
4 -- actually talking to somebody. So we have  
5 the same issues from a technology perspective  
6 and a searchability perspective trying to keep  
7 all these instant messages and everything else  
8 when we don't have to record the phone call.  
9 So we've got a -- this is a big problem for  
10 the CMC membership. Huge problem.

11 In the case of my company in  
12 particular we immediately just said no more  
13 doing anything with cell phones, or texting  
14 with mobile devices. You have to actually  
15 make a phone call. So we have forced them  
16 into the area where you gave us some relief  
17 because we are unable to do a lot of things  
18 with mobile devices especially.

19 So we don't think that's probably  
20 what the policy should have been. You know,  
21 we get relief from recording phone calls and  
22 that's what we're ironically forcing everybody

1 to do now. So a lot of members of CMC are  
2 very concerned.

3 CHAIRMAN GENSLER: Sir, your  
4 company is a registered FCM?

5 MR. KOTSCHWAR: No, we're just a  
6 member. We're a non-clearing member of a DCM.

7 CHAIRMAN GENSLER: Non-clearing  
8 member. Thank you.

9 MR. MILLER: I think the points  
10 being made here are salient from that  
11 perspective of there was an increasing amount  
12 of the transactions, particularly into things  
13 like branch offices, et cetera, that are  
14 coming from the tractor seat if you will, that  
15 are coming in the form of texts and these  
16 other types of things.

17 And I just would encourage the  
18 Commission to take a look at what type of  
19 requirements and administrative burden are you  
20 imposing if you expand those things into  
21 recordings that go beyond the voice recordings  
22 of these other things.

1 I probably do half of my cash  
2 grain transactions by text. And that's just  
3 the new technology. And I don't know of any -  
4 - to be honest I assume my texts are not being  
5 recorded someplace unless it's NSA.

6 (Laughter.)

7 MR. MILLER: But so I think as you  
8 look at the old requirement that assumed  
9 everything was by voice is rapidly changing.

10 And in fact here may be, again,  
11 different entities. I know internally just  
12 our company has rules that are based upon  
13 other agencies and other things with regard to  
14 how long you store emails.

15 And if you extend this, what's the  
16 recording requirement. How long would these  
17 have to be stored. All these types of things  
18 become issues I think that need to be taken at  
19 least into consideration as to how extensive  
20 we're making these regulations and what the  
21 burden may be there.

22 MR. FRIESEN: So if I would walk

1 into my broker's office and visit with him and  
2 tell him to place an order then there's no  
3 communications that's recorded at all.

4 MR. MCGONAGLE: That's correct.

5 MR. FRIESEN: So it's just the  
6 telephone conversations. And I guess when I'm  
7 thinking now the times that I've done this  
8 there are some times he's on the road  
9 traveling quite a bit and so I do it by phone.  
10 But then he will have to call it in, I take  
11 it.

12 But now I won't be able to do that  
13 anymore. I'll have to call his home office or  
14 somewhere and place my order because he could  
15 no longer do that transaction. Is that  
16 correct?

17 MR. GRIFFIN: Are you talking  
18 about like a cell phone type situation where  
19 he's on the road? It would depend on how the  
20 broker or the FCM, how they would set up their  
21 structure.

22 Again, drawing from the lessons

1 that we've seen or that we've gotten over the  
2 last several months with the swap dealer, in  
3 the swap dealer context the mobile recording  
4 has been something that they have grappled  
5 with as well to varying degrees of success.  
6 And talking about having the ability to have  
7 these conversations when you're on the road,  
8 when you're away from your office.

9 One of seemingly the more workable  
10 solutions that firms have employed, while  
11 they're expecting the mobile technology, the  
12 mobile recording technology to improve here in  
13 the relatively near term, as a bit of a  
14 stopgap measure they are instructing their  
15 folks to essentially set up bridge lines,  
16 bridge conference lines with the home office.

17 So that whether they're on the  
18 road going home, or they're out at lunch, or  
19 they're going to Chicago for something that  
20 they can still have that customer interface  
21 through their mobile handheld. The actual  
22 call itself though is just being routed

1 through the home office. There's a bridge  
2 conference line that then is -- is then being  
3 recorded and making sure the call is fully  
4 compliant.

5 CHAIRMAN GENSLER: And as I  
6 understand it, now these are the swap dealers  
7 many of whom also control FCMs. Scott's firm  
8 is different, I do recognize that. But if you  
9 look at the major, some of the 10 or 15  
10 largest FCMs they're broker-dealers and  
11 they're part of the same swap dealer families.  
12 That's how they're addressing this.

13 MR. CORDES: If I could just add  
14 though too. I would ask that the staff and  
15 the Commission do look a little bit at the  
16 cell phone recording issue. It really comes  
17 into what's a practical size and scale, and  
18 what's at risk to the industry.

19 I know in our particular situation  
20 I talked about our home office and our other  
21 two primary offices. They tend to deal with  
22 farmers and commercial entities in the trade,

1 probably a lot of the folks in this room. The  
2 majority of our business is transacted in the  
3 office on the phone.

4 But with the extended trading  
5 hours that are out there occasionally one of  
6 those employees could get a call from one of  
7 those customers on the way home or on the way  
8 into work. And how do you handle all that?  
9 I mean you're going to set up a bridging for  
10 each potential ones? Because it might happen  
11 once a week, it might happen once a month.  
12 It's not the majority of what takes place.  
13 But is it going to be strict that you have to  
14 cover every single phone call?

15 MR. MCGONAGLE: So the Commission  
16 did discuss this issue a little bit in coming  
17 out with the rule and talked about the concern  
18 if we didn't cover the use of mobile phones  
19 that it would chase the business to mobile  
20 phones, to an area then that wasn't captured.  
21 And so I think that's basically where the  
22 Commission came out.

1           If you're going to use a mobile  
2 phone and that's going to be part of your  
3 business then come up and use that technology  
4 that's available to record it or otherwise  
5 seek the alternative compliance schedule that  
6 Ward referenced and get that into the  
7 Commission as soon as possible.

8           MR. WELLMAN: As a producer, if  
9 I'm not making my own trades on the CME I'm  
10 calling one of those similar branches that  
11 Scott mentioned. But probably calling the  
12 employee on his personal cell phone because  
13 they're out not necessarily sitting in the  
14 office because like Scott said that's not  
15 their full-time job necessarily. So I  
16 question.

17           And maybe, you know, he then calls  
18 back to somebody in the office and actually  
19 makes the transaction. So I'm not sure where  
20 -- how that's all getting recorded.

21           And I don't quite, from my  
22 perspective, I'm not sure why it's necessary.

1 I don't know exactly what problem we're trying  
2 to solve here, what problem we've had in the  
3 countryside that's trying to be addressed by  
4 this.

5 MR. FRIESEN: A little bit -- what  
6 I feel. I mean you're doing this as a  
7 protection for me as a hedger? I mean, I fail  
8 to see I guess. I'm not a speculator. I  
9 don't trade in large volumes. So by  
10 implementing this, is this a protection for  
11 the consumer, me?

12 CHAIRMAN GENSLER: Yes, very much  
13 so. It's about market integrity, our  
14 enforcement efforts. And this is true around  
15 the globe, whether it's in the United Kingdom  
16 or here or elsewhere have more and more gone  
17 to saying that these dealers, I'm going to use  
18 the word broadly, record their transactions  
19 and part of their record-keeping is these  
20 voice recordings. That's what's been  
21 implemented here for the swap dealers already.

22 And it had a provision similar I

1 think to this that -- I can't remember what  
2 you called it. Alternative compliance is it?  
3 Where a futures commission merchant or dealer  
4 could say no, actually the technology doesn't  
5 yet exist. We need more time. We need to  
6 change this.

7 But it's broadly speaking to help  
8 promote market integrity. Not that you're  
9 going to be a bad actor but it's that somebody  
10 on the other side, what they're doing.

11 And we need to address and sort  
12 through Scott's issue of these one- or two-  
13 person offices. I appreciate that.

14 But the broad conceptual framework  
15 is just that a member -- I mean it was carved  
16 back. It's really a member of an exchange  
17 that's -- the futures commission merchants or  
18 the introducing brokers over a certain size if  
19 I remember.

20 And not to try to stop somebody  
21 from the occasional cell phone call at night.  
22 That's not the purpose.

1 MR. ANDERSON: Maybe just to  
2 piggyback a little bit on Curtis's point as  
3 well.

4 When that call is made in the  
5 middle of the night for that transaction  
6 that's going to represent a contract that then  
7 is going to be followed up in writing,  
8 required a signature coming back. So, there  
9 is another touch point after that phone call.

10 MR. FORTENBERY: Any other -- yes,  
11 go ahead.

12 MR. KOTSCHWAR: I don't want to be  
13 monopolizing time here or piling on, Mr.  
14 Chairman. But you know, this --

15 CHAIRMAN GENSLER: We always enjoy  
16 our exchanges.

17 (Laughter.)

18 MR. KOTSCHWAR: Many of the  
19 members of CMC are -- many of our members have  
20 exchange memberships. We're non-clearing  
21 members. We do all of our business through an  
22 FCM. So the reason we're on the exchange,

1       it's an economic reason that we've decided to  
2       join the exchange because of the amount of  
3       trading we do, to take advantage of the  
4       benefits of membership.

5                 That's the only reason we seem to  
6       be caught, wrapped around the axle in this  
7       whole notion of in our case it's not the oral  
8       recording. Oral recording worked out for us.  
9       It's the written records that are associated  
10      with it. Because we're really struggling with  
11      that.

12                Take a good example. My company  
13      has got hundreds of locations all across the  
14      country. On any given day we'll be buying and  
15      selling all kinds of grains. We'll be buying  
16      corn from farmers in 20 different states.  
17      We'll be selling corn elsewhere.

18                At the end of the day, every time  
19      we buy 5,000 bushels of corn from a farmer we  
20      don't go hedge that discretely. We have to  
21      look at our overall book and see where we are.  
22      Are we net long or are we net short. Then

1 we're going to go take that position to the  
2 exchange is what we'll do. Or adjust our  
3 position on the exchange.

4 So the way we're dealing with this  
5 written communication record is those cash  
6 transactions cumulatively are why we're  
7 ultimately doing our futures transactions. In  
8 an abundance of caution we're looking at all  
9 those records saying, okay, we've got to keep  
10 all that electronic communication that led up  
11 to those cash grain sales. We're not sure if  
12 that's very good policy.

13 We keep the records we have to  
14 with farmers that we feel are commercially  
15 necessary. Any kind of communication we have  
16 with the farmer leading up to a sale, we still  
17 need a piece of paper. We're going to have a  
18 contract with that farmer. And that's the  
19 kind of stuff we keep.

20 Any of the communications we're  
21 having up to that, we don't have to record our  
22 phone calls. But to try and keep text

1 messages leading up to that, that is a huge  
2 burden which is why we're not doing it right  
3 now.

4 MR. ANDERSON: And to Lance's  
5 point even further. His competition may not  
6 be required to do that because they may not be  
7 a member of an exchange. So his elevator  
8 might be here not being able to communicate  
9 via text because the burden of recording is  
10 too great. But the elevator or the  
11 cooperative system next door who's not a  
12 member of an exchange doesn't get tangled up  
13 in this and therefore isn't subject to those  
14 same requirements.

15 MR. GRIFFIN: Aside from the  
16 policy point that I think you're trying to  
17 make, I think one point that's instructive is  
18 noting that the Commission said in the  
19 preamble to the final rule that there was  
20 actually an advisory that our Division of  
21 Market Oversight issued back in 2009 that  
22 addressed as you mentioned the 21st century

1 written communication, electronic  
2 communication component of -- the relationship  
3 there.

4 And the DMO had come out with this  
5 advisory saying that under the preexisting  
6 1.35, before this rule amendment was finalized  
7 in December that 1.35, the older version  
8 already required the retention of these  
9 written records by members of designated  
10 contract markets.

11 So I mention that just kind of in  
12 passing. Again, that doesn't address the  
13 underlying policy concern that's there. But  
14 just want to make clear that at least it was  
15 the Commission's view by virtue of the DMO  
16 advisory that was put out in '09 that the  
17 capture and retention of these written  
18 communications were already required.

19 MR. KOTSCHWAR: And just  
20 respectfully I don't believe -- I think it's  
21 accurate to say that among the CMC membership  
22 no one was paying attention to industry

1 guidance. You know, we have a hard enough  
2 time figuring out what the regs are.

3 You know, when you put out  
4 guidance saying here's what the reg means,  
5 most people -- most people were not paying  
6 attention to that.

7 MR. MCGONAGLE: So when the rule -  
8 - when we have the clarification talks about  
9 electronic records we're focused on what is  
10 the communication. The content of the  
11 communication is what's driving the obligation  
12 to retain the records. That's what we're most  
13 interested in.

14 And to the extent that folks  
15 wanted to get tripped up in the method of  
16 communication I think the 2009 guidance came  
17 out that said don't get tripped up on the  
18 method of communication. If you want to text  
19 that's within your business right to do that  
20 but you need to retain it.

21 And so I'm saying that maybe more  
22 forcefully as an enforcement person than, you

1 know, you're going to hear from other sides of  
2 the house. But the record-keeping obligations  
3 have been in 1.35 to members of the contract  
4 markets, FCMS, RFEDs going back for a period  
5 of years. Members of a contract market have  
6 been required to maintain records of cash  
7 transaction 25-30 years now.

8 So I want to make sure that people  
9 are focused on that and are thinking that this  
10 isn't a new obligation when it comes to those  
11 transactions. And you're doing your best to  
12 comply with those provisions.

13 MR. ANDERSON: I think a lot of  
14 our membership has quickly caught up. Because  
15 we were caught a little off guard as well.  
16 But I think we've quickly caught up and made  
17 some decisions similar that if we can't track  
18 it then we're not going to do it that way.

19 However, again there's a little  
20 bit of a dichotomy between what a member of an  
21 exchange may have to do even if they're  
22 clearing through an FCM versus another --

1 their competition who may not be a member and  
2 therefore may be able to not have to record.

3 MR. GRIFFIN: At least to some  
4 extent with that if you're talking about  
5 communications between the member and the FCM  
6 with whom they're going through there is that  
7 component that the Commission discussed that  
8 one registrant or one affected entity can  
9 contract out with another entity that has to  
10 maintain the same records. So that you don't  
11 have a requirement where both sides are being  
12 forced to maintain the same record.

13 So in that case if -- to the  
14 extent that you're talking about  
15 communications between a member of a contract  
16 market, or a SEF for that matter, but member  
17 of a contract market and the FCM through whom  
18 they conduct business, there can be an  
19 agreement with the FCM that the FCM will  
20 retain those records for the required period.

21 MR. ANDERSON: I'm talking more in  
22 the case of a farmer. A farmer calls up

1 someone at the elevator, or texts someone at  
2 the elevator from the combine and says "Hey,  
3 what's December corn doing." And gets a text  
4 back that says "Five dollars."

5 If you're a member of an exchange  
6 the way our groups have been interpreting it  
7 you had to somehow record and make available  
8 that text. Whereas if that farmer sends that  
9 to a member who is -- or a company who's not  
10 a member of an exchange there's no obligation  
11 to retain that text on record.

12 MR. MCGONAGLE: Thanks, I  
13 appreciate that. Thank you.

14 MR. FORTENBERY: Any other  
15 comments? Questions?

16 MR. GALLAGHER: We're not -- the  
17 company I work for is not in the same --  
18 doesn't have the issue that you have because  
19 we're not one of those entities that have to  
20 keep track.

21 But boy let me tell you, when I  
22 listen to this conversation something is not

1 connecting here. Because this is crazy. To  
2 expect that the stuff that you were talking  
3 about has to be reported.

4 I can see the point when you are  
5 Goldman Sachs and you make a multiple billion  
6 dollar transaction that you get it recorded  
7 and something shows up so there's a trail.

8 But when you're talking about a  
9 farmer trying to protect their million dollar  
10 investment in their farm, or 2 or 3, whatever  
11 it ends up being, and they're calling about  
12 4,000 or 5,000 bushels of corn. And you're  
13 going to treat them the same way as you're  
14 going to treat Goldman Sachs, I think there's  
15 a big disconnect between the people that are  
16 trying to do what they think is right with the  
17 practicality of what happens in the broader  
18 agricultural world.

19 And I really would encourage you  
20 to revisit this thing. Because this is a  
21 little bit out of control.

22 CHAIRMAN GENSLER: Ed, I hear you

1 but oral recording is exactly -- that's what  
2 we did. The farmer doesn't have to record  
3 anything.

4 MR. GALLAGHER: I understand that,  
5 but the way these transactions happen is --  
6 it's not going to happen in a way where  
7 there's -- you know, Goldman Sachs is going to  
8 be able to have, pay somebody \$50,000 to be a  
9 clerk sitting at a desk that can always --

10 CHAIRMAN GENSLER: No, no, we've  
11 got to address Scott's issue of this branch  
12 issue. And this has been very helpful. All  
13 of the issues, Lance's included, all of the  
14 issues -- that's because we're friends. But  
15 all of the issues are very helpful. And  
16 that's what an advisory committee is about, to  
17 bring these issues to us. But the farmer  
18 doesn't have to record it.

19 MR. PENNER: Thank you, Chairman.  
20 From my standpoint my cooperative  
21 representative which is a full-time guy from  
22 my cooperative, they have a policy where they

1 refuse to accept texts as orders anymore for  
2 that reason. And they actually even  
3 discourage the phone call because they want to  
4 have -- they don't want to have to do that.  
5 They want you to come in or say, you know,  
6 we'll send you a sheet and you will sign this.

7 So it actually discourages farmers  
8 from actually making timely marketing  
9 decisions at this point. Because that's the  
10 continued feedback.

11 MR. STRONG: Scott, do you have  
12 any global issues?

13 MR. CORDES: Not at this point I  
14 don't. Our firm is not stretched far enough  
15 outside the U.S. borders to be an issue yet.  
16 But I'm sure there's probably other ones that  
17 do.

18 MS. PRESTON: I have a question  
19 here. And I know some of our members are  
20 affected by this but I have not paid detailed  
21 attention to this.

22 It sounds like the Commission is

1 familiar with some of the technology that  
2 maybe the larger players are using, bridge  
3 technology. How is that functioning? And is  
4 that for incoming and outgoing calls? Or how  
5 is that set up?

6 MR. GRIFFIN: I will admit I am  
7 not a technology expert. So when I mentioned  
8 those things I'm basically passing along  
9 feedback that we have received from operations  
10 folks, technological experts either internally  
11 here or at some of the affected firms.

12 I'm not entirely certain how from  
13 a systems setup standpoint that would be  
14 constructed. But we'd be happy to talk with  
15 you further about that.

16 MS. PRESTON: Thanks. Yes, I mean  
17 I shouldn't do this but I'll think out loud.  
18 In terms of incoming calls call forwarding  
19 seems to work. And I don't know if the  
20 technology is there, is it a problem to record  
21 because it's forwarding to a cell phone.

22 So I guess then the issue might be

1 outgoing calls from a cell phone? Or we just  
2 don't have enough information yet?

3 MR. GRIFFIN: Yes, I think -- I  
4 think with those generally if you have an  
5 outgoing call if you are, you know, an AP of  
6 an FCM and you want to talk with your  
7 customer. You are on the road and you want to  
8 call that person that would generally involve  
9 calling in to the home office and having it  
10 then conferenced over to whomever that person  
11 is calling. That's my understanding but again  
12 I don't profess to be an expert on technology.

13 MS. PRESTON: And does the  
14 recording have to be within the control of the  
15 entity that has the recording obligation? Or  
16 can it be a third party?

17 MR. GRIFFIN: How do you mean  
18 that?

19 MS. PRESTON: Looking at the  
20 entity that is doing the bridging, that is  
21 doing the connectivity between the incoming  
22 call. Can that be done through a third party,

1 or does it have to be done through the party  
2 that has the recording obligation?

3 MR. GRIFFIN: No, I mean the  
4 obligation, and Vince can correct me if I'm  
5 wrong, but the recording obligation goes to of  
6 course the registrant. But as you'll have  
7 with many different functions that are  
8 required for a particular registrant they'll  
9 contract with a third party vendor to assist  
10 in this case with recording and even retaining  
11 those oral communications for whatever period  
12 of time.

13 So in that instance it may not --  
14 I mean when I said earlier that there are, or  
15 we've been told about many off-the-shelf  
16 applications that are available, when I say  
17 that I mean there are -- there isn't a need  
18 for affected firms to have to go out and  
19 wholly construct from scratch an entirely new  
20 system that works for their program and fits  
21 within their computers or whatever the case  
22 may be. That there are applications out

1       there.

2                       Because this has been in place in  
3       other contexts both domestically and  
4       internationally to varying degrees for a  
5       little while. And that has allowed the  
6       technology to become a bit more mature. And  
7       so it makes it -- again, from what we have  
8       been told repeatedly, that there are a number  
9       of opportunities out there.

10                      But back to the original question  
11       who actually does it. I mean, the ultimate  
12       responsibility would be on the registrant  
13       itself. But if they're relying on a third  
14       party vendor to assist in capturing and  
15       whatnot I would believe that's perfectly fine.

16                      MR. MCGONAGLE: I agree with Ward.  
17       I was just trying to find it somewhere in the  
18       rule release and I haven't been able to come  
19       up with it so quickly.

20                      MS. PRESTON: I just want to offer  
21       since our members have a lot of data security  
22       responsibilities already that if we can be of

1 assistance please let me know.

2 MR. GRIFFIN: Appreciate it.

3 Thank you.

4 MR. FRIESEN: I guess listening to  
5 this as a producer and seeing the costs of it.  
6 And it's going to get passed down to me. I  
7 guess the benefit-cost ratio I would say we  
8 don't need it. But that's my opinion. You're  
9 asking for it, you got it.

10 I just don't see the risk-benefit  
11 as protecting my interest or the market's  
12 interest when you're talking just the small  
13 hedger. I don't see it. I can see the  
14 Goldman Sachs, some of the big companies, yes.  
15 I definitely would want to be recorded making  
16 transactions like that. But on our small  
17 scale I don't see that it's ever going to be  
18 used. I don't see a need for it.

19 COMMISSIONER O'MALIA: Vince or  
20 Ward, do you want to comment on the cost-  
21 benefit analysis that we did on the rule? To  
22 respond to his question. What level of

1       granularity did we take this?

2                   MR. MCGONAGLE: I'll start then.  
3       Ward's reading. He can jump in.

4                   So the cost-benefit analysis  
5       outlined what we understood to be some typical  
6       costs. For example, commenters estimated that  
7       for a producer that's using one cloud-based  
8       solution monthly fees would be about \$90 a  
9       month for mobile phones and approximately \$50  
10      a month for line and land lines.

11                  So we have for a few pages in the  
12      cost-benefit analysis some level of  
13      granularity about what we understood from the  
14      community on these off-the-shelf software  
15      programs, about what they anticipated  
16      expenditures could be.

17                  I haven't heard anything today  
18      from the users about what costs associated  
19      they've seen. But I would certainly be  
20      interested in hearing that.

21                  MR. GRIFFIN: Yes, there's a  
22      measure of granularity in terms of some of the

1 numbers. But I mean beyond that, beyond what  
2 Vince said I don't have anything to add.

3 MR. GALLAGHER: Could you guys  
4 share who you looked at? So the cloud  
5 technology for \$90 a month and some of the  
6 others. Would it be possible to share what  
7 company's technology you looked at?

8 MR. MCGONAGLE: Yes. The rule  
9 that's available outlines who the entities  
10 were and the comment letters that they  
11 submitted that had those costs.

12 In looking at the costs. I'm  
13 going by footnotes. Starting around footnote  
14 91 is where you're going to see in the cost-  
15 benefit analysis the cross reference to what  
16 we were seeing or what we were hearing from  
17 the community about potential costs for  
18 implementing an audio taping system.

19 MR. GRIFFIN: And in that  
20 particular area, and again, I can't -- I don't  
21 have their letter here in front of me, but the  
22 footnotes to which Vince is referring is a

1 comment letter we received from a company  
2 called Compliant Phones where they provided  
3 some information on these particular issues.

4 I should stress in terms of not  
5 just that particular comment letter but all  
6 the comment letters there is still a comment  
7 file that's very much available on the  
8 Commission's website.

9 If you go onto the Federal  
10 Register final rules page and you pull this  
11 up. This again was from December 21, 2012.  
12 There's a link to the comment file that will  
13 have that comment letter as well as all the  
14 others that the Commission received.

15 MR. MILLER: Again, just listening  
16 to the various issues it's not one that from  
17 my perspective I deal with directly. I use an  
18 online app and I trade directly. I don't go  
19 through -- I don't make any calls unless  
20 somebody's website goes down.

21 But the challenge is I think there  
22 are a number of people that do. And to the

1 extent that a rule, particularly a recording  
2 rule is changing the dynamics in the  
3 countryside of who can accept text and email  
4 communications versus who can't accept them,  
5 and decisions being made, there's a  
6 competitive structure that starts being  
7 influenced.

8           It really becomes a market access  
9 issue that ultimately falls to the farmer,  
10 that in particular areas I may lose the  
11 ability to have market access by the means of  
12 communication not because I chose it. So it  
13 wasn't protecting me as a farmer. It's because  
14 costs that are deemed by somebody at some  
15 point not to be worth the benefit for whatever  
16 their customer base is. And you lose a  
17 communications technology advantage that is an  
18 advantage that is very good at the farm level.

19           I can tell you there are a number  
20 of places on my farm where I have texting  
21 capability where I do not have voice  
22 capability. I can't maintain a signal well

1       enough to do a call but I can do a text  
2       because the text either goes through or it  
3       doesn't go through. And those places vary as  
4       you go across the field.

5                   And so I guess I would just point  
6       out that the rule is having implications and  
7       we're hearing that out in the countryside that  
8       are totally unintended consequences of this  
9       rule. And would encourage the Commission to  
10      take a look at whether it's solving some of  
11      the branch office issues, but also some of the  
12      issues of -- my guess is there are less direct  
13      FCMs that are willing to deal with farmers  
14      because of this. And so the options of market  
15      access through whatever competitive measures  
16      are being unduly influenced by the rule.

17                   MR. FORTENBERY: Any additional  
18      comments?

19                   MR. ANDERSON: One quick one. You  
20      mentioned the cost \$90 to \$50 a month. Was  
21      there -- in that same spot, you know, footnote  
22      91, does it start talking about the benefits

1 value you guys placed on it as well?

2 MR. GRIFFIN: The benefits weren't  
3 quantified in terms of a dollar amount. I  
4 mean, it's I'm sure you can imagine pretty  
5 difficult to put a dollar figure on market  
6 integrity and preventing fraud and  
7 manipulation, things like that.

8 There's a great deal of discussion  
9 on the costs and to the extent that we were  
10 given some specific number figures of course  
11 they were very much put in and considered. In  
12 terms of the benefits there's a great deal of  
13 discussion on that as well.

14 MR. PENNER: Scott, I have a  
15 question for you. In terms of your office that  
16 you handle orders from all your agents, if you  
17 utilized this technology would you not be  
18 covering the required percentage of calls and  
19 orders that would satisfy the amount of the  
20 volume of trades that would actually may be  
21 called into question at some future time?

22 You know, there's a threshold.

1 You know, materiality is an accounting  
2 concept. There's a threshold that you could  
3 stand.

4 MR. CORDES: Yes, I think you're  
5 getting to what's the size and scale. And the  
6 way it's written today you've got to record  
7 everything. The majority of our volume is  
8 handled at the home office and probably the  
9 two or three other offices kind of thing.

10 And I would also caution as you  
11 talk about the cost economic benefit, you can  
12 talk \$90 per month per cell phone. Well, it  
13 doesn't sound like much. Well, now you're  
14 pushing \$1,000 a year. If you've got 20  
15 employees and just in case you take a phone  
16 call on the way home, you've now got \$20,000  
17 a year. I mean it starts to add up in a  
18 hurry. You know, monthly charges don't look  
19 like a lot but they multiply fast.

20 MR. FRIESEN: Down the road if I  
21 have an app for my phone where I can enter  
22 trades in I imagine there's an electronic

1 tracking of that since it is a trade. So, I  
2 mean, as I see technology coming, I mean I  
3 already on my home computer do all my own  
4 hedging through a program that the broker  
5 gives me.

6 So I mean, it makes it very simple  
7 and I can see it being an app on a phone  
8 pretty quick. And so is all of this kind of  
9 a moot point if down the road I guess we can  
10 all just enter it in from our phone and do  
11 these transactions and we're done?

12 CHAIRMAN GENSLER: Curt, I'll  
13 react this way. I think you're absolutely  
14 right. I think that whether it's Globex at  
15 CME or whatever that platform is at ICE or  
16 elsewhere that they have -- I mean a farmer  
17 sitting on their tractor in Iowa can use an  
18 app probably even today to do that  
19 transaction. And then there is an audit trail  
20 over at the Exchange.

21 And in most large offices -- this  
22 branch issue is an important one -- but most

1 large offices people are already voice  
2 recording possibly just to protect the FCM  
3 against some customer who says well, I don't  
4 know what trade you're talking about. They  
5 might have been recording it just for their  
6 own risk profiles. Yes, to protect against  
7 the amnesia trade.

8 So we weren't trying to pile on or  
9 do anything like that. Just trying to capture  
10 the audit trail that's already there. I do  
11 understand, you know, when you have one-person  
12 offices maybe we've got to address something.

13 And the text messaging and so  
14 forth is just a variation on the apps. To  
15 have the -- not the farmer but the firms keep  
16 an audit trail and not try to change it that  
17 the farmer can use whatever means to hedge  
18 their risk is ultimately -- that's what these  
19 markets are for. They're for commercial  
20 enterprises, whether they be farmers and  
21 ranchers, the millers and so forth, or even  
22 just a local bank and so forth to hedge their

1 risk, lock in a price, focus on what they do  
2 well which is innovate and produce services  
3 and goods in our economy.

4 MR. FRIESEN: I checked with my  
5 local elevator quick while we're here and they  
6 had estimated their cost at \$20,000 per  
7 location. Don't know what kind of technology  
8 they're looking at.

9 MR. FORTENBERY: Ward, Vince,  
10 Scott, thank you very much for your -- oh yes,  
11 go ahead. I'm sorry.

12 MR. DIERKS: Actually more of a  
13 comment. And I guess -- and I think, Chairman  
14 Gensler, I thought your comments about making  
15 sense out of this is really good. Thanks for  
16 that. I mean half-person offices, how do you  
17 make it?

18 But actually I think for everybody  
19 in this room the reality of it is given the  
20 charge that CFTC's been given over the last  
21 few years and the scale of things, I think the  
22 real charge for the people in this room is how

1 the CFTC goes through.

2           Because how -- what kind of  
3 exceptions do you make for agriculture? Given  
4 your futures in the Globex or the scale of the  
5 markets and the scale of the responsibility  
6 CFTC has. And I think that -- is that not  
7 going to be the ongoing challenge that it's  
8 easy for us in agriculture sometimes to say we  
9 need to be -- and for good reason we need to  
10 be carved out.

11           Because there are some real issues  
12 that if our food and fiber system is going to  
13 continue to produce and manage risk we have to  
14 do it kind of in a way that works with them.  
15 At the same time we have to have integrity of  
16 markets because I think we're still suffering  
17 at least in our industry from the two events  
18 that shall not be named on trust of the  
19 marketplace.

20           And I think it's very -- I  
21 congratulate you on recognizing that there are  
22 some fundamental things on the ground that,

1 kind of, why do we spend this much money when  
2 it doesn't generate it.

3 But to David's point, there are  
4 issues of marketplace access that can change  
5 the structure of agriculture depending on can  
6 you manage your risk or not. And I guess, I  
7 don't know, that's how I see the world.

8 I want to congratulate you, I'm  
9 glad you had this meeting. It's too bad we  
10 haven't had one for 2 years.

11 Because I'd also, the last parting  
12 comment I'd like to make is the fact that I  
13 think this group can serve as an advocate to  
14 the customers and the users of the marketplace  
15 when we do get unusual events that happen to  
16 help share information so that we don't -- so  
17 we can retain trust in the system.

18 I know we use -- because the hog  
19 business, we use the CME. But when we had our  
20 events of the fall of 2011 we had a lot of  
21 communication with the markets just to say  
22 give us information because we've got

1 producers out here with pitchforks and  
2 torches.

3 And I think in the future if there  
4 is an unexpected event I would suggest that  
5 you touch on this group to help share  
6 information. Because I think it can be a  
7 benefit to help keep the marketplace -- keep  
8 the integrity of the marketplace. Realizing  
9 you guys are trying to do a hard job and keep  
10 it all in place. So excuse me for my long-  
11 winded comments but I wanted to get that in  
12 before the end.

13 I'd also suggest the panel on the  
14 consumer protection, I would suggest you put  
15 that on the agenda next time because I think  
16 there's some issues that didn't get talked  
17 about here that could have been talked about  
18 that I think would have been beneficial. So  
19 thank you.

20 CHAIRMAN GENSLER: Thank you. And  
21 maybe this is the opportunity to thank Randy  
22 for conducting. You run a sharp gavel so it's

1 helpful. But to really elicit your advice and  
2 comments I think all of us at the Commission,  
3 staff and Commissioners alike benefit from  
4 your input, whether it's in the formal setting  
5 here which we should do more regularly as you  
6 said, or if it's directly to us.

7 Please do not be strangers. We  
8 need your advice and counsel. And we need it  
9 particularly because as you said, as Neil  
10 said, so much of what we're doing now relates  
11 to markets like the interest rate swap market  
12 and the credit derivative markets which are  
13 vast, are truly systemic in size.

14 But the agricultural interests of  
15 hedging risk for the farmer, for the miller,  
16 for the producer, rancher are critical. And  
17 it's also our origin. That's what we are. We  
18 started in the Department of Agriculture. But  
19 that's really what this agency is about.

20 And Mike Dunn's here trying to see  
21 if this city kid can say the right things.  
22 And he'll tell me afterwards what I missed.

1 But it really is our culture. So please keep  
2 the advice coming.

3 And we'll take up the issues on  
4 the customer protection, this voice recording,  
5 the Dodd-Frank implementation and even these  
6 RIN markets, but other topics as they come,  
7 please. Thank you.

8 COMMISSIONER O'MALIA: Thank you  
9 to Professor FORTENBERY and our staff for  
10 organizing this. And especially thank you to  
11 all the participants and your associations  
12 that have contributed thus far to our  
13 rulemakings. Thank you for your participation  
14 here. This was very helpful. Thanks.

15 MR. FORTENBERY: Okay, we've about  
16 reached the end of the day. Thanks very much  
17 to Chairman Gensler for sponsoring this  
18 Committee.

19 I realize that I had to cut us off  
20 a little early on the customer protection  
21 discussion. I apologize for that. I  
22 apologize to Vince and anybody else whose name

1 I messed up this afternoon. I sometimes talk  
2 faster than I read and it doesn't always end  
3 up well.

4 And I thank all of you for coming.  
5 I know it's a big time commitment, long travel  
6 for some people. Thanks very much for  
7 participating. I hope you got some value out  
8 of it as well as the CFTC staff and  
9 Commissioners.

10 I will appreciate any input you  
11 might have on future meeting topics including  
12 the customer protection issue. And we will be  
13 communicating with you on the most effective  
14 way to let us know, provide additional input  
15 and let us know what kind of topics and issues  
16 you think should be at the -- on the forefront  
17 the next time we meet.

18 So at this point I'm going to  
19 adjourn the meeting. Oh yes, sorry.

20 CHAIRMAN GENSLER: Randy, can I  
21 just suggest if you all can give Randy some  
22 sense if we were to meet -- rather than

1 waiting 2 years but say in 6 months or  
2 something. And just, obviously we can meet  
3 sooner if there's a need. But just to figure  
4 out some dates. So rather than waiting a long  
5 time to put something on the schedule, let's  
6 get something on the schedule.

7 COMMISSIONER O'MALIA: Mr.  
8 Chairman, I try to conduct a TAC meeting on a  
9 quarterly basis. So if that's any standard.  
10 Once a quarter.

11 CHAIRMAN GENSLER: Commissioner  
12 O'Malia always setting very high standards.

13 MR. FORTENBERY: I guess I'm not  
14 quite sure what our options are. Do we know?  
15 Okay. We'll be in touch about that. So you  
16 might think about what the optimal time frame  
17 is. Is that acceptable? Okay.

18 So at this point I'm going to  
19 adjourn the meeting. Thank you very much for  
20 your time and your input and safe travels.

21 (Whereupon, the above-entitled  
22 matter adjourned at 2:19 p.m.)

<b>A</b>				
<b>AAA</b> 118:4	58:15 59:14 71:18	69:15	218:8 219:2	<b>agricultural</b> 1:3
<b>ability</b> 66:20 91:1	75:15 76:3 80:7	<b>additional</b> 20:2	<b>advisory</b> 1:3,12	2:8 9:21 10:8
91:11 98:11	85:19 90:11,16	38:6 58:8 60:1	2:20 5:5 6:17,20	11:4 27:14,20
104:16 144:3	104:9 110:6	61:5 70:20,21	11:19 13:8 101:2	31:1 37:19 42:12
161:18 182:6	<b>account-holders</b>	79:3 86:1 93:15	147:21 191:20	45:18 121:21
208:11	76:16	151:6 209:17	192:5,16 198:16	123:2 163:7
<b>able</b> 23:8 53:12	<b>accumulated</b> 136:8	220:14	<b>advocacy</b> 13:3	197:18 218:14
59:5 71:19 75:10	136:22	<b>additive</b> 112:19	<b>advocate</b> 70:7	<b>agriculture</b> 5:5 9:4
81:3,8 108:20	<b>accurate</b> 116:18	<b>address</b> 24:3 42:9	81:19 216:13	16:17 33:6 43:2
118:1 146:6	192:21	47:20 57:10 74:22	<b>affect</b> 160:5	46:3 147:21 169:9
161:11 162:2	<b>achieve</b> 156:12	78:14 121:11	<b>affirmation</b> 41:6	215:3,8 216:5
181:12 191:8	<b>acknowledging</b>	152:12 187:11	<b>affirmative</b> 75:14	218:18
195:2 198:8	153:4	192:12 198:11	<b>afforded</b> 154:19	<b>ahead</b> 28:5 60:3
203:18	<b>act</b> 17:12,17 32:11	213:12	155:1,13	61:17 115:21
<b>above-entitled</b> 47:8	72:18 114:2,3,4	<b>addressed</b> 40:7	<b>aftermath</b> 55:14	144:7 145:20
221:21	116:4 120:3	92:7 150:12,17	<b>afternoon</b> 146:15	147:5 168:16
<b>absolute</b> 116:11	133:18 164:2	151:2 173:5 186:3	147:15 157:17	173:6 188:11
<b>absolutely</b> 212:13	<b>acting</b> 3:8 156:3	191:22	220:1	214:11
<b>abundance</b> 190:8	<b>action</b> 51:9	<b>addresses</b> 43:21	<b>ag</b> 11:18 12:2,5,10	<b>Alabama</b> 122:6
<b>abuse</b> 30:15	<b>actions</b> 41:14 78:3	75:16,17 76:12	91:18 127:22	<b>albeit</b> 99:5
<b>abusive</b> 151:19	159:7,21	<b>addressing</b> 121:21	<b>agencies</b> 6:18	<b>alert</b> 71:15,17
<b>accelerates</b> 79:20	<b>active</b> 23:14 40:16	183:12	180:13	76:16
<b>accelerating</b> 79:11	119:13 131:12	<b>adept</b> 35:5	<b>agency</b> 1:25 13:17	<b>alerted</b> 77:5
<b>accept</b> 199:1 208:3	135:15	<b>adequate</b> 65:18	34:6 39:19 69:11	<b>aligned</b> 169:1
208:4	<b>actively</b> 15:7	<b>adjourn</b> 220:19	69:20 120:10	<b>alike</b> 218:3
<b>acceptable</b> 221:17	<b>activities</b> 107:19	221:19	125:20 138:11,13	<b>alive</b> 28:1,7
<b>access</b> 46:3,22	135:20 164:15	<b>adjourned</b> 221:22	138:20 141:11	<b>allegations</b> 159:9
58:17 59:3 148:16	177:3,4	<b>adjust</b> 31:18 190:2	145:1 218:19	159:14
161:11 166:6	<b>activity</b> 119:19	<b>adjusting</b> 31:15	<b>agenda</b> 16:20	<b>alleged</b> 133:8
208:8,11 209:15	152:5,11 159:21	<b>adjustment</b> 121:5	217:15	<b>allow</b> 59:2 60:3
216:4	159:22 160:9	<b>adjustments</b> 9:1	<b>agents</b> 210:16	61:16 74:9 124:3
<b>accessible</b> 22:12	<b>actor</b> 187:9	31:12	<b>aggregate</b> 51:22	157:9,10
24:7	<b>actors</b> 75:6 84:1	<b>administrative</b>	175:9	<b>allowed</b> 51:14
<b>accommodation</b>	125:19	68:22 179:19	<b>aggregator</b> 58:19	203:5
41:12,13	<b>acts</b> 151:20	<b>Administrator</b>	<b>ago</b> 38:3 51:12	<b>allowing</b> 80:6
<b>account</b> 52:3 59:4	<b>actual</b> 100:12	137:19 138:12	69:21 74:19 80:16	147:21 154:2
66:19 75:12,13	182:21	<b>admit</b> 200:6	80:20 112:3	163:2
78:14 85:16 89:19	<b>adapt</b> 149:10	<b>adopt</b> 162:17	117:11 119:17	<b>alluded</b> 132:22
91:4 93:21 94:14	<b>adaptation</b> 149:11	<b>adopted</b> 56:7,20	123:19 136:2,2,8	<b>AlphaMetrix</b> 51:21
96:20 100:2	<b>add</b> 39:11 69:2	57:1	136:10 156:22	54:15 58:18 75:22
103:21,22 105:7	78:2 92:18 94:12	<b>advance</b> 151:18	157:21 158:10	76:1
105:10 165:11	113:8 163:4	<b>advanced</b> 124:7	176:3	<b>alternative</b> 73:18
<b>accountants</b> 59:22	183:13 206:2	<b>advances</b> 149:4	<b>agree</b> 203:16	73:22 151:12
<b>accounting</b> 56:1	211:17	<b>advantage</b> 189:3	<b>agreement</b> 121:2	155:17,21 185:5
130:3 211:1	<b>adding</b> 169:8	208:17,18	195:19	187:2
<b>accounts</b> 57:22	<b>addition</b> 18:9,19	<b>advice</b> 7:11 8:9,16	<b>agreements</b> 56:14	<b>amended</b> 65:4
	20:1,13 25:3	31:5 67:20 218:1	<b>agribusiness</b> 85:2	<b>amendment</b> 192:6

<b>amendments</b> 56:11 148:5,14 149:13 149:21 150:3,4,8 150:18	<b>and/or</b> 172:19 <b>Ann</b> 3:4 4:6 17:5 18:4 25:12 31:21 39:18 40:3,3 46:16	121:11 187:13 196:13 204:2 220:10	<b>associate</b> 147:16 <b>associated</b> 59:8 189:9 205:18	196:7 202:16 206:9 207:7
<b>America</b> 2:7 14:5 14:12	<b>Anne</b> 3:20 4:9 47:22 55:6,13 57:5,8,14 58:7 64:2,6,11 75:18 111:6,14	<b>appreciated</b> 41:10 <b>approach</b> 65:7 160:22	<b>Association</b> 1:18 1:19,22,23 2:2,5,6 2:10,11,13 14:1,3 14:20 15:12,14,16 15:20 16:2,12,15 40:12	<b>average</b> 118:4,22 164:19
<b>American</b> 1:18 2:2 2:3,6,8,9,11 14:1 14:3 16:2,7,11,15 16:17 40:11 92:15	<b>anniversary</b> 155:10	<b>appropriate</b> 31:13 87:12 121:17 172:18	<b>associations</b> 219:11	<b>avoid</b> 107:9 154:3
<b>Americans</b> 10:10	<b>annual</b> 42:6,7,15 59:18,19 62:12	<b>approved</b> 50:22 57:6	<b>Association's</b> 57:7	<b>awaiting</b> 85:7
<b>amnesia</b> 213:7	<b>answer</b> 25:5 75:5 78:10,21 88:11 101:17 102:2 174:18	<b>approximately</b> 50:7 51:2 53:17 155:1 205:9	<b>assortment</b> 78:2	<b>aware</b> 22:17 45:3 45:14 48:9 77:14 142:12
<b>amount</b> 12:1 82:3,3 82:5 83:1 113:13 125:11,12 126:8 140:1 141:19 154:18 155:2 173:5 179:11 189:2 210:3,19	<b>answers</b> 34:5,7,7 70:18,22	<b>apps</b> 213:14	<b>assume</b> 11:9 101:19 180:4	<b>awhile</b> 23:19 119:18 177:11
<b>amounts</b> 35:10 36:5 81:5,6 82:5 125:10	<b>anticipated</b> 205:15	<b>April</b> 20:5	<b>assumed</b> 107:14 180:8	<b>axle</b> 189:6
<b>analogues</b> 177:20	<b>anti-money</b> 67:1	<b>area</b> 9:13 18:6 23:15 135:15 139:4 172:13 178:16 184:20 206:20	<b>assumptions</b> 126:6 127:12,13	<b>A-G-E-N-D-A</b> 4:1
<b>analogy</b> 142:2	<b>anxiously</b> 85:7	<b>areas</b> 12:9 24:22 25:13 150:5,9 208:10	<b>attempt</b> 102:19,21 140:11	<b>a.m</b> 1:13 5:2 47:9 47:10
<b>analysis</b> 67:11,11 67:12 109:5,5 152:2 204:21 205:4,12 206:15	<b>anybody</b> 22:12 46:15 93:7 120:9 219:22	<b>argued</b> 108:21	<b>attention</b> 12:9 123:7,14 128:19 177:16 192:22 193:6 199:21	<hr/> <b>B</b> <hr/>
<b>analysts</b> 127:5,20 128:6	<b>anymore</b> 181:13 199:1	<b>arguments</b> 109:1	<b>attractive</b> 118:1	<b>back</b> 5:20 11:8 18:15 34:16 47:3 53:12 55:3 63:16 71:13 78:22 84:9 99:19 101:8,9,12 102:14,16 103:14 110:1,5 117:7 118:16 120:6 121:13 123:17,19 123:21 125:16 130:2 131:17 136:5 142:6 143:17 144:10 146:13 165:20 176:5 185:18 187:16 188:8 191:21 194:4 196:4 203:10
<b>analytics</b> 53:4 161:17,17 162:3 162:10	<b>AP</b> 201:5	<b>Argus</b> 141:16	<b>audit</b> 62:12 212:19 213:10,16	<b>backdrop</b> 158:13
<b>analyze</b> 84:14	<b>apologies</b> 18:16	<b>arises</b> 6:4 96:2	<b>auditing</b> 56:1 164:11	<b>background</b> 112:10
<b>analyzing</b> 52:21	<b>apologize</b> 219:21 219:22	<b>Aron</b> 39:15 40:5	<b>audits</b> 3:20 59:20	<b>backloading</b> 20:3
<b>Ananda</b> 3:12 94:7 94:9 97:18 107:9 108:1	<b>app</b> 207:18 211:21 212:7,18	<b>arrangement</b> 44:10	<b>August</b> 19:20 26:13 26:20 28:2	<b>bad</b> 75:6 84:1 137:16 187:9 216:9
<b>ancillary</b> 164:14 169:6,20	<b>applicable</b> 175:16 175:18	<b>articulate</b> 88:15	<b>authorities</b> 138:12	<b>Bagan</b> 3:20 4:9 47:22 48:7,8 75:22 78:1 94:12 96:7,14 108:1 111:19
<b>Anderson</b> 1:17 14:17,17 84:22 86:22 171:10 173:7 188:1 191:4 194:13 195:21 209:19	<b>applications</b> 157:8 157:11 202:16,22	<b>Aside</b> 191:15	<b>authority</b> 155:16 155:21	
<b>Andersons</b> 14:18	<b>applied</b> 153:2	<b>asked</b> 23:7 24:13 25:18 32:14 64:21 78:11	<b>available</b> 20:12 21:5 22:9 23:4,16 24:2,9 46:20 58:8 117:21 131:10 140:20 152:7 162:3,9 185:4	
	<b>applies</b> 32:17 33:2	<b>asking</b> 41:2 53:8 93:7 204:9		
	<b>applying</b> 91:22	<b>aspects</b> 85:2		
	<b>appreciate</b> 35:20 37:17,18,22 40:20 41:11 44:15 46:2 71:6 80:12 85:5	<b>assembled</b> 11:21		
		<b>assessments</b> 82:11		
		<b>asset</b> 19:21 24:12 65:21		
		<b>assist</b> 23:9 202:9 203:14		
		<b>assistance</b> 204:1		

<b>Bair</b> 1:18 13:22,22	<b>bear</b> 171:15	<b>biofuel</b> 124:7	<b>booked</b> 130:6,14	153:11,14 164:3
<b>balance</b> 82:6 94:15	<b>beginning</b> 18:21	125:21	<b>bookkeeper</b> 89:2	181:20 212:4
97:4 160:15	117:3	<b>biofuels</b> 145:11	<b>books</b> 75:7 76:8	<b>brokerage</b> 164:13
175:20	<b>begun</b> 19:15 51:12	<b>birthday</b> 111:15	88:19 158:9	<b>brokers</b> 52:11,14
<b>balances</b> 51:15,22	<b>behalf</b> 27:17 52:1	<b>bit</b> 6:15 36:13,17	<b>bookshelves</b> 122:8	129:9 130:10,11
52:10 54:8,15,16	<b>believe</b> 44:1 48:15	53:17 55:7 56:7	<b>borders</b> 199:15	130:18,20 131:3
102:13	144:9 192:20	67:18 71:9,12	<b>bore</b> 134:5	148:8 153:10
<b>balancing</b> 80:9	203:15	80:8 84:8 97:11	<b>bottom</b> 127:21	175:4,8 176:16
<b>bandage</b> 92:1	<b>believes</b> 148:16	112:1,10 123:16	<b>bottom-up</b> 128:21	187:18
<b>bank</b> 15:18 30:11	<b>belly</b> 101:16	124:16 128:15	<b>bought</b> 115:5 136:1	<b>broker's</b> 181:1
58:15 59:3 75:12	<b>beneficial</b> 217:18	130:19 132:7,8	136:9 177:22	<b>broker-dealers</b>
213:22	<b>benefit</b> 140:22	144:16 146:7	<b>boy</b> 196:21	183:10
<b>Bankers</b> 2:6,7	143:10 152:1	163:3,4,12,15	<b>branch</b> 163:19,22	<b>brought</b> 29:14
15:20 16:15 40:12	172:17 204:21	165:22 167:12,22	164:1,4,6,16	<b>building</b> 127:14
<b>banking</b> 66:2,12	206:15 208:15	171:11 177:15	166:3,13,15,17	<b>built</b> 36:10
<b>bankrupt</b> 101:10	211:11 217:7	181:9 182:13	167:2,8 168:7	<b>Bunge</b> 14:4
101:11 102:3,6	218:3	183:15 184:16	171:4 175:21	<b>burden</b> 152:16
110:4	<b>benefits</b> 121:14	186:5 188:2	176:22 177:5	156:9 172:13,17
<b>bankruptcy</b> 53:14	167:6 189:4	194:20 197:21	179:13 198:11	179:19 180:21
83:20,22 98:9,12	209:22 210:2,12	203:6	209:11 212:22	191:2,9
98:17,18 100:1,19	<b>benefit-cost</b> 204:7	<b>black</b> 113:6	<b>branches</b> 185:10	<b>burdensome</b> 153:7
100:22 103:7,18	<b>best</b> 43:14 69:14	<b>blend</b> 113:3,8	<b>break</b> 46:15 84:2	<b>Bureau</b> 2:3 16:6,7
105:13	74:20 174:18	114:11 115:20	145:20	92:15 116:16
<b>banks</b> 30:7,7 41:7,7	194:11	117:18,19 126:4,8	<b>bridge</b> 182:15,16	<b>bushels</b> 189:19
41:16 46:4 51:15	<b>better</b> 30:17 33:2	136:6 137:18	183:1 200:2	197:12
52:1,9	33:21 37:13 43:9	144:1	<b>bridging</b> 184:9	<b>business</b> 30:12,15
<b>Barnett</b> 3:3 4:10	60:12 61:17 74:9	<b>blended</b> 114:1,6	201:20	64:13 67:2 83:3
48:2 55:5 67:16	160:21	115:12 125:11,12	<b>brief</b> 110:17	88:21 112:20
71:22 78:21 84:17	<b>beyond</b> 41:20 71:9	<b>blending</b> 113:7	<b>briefest</b> 17:11	175:9 184:2,19
<b>barrier</b> 128:1	156:6 179:21	116:12 125:8	<b>briefly</b> 76:21	185:3 188:21
<b>base</b> 208:16	206:1,1	142:22	157:18	193:19 195:18
<b>based</b> 19:8 128:11	<b>bid</b> 131:15	<b>block</b> 136:14	<b>bring</b> 25:18 35:4	216:19
145:3 159:10	<b>big</b> 33:9 66:18 73:1	<b>blocked</b> 139:12	70:19 134:21	<b>businessman</b> 83:8
180:12	103:3,5 178:9	<b>blocking</b> 139:15	170:20 177:8	88:18
<b>basic</b> 20:1 61:10	197:15 204:14	<b>Bloomberg</b> 120:22	198:17	<b>bust</b> 97:8
121:3	220:5	141:15	<b>bringing</b> 12:8 91:2	<b>button</b> 5:18 13:15
<b>basically</b> 20:19	<b>bigger</b> 90:6	<b>blows</b> 100:16	<b>brings</b> 143:3	<b>buy</b> 55:21 83:16
57:3 61:13 66:5	<b>biggest</b> 34:11 110:2	<b>blue</b> 125:22 126:14	<b>Brittany</b> 1:25	115:6 126:21
75:6 86:16 93:18	<b>bilaterally</b> 22:6	126:18	14:21	189:19
121:4 126:6 130:6	<b>Bill</b> 2:2 16:10	<b>board</b> 49:15 82:13	<b>broad</b> 10:14 25:13	<b>buyer</b> 115:5
161:16 184:21	<b>billion</b> 10:9 11:4	117:10	159:21 160:10	<b>Buyers</b> 115:2
200:8	46:9 114:5,7,9	<b>Bob</b> 15:15 94:7	187:14	<b>buying</b> 127:8,9,10
<b>basis</b> 38:6 50:2,4	131:9 197:5	98:5 107:9	<b>broader</b> 197:17	165:4 189:14,15
53:13 54:3,14,16	<b>binding</b> 127:18	<b>bolster</b> 73:16	<b>broadly</b> 55:17	
56:16 62:16 65:12	145:15	<b>bond</b> 142:4	186:18 187:7	
81:13 157:21	<b>biodiesel</b> 114:22	<b>bonds</b> 142:1	<b>broke</b> 116:21	
221:9	124:5 143:3	<b>book</b> 130:1 189:21	<b>broker</b> 104:20	
				<b>C</b>
				<b>call</b> 6:6 51:8 63:1
				65:1 66:18,21

77:19 82:20 85:16 87:3 91:7,9,10,11 91:11 93:12,19,20 94:18 95:10,21 104:17 141:17 143:4 165:14 166:7 175:7 178:1 178:8,15 181:10 181:13 182:22 183:3 184:6,14 187:21 188:4,9 199:3 200:18 201:5,8,22 209:1 211:16 <b>called</b> 8:17 9:20 22:20,22 25:20 27:6,8 48:16 51:21 53:10 76:10 114:16 187:2 207:2 210:21 <b>calling</b> 120:2 185:10,11 197:11 201:9,11 <b>calls</b> 24:18 93:5 115:11 165:20 177:20 178:21 185:17 190:22 195:22 200:4,18 201:1 207:19 210:18 <b>capability</b> 162:15 208:21,22 <b>capable</b> 162:9 <b>capacity</b> 153:18 <b>capital</b> 61:21 66:4 66:9,14,15 79:7 81:6 85:12 87:13 89:11 96:19 <b>capture</b> 192:17 213:9 <b>captured</b> 184:20 <b>capturing</b> 203:14 <b>cards</b> 64:18 <b>care</b> 176:21 <b>careful</b> 22:10 105:16,19 <b>carefully</b> 84:21	136:7 140:18 <b>carry</b> 137:9 <b>carrying</b> 52:11,13 <b>carved</b> 168:2 175:16 187:15 215:10 <b>carves</b> 174:20,21 175:3,7 <b>carve-outs</b> 176:13 <b>carving</b> 176:20 <b>case</b> 71:12 86:2 89:22 96:11 100:15 118:3 178:11 189:7 195:13,22 202:10 202:21 211:15 <b>cases</b> 36:19 40:18 110:10 159:12 <b>cash</b> 52:1 66:20 76:3 132:16 150:22 152:21 153:3 171:19,20 172:7,10 173:3,9 173:13 175:1 176:20 177:3 180:1 190:5,11 194:6 <b>catch</b> 72:13 74:19 <b>categories</b> 50:17 173:18 <b>caught</b> 31:2 123:6 123:14 189:6 194:14,15,16 <b>causality</b> 92:4 <b>cause</b> 65:2 <b>causes</b> 152:4 <b>causing</b> 91:17 128:18 <b>caution</b> 133:8 190:8 211:10 <b>cell</b> 5:15 43:21 167:13 178:13 181:18 183:16 185:12 187:21 200:21 201:1 211:12 <b>cellulosic</b> 138:4,5	<b>Center</b> 1:12 <b>centers</b> 149:9 <b>central</b> 28:11,13,18 29:3,8,22 46:11 <b>centralized</b> 27:5 129:22 <b>centrally</b> 17:19 <b>Centre</b> 1:12 <b>cents</b> 93:14 117:6 123:17 132:3 140:5,14 141:5 <b>century</b> 177:19 191:22 <b>CEO</b> 14:7 16:11 76:10 <b>certain</b> 18:10 20:15 80:7 99:10 137:11 148:8,8 153:14 173:15,16 176:16 187:18 200:12 <b>certainly</b> 13:10 36:3 39:9 132:17 205:19 <b>certification</b> 59:19 115:8 <b>certified</b> 59:19 <b>cetera</b> 92:10 106:10 179:13 <b>CFTC</b> 3:1 9:12 17:17 49:13 57:6 57:9 64:15 68:5 75:10 77:12 103:18 122:3 133:11 137:15 138:7 155:6 215:1 215:6 220:8 <b>CFTC's</b> 8:12 133:9 147:17 214:20 <b>chair</b> 6:21 <b>chaired</b> 8:5,5 <b>chairing</b> 6:14 <b>chairman</b> 1:13,17 2:19 4:2 5:10 6:8 6:10 11:16 13:20 16:2 25:10 31:21 33:4 39:2,17 43:11 68:1,16,18	70:14 75:4 76:1 76:20 78:10 86:6 87:1 88:7,17 94:6 101:1 103:2 105:17 106:5 108:15 111:10 121:22 125:15,18 126:3,13,17 127:2 133:7,13 138:15 142:6 143:8,16 168:17 169:10 170:1,7,10 174:13 174:17 175:19 179:3,7 183:5 186:12 188:14,15 197:22 198:10,19 212:12 214:13 217:20 219:17 220:20 221:8,11 <b>chairmanship</b> 7:2 <b>Chairman's</b> 17:3 <b>challenge</b> 34:12 63:18 88:1,2,10 167:13 207:21 215:7 <b>challenges</b> 41:3 86:8 163:13 <b>challenging</b> 41:9 <b>change</b> 39:6 43:21 43:22 77:18 85:17 94:19 100:17,21 111:8,22 117:15 137:20 138:13 187:6 213:16 216:4 <b>changed</b> 137:21 138:3 158:7 173:1 <b>changes</b> 61:21 69:16 71:14 80:16 144:19 149:9 152:14,16 <b>changing</b> 61:11 180:9 208:2 <b>charge</b> 14:4 85:12 214:20,22 <b>charged</b> 63:2 <b>charges</b> 211:18	<b>chart</b> 113:5 116:5 118:7 145:2,18 <b>charter</b> 7:15 <b>chase</b> 126:20 184:19 <b>check</b> 21:5 91:2 105:4 <b>checked</b> 23:2 119:14 214:4 <b>Chicago</b> 82:13 182:19 <b>chief</b> 3:8,14 112:11 112:12 147:17 <b>child</b> 122:8 <b>Chilton</b> 7:21 <b>choice</b> 28:17 29:2 139:17 166:11 <b>choices</b> 167:10 <b>choose</b> 140:1 <b>chose</b> 208:12 <b>chosen</b> 139:13 <b>Christa</b> 3:2 7:3,3,4 7:9,13,15 <b>CHS</b> 15:4 147:4 163:19 <b>CICI</b> 23:1,3,5,13 42:8 43:6 <b>CICIs</b> 41:22 44:12 <b>circles</b> 134:18,20 <b>circumstances</b> 43:17 <b>cite</b> 174:7 <b>city</b> 49:5 166:22 218:21 <b>clarification</b> 34:17 170:14 193:8 <b>clarified</b> 35:22 <b>clarify</b> 95:19 108:14 171:11 <b>clarity</b> 163:5 <b>classes</b> 19:21 24:12 <b>clear</b> 32:21 34:4 91:3 108:16 119:12 158:21 192:14 <b>cleared</b> 17:20 50:19 82:4,4
--	--	---	---	---

115:7	<b>collection</b> 148:16	<b>comments</b> 6:9	2:21,22 4:3 6:22	172:11 173:3,6,13
<b>clearer</b> 34:16	<b>color</b> 130:19	11:13 32:1,10	7:18,19,20 8:3,6	177:9
<b>clearing</b> 3:13,16	132:18 133:15	33:15 40:10 42:17	11:12,14,15 33:17	<b>common</b> 21:6
28:11,13,19 29:3	163:4	56:2 60:22 61:5	37:21 39:3,22	22:14
29:8,22 33:8	<b>colors</b> 118:7	67:22 68:16 92:19	41:2 68:15 69:1,4	<b>commonsense</b>
45:19,22 46:11	<b>column</b> 115:15	93:1 121:12	78:9 80:10,14	25:18
52:11 94:9 95:22	<b>combination</b> 34:8	142:15 146:21	92:20 98:5,8,22	<b>communicate</b>
141:21 194:22	34:11	149:22 150:1,2,6	99:18,21 100:14	191:8
<b>clearinghouse</b>	<b>combine</b> 196:2	150:7 151:8,9	101:12 107:8,10	<b>communicating</b>
29:15 56:19 57:1	<b>come</b> 10:18,19 25:6	152:12 160:2	111:9,13 140:3	220:13
108:8 111:4	28:5,7,15 31:10	176:5 196:15	204:19 219:8	<b>communication</b>
<b>clearinghouses</b>	39:21 41:4 55:3	209:18 214:14	221:7,11	153:6 175:5 190:5
29:12 56:15	67:9 79:8 80:7	217:11 218:2	<b>Commissioners</b>	190:10,15 192:1,2
108:12	91:5 99:18 103:8	<b>commercial</b> 150:20	2:17 7:18 11:9	193:10,11,16,18
<b>clearly</b> 92:6 121:14	106:21 116:13	153:8 183:22	61:4,6 68:3,6,8,13	208:12 216:21
<b>clerk</b> 198:9	120:9,20 139:13	213:19	94:3 176:11 218:3	<b>communications</b>
<b>click</b> 57:18	140:13 142:22	<b>commercially</b>	220:9	148:11 152:20
<b>close</b> 43:11 99:7	154:19 155:3	162:9 190:14	<b>Commission's</b>	153:11 154:21
175:22 177:16	165:6 166:7	<b>commingle</b> 72:8	24:10 151:18	162:14,22 174:22
<b>closed</b> 60:21	176:10 185:3	<b>commingled</b> 80:18	157:14 192:15	181:3 190:20
<b>closely</b> 139:1	192:4 199:5	<b>commission</b> 1:1 5:6	207:8	192:18 195:5,15
145:16 158:7	203:18 219:6	9:6 11:20 12:19	<b>commitment</b> 28:13	202:11 208:4,17
<b>cloud</b> 206:4	<b>comes</b> 8:14,19 9:5	29:10 31:14,15	220:5	<b>community</b> 2:6
<b>cloud-based</b> 205:7	68:10 118:3 167:3	40:21 44:15 45:11	<b>committed</b> 65:19	9:22 11:6 15:20
<b>CMC</b> 178:10 179:1	183:16 194:10	46:11 61:8 76:7	66:3	91:19 169:9 176:6
188:19 192:21	<b>comfort</b> 62:15 63:9	76:22 77:4,7	<b>committee</b> 1:3,12	205:14 206:17
<b>CME</b> 3:20 15:8	<b>coming</b> 5:4 23:17	86:17 87:6,10,16	2:20 5:5 6:11,14	<b>companies</b> 29:1,1,2
19:2 48:1 49:4	34:12 35:14 54:4	92:7 112:13	6:20 8:11 11:19	29:7 85:1 113:18
50:2,3,6 51:20	62:11 64:9 161:5	121:13 135:13	12:6 13:8,10 32:5	115:20 204:14
52:16 55:21 64:1	169:2,3 179:14,15	148:4,6,12,15,18	47:5 101:2 103:14	<b>company</b> 73:10,13
64:12,20 65:11	184:16 188:8	148:21 149:10,12	121:12 138:16	117:9 178:11
75:20 80:5 82:14	212:2 219:2 220:4	149:18,20,22	142:7 144:6	179:4 180:12
95:2,4,7,15,20	<b>comment</b> 6:4 32:13	150:2,4,10,21	145:22 147:21	189:12 196:9,17
98:1 106:17 110:3	38:7,10,18,21	151:16 152:2,13	167:16 168:13	207:1
111:16 115:12	46:14 56:3,3	153:9,18,19,21	174:14,16 198:16	<b>company's</b> 206:7
119:14 185:9	60:20 61:2 68:17	154:4,5,13,17	219:18	<b>comparative</b> 67:11
212:15 216:19	94:3 103:15 109:2	155:14,19 159:9	<b>committees</b> 6:17	<b>compared</b> 116:8
<b>CME's</b> 53:9	109:15 110:17	161:1 162:16,18	<b>Committee's</b> 7:6	132:13
<b>Code</b> 98:17	111:10,12,21	168:13 172:14,20	12:17	<b>comparison</b> 144:17
<b>codifying</b> 57:3	144:6,16,21	173:1 174:1	<b>commodities</b> 19:21	<b>competition</b> 191:5
<b>coffee</b> 47:3	204:20 206:10	175:15 179:18	135:12 164:21	195:1
<b>cognizant</b> 160:3	207:1,5,6,6,12,13	183:15 184:15,22	168:5 171:21	<b>competitive</b> 208:6
<b>collapse</b> 143:5	214:13 216:12	185:7 187:3,17	<b>commodity</b> 1:1 2:1	209:15
<b>collateral</b> 52:20	<b>commented</b> 177:12	191:18 195:7	5:6 10:15 129:2	<b>complaint</b> 159:10
56:17 60:18	<b>commenters</b> 86:7	199:22 207:14	140:15 150:22	<b>completed</b> 25:21
<b>collect</b> 26:6 56:15	150:12,14,17	209:9 218:2	152:21 153:2,3,15	56:11
95:14	151:2,7 205:6	<b>Commissioner</b>	164:13 172:7,10	<b>completely</b> 54:14

127:16 134:5 176:7 178:3 <b>complex</b> 9:20 25:19 124:16 142:13 <b>compliance</b> 20:5 25:7 54:9 123:10 151:11 154:20 155:4,7,17,22 156:12,13,17 157:2,4 162:7,19 167:7 185:5 187:2 <b>compliant</b> 183:4 207:2 <b>complicated</b> 120:12 137:8,16 137:18 138:6 <b>comply</b> 34:1 107:17 156:4 162:21 163:12 166:15 167:9 194:12 <b>complying</b> 107:16 <b>component</b> 158:19 162:22 172:3 173:1,21 192:2 195:7 <b>components</b> 172:2 173:12 <b>comprehend</b> 71:10 <b>comprehensive</b> 17:12 <b>compromise</b> 121:2 <b>computations</b> 49:22 58:9 <b>computer</b> 212:3 <b>computers</b> 202:21 <b>concept</b> 72:4 85:14 211:2 <b>conceptual</b> 187:14 <b>concern</b> 37:12 89:18 91:21 92:13 110:2 160:17 173:5 184:17 192:13 <b>concerned</b> 45:6 95:7 109:18 179:2 <b>concerning</b> 156:18	161:6 <b>concerns</b> 46:6 160:3 172:5 <b>concludes</b> 157:12 <b>Concluding</b> 4:22 <b>conduct</b> 30:12,16 195:18 221:8 <b>conducting</b> 162:10 217:22 <b>conference</b> 1:12 182:16 183:2 <b>conferenced</b> 201:10 <b>confidence</b> 60:17 70:4 <b>confidential</b> 20:11 45:2 <b>confidentially</b> 45:12 <b>confirm</b> 30:17 <b>confirmation</b> 75:13 75:14 <b>confirmations</b> 51:14 <b>Confirmation.com</b> 51:13 <b>conflicting</b> 106:9 <b>conflicts</b> 72:19 <b>conform</b> 149:13 <b>confused</b> 35:1 <b>confusion</b> 32:17 33:1 <b>congratulate</b> 215:21 216:8 <b>Congress</b> 12:3 25:18 28:19 70:7 113:21 116:3,7 117:14 120:2,3,10 136:5,7 <b>connected</b> 135:11 <b>connecting</b> 197:1 <b>connection</b> 133:12 142:17 <b>connectivity</b> 201:21 <b>conscious</b> 139:17 140:2	<b>consensus</b> 120:3 <b>consequences</b> 209:8 <b>consider</b> 162:19 <b>consideration</b> 61:8 73:20 180:19 <b>considered</b> 35:9,17 56:2 110:20 150:2 161:1 210:11 <b>considering</b> 12:21 135:16 <b>consistent</b> 106:8 <b>constant</b> 122:9 <b>constantly</b> 104:18 <b>constraint</b> 127:17 145:14 <b>constraints</b> 145:12 <b>construct</b> 202:19 <b>constructed</b> 200:14 <b>constructing</b> 32:7 <b>consultants</b> 52:20 <b>consultation</b> 166:10 <b>consultations</b> 55:19 <b>consults</b> 39:13 <b>consume</b> 116:16 <b>consumer</b> 141:1 186:11 217:14 <b>consumers</b> 116:14 118:1 <b>consumption</b> 116:11,17,20 <b>contact</b> 39:15 105:1,1 166:5 <b>contain</b> 125:13 <b>contemplate</b> 36:4 <b>content</b> 193:10 <b>context</b> 182:3 <b>contexts</b> 203:3 <b>continue</b> 145:21 146:8 215:13 <b>continued</b> 37:16 60:22 123:18 199:10 <b>continues</b> 119:7 <b>continuing</b> 58:20 58:21	<b>continuity</b> 64:13 67:2 <b>continuously</b> 84:3 <b>contract</b> 27:7 57:3 90:21 119:14,17 119:18 139:14 148:9 153:20 172:9 188:6 190:18 192:10 194:3,5 195:9,15 195:17 202:9 <b>contracting</b> 173:9 <b>contractor</b> 154:1 <b>contracts</b> 36:22 37:7 90:22 112:3 119:16 129:4 132:20 135:8 <b>contradicts</b> 46:10 <b>contributed</b> 149:5 219:12 <b>contributes</b> 140:6 <b>control</b> 63:4 65:5 183:7 197:21 201:14 <b>controls</b> 59:13 62:18 63:6 64:3 <b>Conventional</b> 128:5 <b>conversation</b> 23:15 103:17 196:22 <b>conversations</b> 158:17,19 159:11 181:6 182:7 <b>convictions</b> 133:17 <b>cooperative</b> 36:21 164:8 191:11 198:20,22 <b>cooperatives</b> 1:20 15:3 31:1 46:1,7 163:9 <b>coordinate</b> 64:11 <b>coordinated</b> 57:8 <b>cops</b> 72:13 <b>Cordes</b> 1:19 4:19 15:1,2 32:13 34:10 92:18 95:12 110:16 147:4	163:1 169:5,15 170:5,9,22 171:17 177:2 183:13 199:13 211:4 <b>core</b> 73:6 <b>corn</b> 1:21 13:19 14:4 15:6,8 16:3,8 90:22,22 93:14 135:14 138:18 142:17 143:10 170:19 189:16,17 189:19 196:3 197:12 <b>corner</b> 60:4 <b>corn-based</b> 124:1 <b>correct</b> 102:20 126:1 169:5 170:6 170:21 176:18 181:4,16 202:4 <b>correctly</b> 44:21 83:11 <b>correlation</b> 144:19 <b>cost</b> 53:6 83:17 85:8 113:1,10 157:7 167:6 172:16 204:20 206:14 209:20 211:11 214:6 <b>costs</b> 150:14 204:5 205:6,18 206:11 206:12,17 208:14 210:9 <b>cost-benefit</b> 172:19 205:4,12 <b>cotton</b> 2:2 16:11,12 <b>Council</b> 1:19,21,24 2:1 14:8 15:2,22 163:8 177:10 <b>counsel</b> 3:5,14 17:6 24:18 40:6 147:17 218:8 <b>counterparty</b> 21:12 21:16 22:18 23:11 26:22 45:5,15 134:4 135:1 161:13 <b>country</b> 118:21
--	--	--	--	--

139:2 189:14 <b>countryside</b> 163:20 186:3 208:3 209:7 <b>couple</b> 5:13 48:11 64:19 123:12 127:15 135:6 136:3 144:5 157:18 <b>course</b> 9:9 19:3,12 20:9 21:22 27:1 33:8 60:15 64:10 67:18 121:18 123:7 144:22 159:20 161:4 202:6 210:10 <b>cover</b> 66:20 93:8 94:17 104:6 184:14,18 <b>covered</b> 94:15 153:20 154:2 162:12,13 <b>covering</b> 210:18 <b>co-ops</b> 32:20 <b>CPA</b> 62:11,13,17 63:1,2,17,18 <b>CPAs</b> 61:18 63:10 <b>crazy</b> 197:1 <b>create</b> 71:20 76:18 79:19 <b>created</b> 71:15 115:2 136:4 <b>creates</b> 120:17 <b>creating</b> 92:8 <b>creation</b> 90:9 <b>credit</b> 1:24 10:2 15:22 19:16 27:12 29:13,20 33:10,11 46:1,7 102:13 134:4 135:1 218:12 <b>credits</b> 114:16,19 123:9 127:9,10 <b>crises</b> 55:14 <b>crisis</b> 25:17 58:22 59:4 64:11 <b>critical</b> 8:12,16 9:14 62:22 68:2	68:11 218:16 <b>crop</b> 165:8 <b>cross</b> 206:15 <b>crowded</b> 6:5 <b>crude</b> 119:17 <b>culture</b> 219:1 <b>cumulatively</b> 190:6 <b>curious</b> 41:20 42:11 71:11 94:2 <b>current</b> 59:9 74:20 120:15 125:13 152:6 <b>currently</b> 20:22 21:1,2 24:2 135:20 139:6 162:3 <b>Curt</b> 15:5 88:16,17 88:17 89:2 96:14 97:10,21 100:7,11 101:4,10,11,15,15 101:16,21,22 102:3,6,17,21 106:16 212:12 <b>CURTIS</b> 1:21 <b>Curtis's</b> 188:2 <b>Curt's</b> 89:5 95:3,6 97:10 100:9 102:9 106:16 <b>curves</b> 33:9 <b>custodial</b> 58:15 59:3 75:13 76:3 <b>customer</b> 4:9 9:8 12:15 13:4 47:6 47:14,19 48:13,19 49:7,19,21 50:11 53:15 54:7 55:7 55:18 56:9,13,21 57:1,13 59:14 60:13 66:6,7,18 66:18 72:8,9 73:14 76:22 78:5 78:12,12,17,18,19 81:18 82:4,5 85:10 90:3,3,11 90:15,19 92:11 93:11,18 97:2 105:4 106:10	110:5 159:15 160:10 175:6 182:20 201:7 208:16 213:3 219:4,20 220:12 <b>customers</b> 48:21 52:2 53:12,18 55:12,22 58:1 59:7,10 60:16 61:20 78:7 79:14 80:21 82:1,9,10 101:20 102:13 103:1 139:7,7 148:15,20 149:6 151:22 159:1 160:14 184:7 216:14 <b>customer's</b> 56:17 86:12,13 89:10,16 89:17 96:5,6 105:22 108:17 109:11 <b>cut</b> 219:19 <b>cuts</b> 113:1 <hr/> <b>D</b> <hr/> <b>dad</b> 88:21 <b>daily</b> 50:2 51:5 54:16 58:9,14 62:16 64:7 67:8 76:2 99:22 171:9 <b>dairy</b> 2:12 14:12 15:16 36:3,20 37:2 38:14 42:2,6 <b>data</b> 10:4,8,19 18:8 18:8 20:3,10,11 21:2 26:4,5,6 27:18 43:13,13 44:8 45:1,4,11,12 58:22 81:12 84:15 116:17 141:10 161:14,16 203:21 <b>date</b> 20:5 26:12 30:3,4 37:18 50:6 50:11 54:10 82:21 157:4 161:21 <b>dates</b> 10:17 34:13	221:4 <b>Dave</b> 16:5 39:15 40:5 <b>David</b> 2:3,8 16:16 103:14 105:17 <b>David's</b> 216:3 <b>day</b> 15:3 50:8,21 51:7 52:4 77:1,1,2 89:14,15 90:14 95:5,14 102:8 104:18 111:17 131:10,12 170:17 171:1,2 189:14,18 219:16 <b>days</b> 83:3 87:3,5,7 88:13 91:4 106:8 123:19 130:15 143:7 <b>daytime</b> 164:15 <b>day's</b> 93:21 111:2 <b>DCIO</b> 158:4 <b>DCM</b> 153:9,12,15 179:6 <b>DCMs</b> 150:19 175:13 <b>deadlines</b> 19:5 <b>deal</b> 39:20 41:8 72:21 160:13 166:6 168:7 172:4 172:22 183:21 207:17 209:13 210:8,12 <b>dealer</b> 3:4,5,9 21:9 21:10,13 31:3 35:3 48:3,6 147:1 147:18 155:15 182:2,3 183:11 187:3 <b>dealers</b> 17:18 19:10 21:18 23:18 28:12 30:6 32:20 41:6 148:7 149:16 155:3,13 156:18 183:6 186:17,21 <b>dealing</b> 32:20 80:7 129:18 170:17 171:20 190:4	<b>dealt</b> 41:5 55:16 64:18 73:3 131:3 164:21 <b>Dear</b> 77:20 <b>decades</b> 42:3,9 149:2 <b>December</b> 18:16 26:11,19 30:9 148:3 155:8 156:6 156:12 161:6 192:7 196:3 207:11 <b>decided</b> 6:13 136:7 189:1 <b>decision</b> 21:20 <b>decisions</b> 194:17 199:9 208:5 <b>decline</b> 116:13 <b>decrease</b> 50:15 <b>decreases</b> 50:20 <b>deemed</b> 208:14 <b>deep</b> 69:17 <b>default</b> 19:17 89:22 100:15 106:16 <b>defaulting</b> 103:1 <b>defaults</b> 100:11,15 <b>defer</b> 151:19 <b>deficit</b> 66:19 84:18 86:14,20 87:4,9 87:14,18,22 88:3 88:12 89:5,5,17 93:8 103:21,22 104:7,14 105:7,11 109:9 137:10 <b>deficits</b> 90:4 93:4 94:14 <b>definitely</b> 68:19 204:15 <b>definition</b> 38:3 39:13 177:17 <b>definitions</b> 31:3 39:14 <b>degrees</b> 182:5 203:4 <b>delayed</b> 20:6 <b>delays</b> 26:20 <b>delegated</b> 155:14
--	---	--	--	--

155:20 <b>deliberate</b> 101:3 <b>delighted</b> 7:1 <b>deliver</b> 124:18,19 124:20 127:10 <b>deliverability</b> 145:4 <b>delivery</b> 61:15 170:19 <b>delving</b> 159:4 <b>demand</b> 116:2 122:16 139:21 <b>Department</b> 218:18 <b>depend</b> 181:19 <b>depending</b> 216:5 <b>depleted</b> 127:16 <b>deposit</b> 85:22 <b>derivative</b> 29:13,20 129:2 218:12 <b>derivatives</b> 9:21 10:3 17:19,20 29:5,7 33:10,11 132:20 <b>describe</b> 35:17 <b>described</b> 58:7 166:12 <b>designated</b> 3:2 7:7 7:14 27:6 49:22 57:2 148:9 192:9 <b>designed</b> 162:21 <b>desk</b> 198:9 <b>desks</b> 134:20 <b>detail</b> 25:12,15 54:22 64:5 <b>detailed</b> 26:3 50:10 199:20 <b>details</b> 122:14 <b>detect</b> 60:12 151:19 <b>detection</b> 49:17 <b>deterrence</b> 49:18 72:15 <b>develop</b> 35:7 121:17 <b>devices</b> 178:14,18 <b>DFA</b> 14:13 <b>dialogue</b> 37:13,16	37:17 40:20 <b>Diana</b> 2:6 16:14 <b>dichotomy</b> 194:20 <b>dictated</b> 113:21 <b>Dierks</b> 1:21 14:6,6 42:20 170:13 214:12 <b>diesel</b> 114:9 <b>difference</b> 91:8 93:6 109:8 127:8 <b>different</b> 6:15 24:4 36:14 46:5 52:19 73:15 75:3 84:10 104:5 105:10 107:21 108:11 124:2,5 125:9 131:3 140:13 145:12 146:18 163:22 180:11 183:8 189:16 202:7 <b>differently</b> 83:21 <b>difficult</b> 120:17 138:2,9,10 210:5 <b>difficulties</b> 114:21 129:18 133:1,3 134:13 138:8 <b>dig</b> 125:4 <b>diligence</b> 81:11 129:6 <b>diligent</b> 22:10 <b>direct</b> 51:14 58:17 59:2 76:2 142:18 144:8 209:12 <b>direction</b> 61:10 111:22 <b>directions</b> 121:16 <b>directly</b> 57:17 75:5 75:11,15,17 207:17,18 218:6 <b>director</b> 3:3,12,20 16:5 48:1,3 155:15,20 156:8 <b>directors</b> 117:10 <b>disagreeing</b> 95:12 <b>disciplinary</b> 51:9 <b>disclose</b> 81:21	<b>disclosed</b> 82:1 <b>disclosure</b> 59:7 61:20 79:13,16 <b>disclosures</b> 159:14 <b>disconnect</b> 197:15 <b>discourage</b> 199:3 <b>discourages</b> 199:7 <b>discover</b> 63:13 <b>discretely</b> 189:20 <b>discuss</b> 47:13 147:22 184:16 <b>discussed</b> 20:7 150:10,14 175:2 195:7 <b>discusses</b> 60:6 <b>discussion</b> 42:19 55:3 71:4 77:6 93:2 107:10 117:17 135:19 145:21 146:8 170:12 210:8,13 219:21 <b>discussions</b> 55:22 <b>disputes</b> 139:14 <b>disruptive</b> 151:19 <b>disseminate</b> 79:19 <b>disseminated</b> 21:3 <b>disseminates</b> 20:17 <b>dissemination</b> 18:10 <b>distinction</b> 171:12 <b>distressed</b> 60:13 <b>distributed</b> 98:16 149:8 <b>distribution</b> 98:10 98:19 100:1,18,21 103:8 113:13 <b>distributions</b> 103:19 <b>division</b> 3:3,5,6,7,9 3:12,14 17:7 48:3 48:5 94:9 133:9 133:11 147:1,3,17 155:15 156:15 157:15 160:16 161:18 176:9 191:20	<b>DMO</b> 158:4 192:4 192:15 <b>doctoring</b> 75:7 <b>document</b> 48:20 68:4 <b>documentation</b> 30:18 156:10 <b>Dodd</b> 17:11 <b>Dodd-Frank</b> 8:18 16:21 17:17 18:5 24:21 28:9 32:11 137:15 219:5 <b>doing</b> 34:22 44:16 50:3 54:2,8 62:12 64:21,22 67:19,21 69:7 87:7 105:16 108:10,11 129:9 154:22 158:8 160:14 170:8,9 173:9 177:3 178:13 186:6 187:10 190:7 191:2 194:11 196:3 201:20,21 218:10 <b>dollar</b> 35:10 118:16 123:11 197:6,9 210:3,5 <b>dollars</b> 89:19 101:15 196:4 <b>domestically</b> 203:3 <b>Don</b> 2:6 15:17 <b>door</b> 191:11 <b>dots</b> 163:21 <b>double</b> 97:17 <b>double-fund</b> 93:18 <b>doubt</b> 33:10 <b>Dr</b> 11:15 147:20 <b>draft</b> 12:21 61:7 <b>dramatically</b> 89:20 117:2 <b>draw</b> 142:2 <b>drawing</b> 181:22 <b>driving</b> 60:7 193:11 <b>drop</b> 120:19 143:4 167:8	<b>dropped</b> 117:6 119:4 140:5 <b>drops</b> 95:6 139:21 <b>drying</b> 133:22 <b>DSIO</b> 155:20 156:8 <b>DSRO</b> 50:22 <b>DSROs</b> 63:22 64:20 <b>DTCC</b> 19:3 <b>due</b> 81:11 108:21 129:6 130:16 <b>Duffy</b> 3:4 4:6 17:5 17:10 39:11 <b>Dunn</b> 8:4 31:16 <b>Dunn's</b> 218:20 <b>duped</b> 177:15 <b>duties</b> 72:17 169:21 171:9 <b>DWIGHT</b> 1:25 <b>dynamics</b> 208:2 <b>dysfunctional</b> 76:18 <b>D.C</b> 1:13 15:22 <b>D1</b> 138:3 <b>D2</b> 138:3 <b>D4</b> 124:4,5,19,21 125:2 144:18,20 145:5,10 <b>D5</b> 124:4,7,19,21 125:2 133:6 144:17 145:5,10 <b>D6</b> 115:10 123:22 124:19,20 125:1 144:16,18 145:5,7 145:8,14
<b>E</b>				
<b>earlier</b> 26:2 69:4 92:21 202:14 <b>early</b> 28:3 60:2 79:4,6 219:20 <b>Earth's</b> 109:3 <b>easier</b> 35:21 <b>easiest</b> 70:6 <b>easily</b> 22:11 24:7 <b>easy</b> 23:10 166:6 215:8				

<b>economic</b> 116:17 121:13 137:14 189:1 211:11	<b>element</b> 62:16,22 63:10 66:10	<b>engaged</b> 51:20 52:16	119:8 120:7,14 123:10 124:18 127:11 129:20 130:6,13 134:8 137:16,19 145:13	<b>evenly</b> 98:16
<b>economically</b> 156:2 156:14 167:4	<b>elevator</b> 34:21 85:21 92:9 191:7 191:10 196:1,2 214:5	<b>engaging</b> 173:13	<b>enhance</b> 48:13 55:18	<b>event</b> 64:10 217:4
<b>Economics</b> 5:8	<b>elevators</b> 35:6 146:4	<b>enhanced</b> 59:13 78:15	<b>equal</b> 113:2 125:2	<b>events</b> 48:10 107:20 215:17 216:15,20
<b>economist</b> 3:8 112:11,12 136:12	<b>elicit</b> 218:1	<b>enhancements</b> 49:1 49:6 57:2	<b>equation</b> 40:14 41:16	<b>everybody</b> 32:2 37:5 48:9 98:15 126:19 178:22 214:18
<b>economists</b> 127:22	<b>eligible</b> 24:5	<b>enhancing</b> 9:7	<b>equilibrium</b> 140:11	<b>everybody's</b> 98:13
<b>economy</b> 36:7 214:3	<b>eliminated</b> 154:11	<b>enjoy</b> 188:15	<b>equities</b> 19:22	<b>everyone's</b> 123:6 123:14
<b>Ed</b> 2:1 14:10,15 39:3 88:2 89:6 197:22	<b>else's</b> 87:8 93:8 109:12	<b>ensure</b> 31:2 45:11 55:10 56:21 65:22 69:15 70:7 148:19 162:13	<b>equity</b> 58:2 102:14	<b>everything's</b> 72:2
<b>editor</b> 117:5	<b>email</b> 208:3	<b>ensuring</b> 60:16 76:7 100:4	<b>equivalent</b> 119:3	<b>evidence</b> 159:8
<b>education</b> 165:11 166:8	<b>emails</b> 180:14	<b>enter</b> 134:12 211:21 212:10	<b>error</b> 63:15,17,19	<b>evolving</b> 133:2 135:4
<b>EDWARD</b> 1:22	<b>emergency</b> 78:3	<b>entered</b> 133:5	<b>errors</b> 63:13 129:17,17	<b>exact</b> 128:10 171:16 174:7
<b>Ed's</b> 42:20 102:4	<b>emphasize</b> 45:16	<b>entering</b> 158:15	<b>esoteric</b> 25:19	<b>exactly</b> 85:20 125:5 132:7 186:1 198:1
<b>effect</b> 21:2 103:8 143:2 144:8	<b>employed</b> 14:12 182:10	<b>enterprises</b> 28:16 213:20	<b>especially</b> 112:22 139:19 178:18 219:10	<b>exam</b> 62:3
<b>effective</b> 60:2 61:14 66:9 157:8 220:13	<b>employee</b> 164:12 185:12	<b>entire</b> 130:9	<b>essence</b> 156:21	<b>examination</b> 74:14 77:18
<b>effectively</b> 127:3 131:20	<b>employees</b> 88:22 166:21 184:6 211:15	<b>entirely</b> 108:2 200:12 202:19	<b>essentially</b> 70:13	<b>examinations</b> 51:17 53:21 59:18 61:18 65:14 69:7 69:8,17 70:17 71:1 108:4
<b>effort</b> 57:8 85:5 140:2	<b>enacted</b> 17:14	<b>entities</b> 19:12,14 21:17,19 29:4 71:18 134:18 153:7 154:19,22 158:13,16 160:13 161:6 180:11 183:22 196:19 206:9	<b>establish</b> 155:21	<b>example</b> 41:5 99:8 99:19 101:2,5,11 109:10 145:11 161:18 163:14 168:18 189:12 205:6
<b>efforts</b> 35:20 151:18 152:2 156:11,17 186:14	<b>encompass</b> 40:17	<b>entirely</b> 108:2 200:12 202:19	<b>established</b> 17:12 113:16 158:1	<b>exams</b> 65:2,11
<b>effortless</b> 35:20 151:18 152:2 156:11,17 186:14	<b>encompassing</b> 85:1	<b>entitled</b> 102:18	<b>establishes</b> 156:1	<b>exceeding</b> 125:12
<b>EIA</b> 114:10 116:7	<b>encountered</b> 114:20	<b>entity</b> 21:15,15 22:20 23:17 134:9 164:9 195:8,9 201:15,20	<b>establishing</b> 134:14	<b>excellent</b> 48:20
<b>eight</b> 112:3	<b>encourage</b> 179:17 197:19 209:9	<b>entry</b> 165:15	<b>estimated</b> 205:6 214:6	<b>exceptions</b> 176:13 215:3
<b>either</b> 5:15 34:7 43:8 50:2 73:1 77:18 91:16 94:8 101:10 159:8 170:3 171:10 200:10 209:2	<b>ends</b> 197:11	<b>enumerated</b> 174:9	<b>estimates</b> 130:20	<b>excess</b> 50:16,20 58:6 66:4,6,7,8,14 76:10 81:6 90:7 109:18 110:4,7,12
<b>elaborate</b> 92:20	<b>energy</b> 10:14 27:20 114:2,2 116:15 118:6 119:3 141:11	<b>environmental</b> 125:20 133:18 136:13 137:12 138:11,13	<b>et</b> 92:10 106:10 179:13	<b>exchange</b> 19:22 83:6 130:2 148:7 171:13,14 173:8 173:10 187:16
<b>elasticity</b> 141:3	<b>enforce</b> 57:17	<b>EPA</b> 114:3,15,18 114:20 115:4,6,10	<b>ethanol</b> 47:15 112:19 113:3,5,9 113:13,17,22 114:8 115:11,21 117:20 120:5 124:2 126:10,12 129:15 135:14 136:17 138:4,5 139:2 142:21 143:15,21,22 144:1,12	
<b>electric</b> 37:2 40:2	<b>enforcement</b> 3:7 41:14 73:2 114:21 133:10,12 147:3 157:15 158:18,20 159:3,20 160:7,18 161:19 176:9 186:14 193:22		<b>Ethanol/RINs</b> 4:13	
<b>electrical</b> 38:13	<b>enforcement-rela...</b> 159:22		<b>evaluated</b> 124:13	
<b>electronic</b> 59:3 76:2 151:5 154:7 165:15 177:18 190:10 192:1 193:9 211:22	<b>engage</b> 172:10			

188:20,22 189:2 190:2,3 191:7,12 194:21 196:5,10 212:20 <b>exchanges</b> 17:21 129:3 176:14 188:16 <b>exchange-traded</b> 168:8 177:5 <b>excited</b> 51:19 <b>excluded</b> 153:9 <b>excuse</b> 18:15 174:8 217:10 <b>executed</b> 22:5 <b>execution</b> 17:22 27:9,21 28:7 148:10 175:1 <b>executive</b> 51:1 <b>exemption</b> 45:22 46:7 <b>exist</b> 187:5 <b>existed</b> 123:3 129:11 <b>existence</b> 44:7 157:7 <b>existing</b> 113:11 149:14 <b>expand</b> 171:17 172:13 179:20 <b>expanded</b> 177:18 <b>expect</b> 53:2 84:5 140:17 197:2 <b>expected</b> 116:7 <b>expecting</b> 126:9 182:11 <b>expenditures</b> 205:16 <b>expensive</b> 109:2 113:18 <b>experience</b> 39:5 <b>experiences</b> 156:16 <b>experiment</b> 118:18 <b>expert</b> 200:7 201:12 <b>experts</b> 200:10 <b>expire</b> 137:4 <b>explanation</b> 127:6	128:11 <b>explicit</b> 162:17 <b>explicitly</b> 112:5 <b>Export</b> 2:9 14:3 <b>extend</b> 180:15 <b>extended</b> 154:18 184:4 <b>extensive</b> 180:19 <b>extensively</b> 159:2 <b>extent</b> 103:1 159:5 193:14 195:4,14 208:1 210:9 <b>extra</b> 118:14 <b>extremely</b> 40:22 138:6 139:19 <b>E10</b> 118:4,9 119:2 141:12 <b>E15</b> 139:12,13,15 141:12 <b>E85</b> 117:18 118:5 118:11,12,15 119:3,9 139:20 141:12 <hr/> <b>F</b> <hr/> <b>F</b> 2:6 <b>face</b> 30:10 124:10 <b>facilitate</b> 146:4 <b>facilitates</b> 152:7 <b>facilities</b> 17:22 27:9 27:22 28:7 148:10 <b>facility</b> 144:12 <b>fact</b> 24:14 56:5 92:10 97:7 120:19 123:7 124:16 128:6 177:11 180:10 216:12 <b>facts</b> 121:3 <b>fail</b> 186:7 <b>failed</b> 46:18 116:2 <b>failing</b> 73:11 <b>failure</b> 159:16 <b>fair</b> 30:14 69:13 173:5 <b>fairly</b> 127:18 <b>faith</b> 156:4,11 162:19	<b>faithful</b> 103:10 <b>fall</b> 9:13 109:3 216:20 <b>falling</b> 118:12 <b>fallout</b> 93:22 <b>falls</b> 208:9 <b>false</b> 159:17 <b>familiar</b> 18:14 117:21 142:8 200:1 <b>families</b> 183:11 <b>FAQ</b> 48:19 <b>far</b> 54:10 65:15 83:15 95:7 117:17 120:11 171:6 199:14 219:12 <b>farm</b> 1:24 2:3 15:22 16:3,6,7 46:1,7 92:9,15 122:5,7 143:18 144:11 197:10 208:18,20 <b>farmer</b> 1:19 15:3 15:10 42:2,6,14 53:11 92:17 144:9 144:10 163:8 165:6 166:4 167:11 189:19 190:16,18 195:22 195:22 196:8 197:9 198:2,17 208:9,13 212:16 213:15,17 218:15 <b>farmers</b> 1:25 9:2 9:19 14:12,22 28:21 35:5 46:3 142:10 143:9 165:4 170:19 183:22 189:16 190:14 199:7 209:13 213:20 <b>farm-based</b> 42:12 <b>fashion</b> 120:8,13 168:1 <b>fast</b> 34:13 211:19 <b>faster</b> 72:12 220:2 <b>fat</b> 129:17	<b>favorite</b> 24:21 <b>FCA</b> 158:9 <b>FCM</b> 50:15 53:22 55:14 76:16 77:20 78:4 79:19 80:16 81:1,11 84:13,15 85:11,15,22 90:7 90:19 91:12 93:9 94:21,22 95:3,9 95:15 96:2,3,17 96:19 97:8 98:1 101:10 102:3,5,8 102:15 106:15 108:3,6 109:10 110:4 111:3,3 163:6 164:2 165:17 166:17,18 173:14 176:6 179:4 181:20 188:22 194:22 195:5,17,19,19 201:6 213:2 <b>FCMs</b> 49:21 50:5 50:10 52:3,19 55:21 56:16 59:9 59:14 60:11,12 69:7,17 77:20 81:21 85:18 89:13 176:15 183:7,10 194:4 209:13 <b>FCM's</b> 57:22 91:3 <b>feasibility</b> 150:16 <b>feasible</b> 167:4 <b>February</b> 60:21 <b>Federal</b> 3:2 7:7,14 137:14 148:4 149:21 155:11 207:9 <b>Federation</b> 1:23 2:4,4 13:21 14:11 <b>fee</b> 42:15 <b>feed</b> 1:17 14:19 92:14 143:17 <b>feedback</b> 8:21 32:14 199:10 200:9 <b>feel</b> 35:8 39:7 47:3	85:10,17 146:8 177:14 186:6 190:14 <b>feeling</b> 160:20 <b>fees</b> 205:8 <b>fellow</b> 7:17 11:9 56:1 <b>FERC</b> 138:9 <b>FIA</b> 48:15 52:15 55:21 <b>fiber</b> 215:12 <b>fide</b> 159:17 <b>field</b> 9:9 40:2 168:19 209:4 <b>figure</b> 10:11 91:6 140:11 210:5 221:3 <b>figured</b> 116:14 <b>figures</b> 10:6 210:10 <b>figuring</b> 193:2 <b>file</b> 30:1 38:18 68:17 151:5 154:7 207:7,12 <b>filed</b> 38:10 39:4 <b>filing</b> 65:3 103:7 <b>filings</b> 60:2 64:8 <b>final</b> 12:21 61:3 68:4 120:14 148:5 148:13,22 149:20 150:3,11 151:17 151:17 154:8,20 155:10 156:22 173:2 191:19 207:10 <b>finalize</b> 9:12 12:16 61:7 <b>finalized</b> 25:16 29:11,12 70:14 149:18 192:6 <b>finalizing</b> 9:7 12:22 <b>finally</b> 53:9 67:7 116:14 <b>financial</b> 8:17 17:16 19:12 21:15 21:15,19 25:14,17 28:16 29:4,7,9 48:16 52:16 57:9
--	--	--	---	---

59:19 63:3,7 65:4 81:4,12 134:12,18 137:22 142:2 <b>financials</b> 62:15,21 63:14 67:9,12 <b>find</b> 25:1 29:20 63:15,16 76:15 78:7 97:8 115:4 203:17 <b>finding</b> 36:9 <b>findings</b> 156:8 159:9 <b>fine</b> 95:4 102:4,4 111:14 174:19 203:15 <b>fingers</b> 129:17 <b>finished</b> 31:7 <b>FINRA</b> 67:4 74:17 77:13 158:9 <b>fire</b> 113:15 <b>firm</b> 51:1,6 62:20 65:2,20 66:20 96:9 140:20 155:22 156:1,3,9 183:7 199:14 <b>firms</b> 51:6,10 52:5 53:21 54:3 64:4,6 65:16 81:4 94:16 151:13 157:1,5,8 167:18 182:10 200:11 202:18 213:15 <b>firm-related</b> 64:14 <b>firm-specific</b> 59:11 <b>first</b> 6:2 11:18 13:13 15:11 19:11 19:13 34:1 38:9 47:13,18 48:2 57:20 62:2,10 85:5,11 86:20 97:18 100:6 112:7 112:15 113:5 121:10 140:10 144:21 146:22 150:12 152:18 172:4,22 173:12 <b>fit</b> 37:14	<b>fits</b> 71:9 202:20 <b>five</b> 136:2,10 137:13 154:15 157:3 196:4 <b>fix</b> 61:13 73:2 92:2 98:11 <b>fixed</b> 116:11 <b>fixes</b> 134:6 <b>fixing</b> 57:20 <b>flag</b> 71:15 <b>flavors</b> 124:2 <b>flexibility</b> 9:1 37:19 119:8 121:5 <b>floor</b> 35:12 146:2,3 153:11,14,15 175:4,12 <b>flow</b> 26:17 149:8 165:18,19 166:2 <b>focus</b> 38:13 64:19 115:10 121:15 160:13 214:1 <b>focused</b> 123:1 150:9 160:8 162:5 168:21 193:9 194:9 <b>fold</b> 64:19 <b>folklore</b> 68:5 <b>folks</b> 12:2 66:1 70:18 71:7 97:16 163:6,16 174:21 182:15 184:1 193:14 200:10 <b>follow</b> 33:18 36:1 <b>followed</b> 99:9,10,12 99:14,15 158:7 188:7 <b>following</b> 108:5 138:22 158:14 159:13 161:5 <b>follow-up</b> 86:7 <b>food</b> 215:12 <b>Foods</b> 2:12 15:16 <b>footnote</b> 206:13 209:21 <b>footnotes</b> 206:13 206:22 <b>Force</b> 158:2	<b>forced</b> 178:15 195:12 <b>forcefully</b> 193:22 <b>forces</b> 122:16 <b>forcing</b> 178:22 <b>forefront</b> 220:16 <b>foregoing</b> 146:11 <b>foreign</b> 19:22 50:18 148:7 <b>forever</b> 43:4 <b>forget</b> 13:14 <b>Forgive</b> 100:3 <b>forgiven</b> 123:4 <b>form</b> 36:7 154:9 179:15 <b>formal</b> 157:21 218:4 <b>format</b> 6:16 <b>former</b> 8:3 <b>Fortenbery</b> 1:13,17 5:3,7 11:11,16 13:7 16:18 31:20 33:15 34:19 40:9 42:18 46:13 47:11 55:1 71:3 103:12 109:13 110:14 111:5,11,20 121:7 135:18 144:4 145:19 146:14 147:8,13,20 168:15 170:12 188:10 196:14 209:17 214:9 219:9,15 221:13 <b>forth</b> 10:3 21:8,20 22:7 26:21 30:19 31:4 58:10 79:15 84:9 109:3 135:15 149:17 161:9 165:21 213:14,21 213:22 <b>fortunate</b> 82:17 <b>forum</b> 45:18 <b>forward</b> 11:7 39:8 60:8 74:12 137:9 152:22 167:7,20 175:1	<b>forwarding</b> 200:18 200:21 <b>forward-looking</b> 61:16 79:10 <b>for-cause</b> 50:4 65:12 <b>found</b> 40:21 <b>four</b> 33:9 131:21 132:4 136:2 <b>Fourth</b> 154:13 <b>frame</b> 88:8 221:16 <b>frames</b> 20:1,6 <b>framework</b> 17:13 44:20 187:14 <b>Frank</b> 17:12 <b>frankly</b> 39:20 61:19 122:22 <b>fraud</b> 159:17 210:6 <b>frauds</b> 133:8,9 <b>fraudulent</b> 115:4 133:5 151:20 <b>fraudulently</b> 115:2 <b>free</b> 47:3 115:22 146:8 <b>freeze</b> 102:21 152:9 <b>freezes</b> 98:13 <b>frequently</b> 23:7 24:13 60:6 120:10 <b>Friday</b> 87:5 89:1 <b>friends</b> 198:14 <b>Friesen</b> 1:21 15:5,5 34:20 82:12 88:16 109:16 118:15 135:22 138:21 143:19 180:22 181:5 186:5 204:4 211:20 214:4 <b>front</b> 10:18 68:3 69:11 70:12 206:21 <b>frozen</b> 98:15 110:9 <b>fuel</b> 112:19 <b>fuels</b> 114:1,6,7 120:3 121:1 <b>full</b> 8:10 10:20 16:20 26:7 65:10 77:4 151:8 156:12	156:13 157:2 <b>fully</b> 12:19 60:18 183:3 <b>full-time</b> 169:20 185:15 198:21 <b>fulsome</b> 79:13 <b>function</b> 33:22 63:21 67:15,17 <b>functionality</b> 91:18 105:15 <b>functioning</b> 200:3 <b>functions</b> 202:7 <b>fund</b> 53:11,11 84:6 89:10 93:21 95:9 102:9 <b>fundamental</b> 122:16 127:5 128:11 215:22 <b>funded</b> 89:5 <b>funds</b> 1:23 15:14 49:19 50:11,16 52:7 53:15 54:17 55:13 56:9,12,13 57:21 58:7 60:14 60:17 72:8,9 73:14 78:5 81:6 83:21 85:7 89:16 90:7 91:14 96:5 96:17 104:6,8 108:9,17 110:12 <b>further</b> 116:22 125:5 170:13 191:5 200:15 <b>future</b> 158:6 210:21 217:3 220:11 <b>futures</b> 1:1 5:6 27:8 28:14 44:13 45:7 55:10 57:6 59:8 76:7,21 77:7 79:14 86:17 87:6 87:10,16 112:3 129:4 132:14,19 135:6 148:6 165:10 170:8,9,18 177:6 187:3,17 190:7 215:4
--	---	--	--	--

<b>G</b>				
<b>Gallagher</b> 1:22	126:3,13,17 127:2	27:5 49:10 53:5	146:6,14 147:4	<b>grappled</b> 182:4
14:9,10 36:1	133:7,13 138:15	54:13,21 55:1	157:18 163:3	<b>great</b> 11:20 55:5
39:10 41:17 71:6	142:6 143:8,16	63:16 65:6,12,16	167:20 172:12	160:22 177:21
76:14 80:12 88:4	168:17 169:10	67:9 69:13 71:13	182:18,19 184:9	191:10 210:8,12
89:7 196:16 198:4	170:1,7,10 174:13	72:12 77:20 78:8	184:13 185:1,2	<b>greater</b> 10:22
206:3	174:17 175:19	91:5 99:4 102:4,6	186:17 187:9	49:17 59:13 74:7
<b>gallon</b> 114:15	179:3,7 183:5	110:22 112:14	188:6,7 190:1,17	149:7
118:15 139:5	186:12 188:15	119:11 120:6	194:1,4,18 195:6	<b>greatly</b> 85:10
143:22	197:22 198:10	122:6 123:21	197:13,14 198:6,7	<b>green</b> 119:1
<b>gallons</b> 114:6,9,14	212:12 214:14	125:16 136:5	204:6,17 206:13	<b>grew</b> 88:20
126:2 129:15	217:20 219:17	144:7 145:20	206:14 215:7,12	<b>grid</b> 37:2,3
<b>Gary</b> 2:19 3:3 4:2	220:20 221:11	147:5 151:7 158:6	220:18 221:18	<b>Griffin</b> 3:5 4:18
4:10 6:8 48:2	<b>gentleman</b> 109:7	167:7 168:16	<b>Goldman</b> 44:5	146:22 147:15,16
62:5 67:15 68:11	<b>gentleman's</b> 88:14	173:6 179:21	197:5,14 198:7	171:15 172:1
75:4 77:3 80:14	<b>getting</b> 34:6 36:11	188:11 189:20	204:14	173:11 174:15,19
94:11 111:7	50:9 64:5 97:22	190:1 202:18	<b>good</b> 8:8 9:10,11	176:18 181:17
<b>gasoline</b> 113:1,4,7	99:5,7 177:17	207:9,18 209:3,4	12:1,8,17 14:9	191:15 195:3
113:9,14 114:7,8	185:20 211:5	214:11	15:1 39:18 48:8	200:6 201:3,17
115:13 116:1,6,10	<b>give</b> 10:7 32:14	<b>goal</b> 49:16 141:1	48:21 78:11 84:16	202:3 204:2
116:12,17,19	60:2 77:22 96:10	<b>goes</b> 20:11 41:20	89:8 99:6 106:6	205:21 206:19
117:19 118:5,22	102:14,15 128:4	58:11 95:6 96:8	111:21 147:15	210:2
126:8 135:14	128:11 131:1,5	97:8 98:12 101:10	156:3,11 157:16	<b>gross</b> 56:16
136:16 140:21	164:5 167:15	101:11,16 102:3,6	158:16 162:19	<b>ground</b> 142:10
<b>gating</b> 74:1	168:12 171:4	104:13 105:7	172:20 189:12	215:22
<b>gavel</b> 217:22	174:6,10,17	106:15 110:4,19	190:12 208:18	<b>group</b> 3:21 8:5,9
<b>gears</b> 105:15	216:22 220:21	115:4 165:12	214:15 215:9	11:21 13:21 38:10
<b>general</b> 3:4 17:6	<b>given</b> 24:10 50:21	202:5 207:20	<b>goods</b> 214:3	41:21 48:1,17,22
18:12 24:1 40:6	125:6,8 126:8,11	209:2 215:1	<b>gotten</b> 24:18 135:7	49:2 69:9,10
61:9,13	127:6 138:11	<b>going</b> 8:21,21,22	182:1	70:11 157:22
<b>generally</b> 40:1	155:2 189:14	16:19,20 17:2,3	<b>governance</b> 65:20	163:9 216:13
130:15 150:13	210:10 214:19,20	17:10 18:2 19:20	<b>governing</b> 58:6	217:5
159:5 201:4,8	215:3	25:10 32:15 35:16	<b>government</b> 6:18	<b>groups</b> 42:13 48:12
<b>generate</b> 216:2	<b>gives</b> 37:11 95:3	36:4,6 42:8,10	6:19 126:14	49:8 196:6
<b>generated</b> 136:16	212:5	47:12,18 48:1	<b>governmental</b>	<b>grow</b> 10:16
<b>generation</b> 145:10	<b>giving</b> 128:17	50:15 54:6 57:15	125:19	<b>Growers</b> 1:21 2:5
<b>generically</b> 76:6	<b>glad</b> 216:9	62:1,3 67:21 71:1	<b>grain</b> 1:17 2:9 14:3	15:7,12
<b>Gensler</b> 2:19 4:2	<b>glasses</b> 147:14	72:14 74:12 75:4	14:19 34:21 35:8	<b>grown</b> 122:5
6:8,10 25:10	<b>global</b> 57:11 69:12	83:17 84:2 89:20	92:14 164:22	<b>growth</b> 149:5
31:21 33:4 39:2	70:2 71:13 72:1	91:3 93:10,17,17	165:4,9 177:22	<b>guarantee</b> 86:13
39:17 43:11 68:1	76:5 82:16 83:12	93:19,20 108:12	180:2 190:11	96:6 97:1 105:22
68:18 70:14 75:4	83:20 86:5 90:10	109:2,3 111:8,22	<b>grains</b> 189:15	108:18
76:1,20 86:6 87:1	91:16,20 99:1,3,8	112:9,13 115:10	<b>Grange</b> 2:1 14:16	<b>guard</b> 194:15
88:7,17 94:6	199:12	116:22 117:11	<b>grant</b> 155:16	<b>guess</b> 35:19,22 38:9
101:1 103:2	<b>globe</b> 30:8 186:15	120:4 121:4	<b>granularity</b> 205:1	44:12 77:7 82:12
105:17 106:5	<b>Globex</b> 212:14	135:20 138:9	205:13,22	83:15,18,19
121:22 125:15,18	215:4	139:19 141:19	<b>graph</b> 118:3 136:6	109:17 110:2
	<b>go</b> 23:3 24:20 25:1	142:1 145:19	<b>graphs</b> 137:2	143:18,19 181:6

186:8 200:22 204:4,7 209:5,12 212:9 214:13 216:6 221:13 <b>guesses</b> 130:20 131:2 <b>guidance</b> 57:4 161:9 193:1,4,16 <b>Gussow</b> 3:6 4:6 17:7 18:4 <b>guy</b> 198:21 <b>guys</b> 18:20 85:6 171:11 206:3 210:1 217:9	197:17 <b>happy</b> 39:15 111:14 115:20 177:12 200:14 <b>harbors</b> 162:17 <b>hard</b> 140:10 193:1 217:9 <b>harm</b> 151:21 <b>Hays</b> 1:24 15:21,21 <b>hazards</b> 113:15 <b>head</b> 94:9 169:16 <b>heads</b> 77:22 <b>hear</b> 8:20 9:17 31:11 32:2,6 38:15 121:12 146:19 194:1 197:22 <b>heard</b> 109:1 123:8 131:2 132:22 205:17 <b>hearing</b> 11:7 121:14 205:20 206:16 209:7 <b>hearings</b> 120:1 <b>hedge</b> 189:20 213:17,22 <b>hedger</b> 186:7 204:13 <b>hedging</b> 11:6 15:4 15:8 34:21 147:4 163:19 212:4 218:15 <b>held</b> 52:1 53:16 57:21 <b>help</b> 25:6 32:8 34:17 35:7 55:10 56:21 61:17 66:4 69:11 70:12 74:8 79:21 80:5,11,17 80:21 119:13 121:16 146:4 187:7 216:16 217:5,7 <b>helped</b> 40:4 119:16 <b>helpful</b> 8:20 9:15 13:6 24:19 31:4 33:4 34:18 39:7	80:13 81:16 82:8 161:10 168:12 170:11 198:12,15 218:1 219:14 <b>helps</b> 121:15 <b>hesitate</b> 33:7,14 <b>Hey</b> 196:2 <b>he'll</b> 218:22 <b>Hi</b> 14:21 15:1 157:16 <b>hide</b> 7:16 <b>hierarchy</b> 21:7 <b>high</b> 24:17 112:20 116:15 143:11 221:12 <b>higher</b> 25:11 83:14 113:17 128:5,7,8 143:13 <b>highlighted</b> 86:17 <b>highlighting</b> 12:18 <b>highly</b> 48:18 <b>high-volume</b> 27:12 166:2 <b>Hillsboro</b> 15:10 <b>historic</b> 20:2 <b>historical</b> 18:18 <b>history</b> 72:2 122:3 <b>hit</b> 34:13 104:19 <b>hog</b> 216:18 <b>hold</b> 108:9,10 <b>holding</b> 51:15 58:3 78:4 <b>hole</b> 98:15,15,18 100:2,5,16 <b>home</b> 165:17 166:20 181:13 182:16,18 183:1 183:20 184:7 201:9 211:8,16 212:3 <b>honest</b> 180:4 <b>hope</b> 12:16 52:12 84:15 102:6 134:22 220:7 <b>hopefully</b> 12:21 25:8 99:6 160:15 168:11 175:20	<b>hoping</b> 109:22 <b>horizontal</b> 65:13 <b>hour</b> 72:12 <b>hours</b> 184:5 <b>house</b> 12:5 36:10 36:11 44:19 69:5 194:2 <b>housekeeping</b> 5:13 <b>hubs</b> 170:2 <b>huge</b> 141:19 178:10 191:1 <b>human</b> 74:8 <b>hundreds</b> 39:20 189:13 <b>Hurricane</b> 64:13 67:3 <b>hurry</b> 211:18 <b>hurt</b> 80:11	<b>illegal</b> 152:10 <b>imagine</b> 129:14,16 176:9 210:4 211:22 <b>immediate</b> 98:2 140:7 <b>immediately</b> 50:13 78:6 96:9,10 157:6 178:12 <b>impact</b> 38:15 133:20 137:14 143:21 <b>impactful</b> 121:16 <b>impacts</b> 163:16 <b>implement</b> 61:20 <b>implementation</b> 17:1 18:5 19:7,19 31:9 32:11 70:16 219:5 <b>implemented</b> 8:18 25:14 45:20 120:12 186:21 <b>implementing</b> 153:5 186:10 206:18 <b>implements</b> 114:4 <b>implications</b> 209:6 <b>importance</b> 69:6 73:6 122:10 <b>important</b> 11:18 12:12,13 13:3 37:9,10 56:8 58:16 59:15 63:20 70:9 71:2 84:19 106:12 152:9 158:19 212:22 <b>importantly</b> 121:12 <b>impose</b> 125:7 <b>imposes</b> 120:11 <b>imposing</b> 179:20 <b>impracticable</b> 156:3,14 <b>improperly</b> 72:9 <b>improve</b> 182:12 <b>improvements</b> 56:8 <b>inability</b> 102:9 120:7
<b>H</b>			<b>I</b>	
<b>half</b> 10:15 132:11 176:2 180:1 <b>halfway</b> 31:8 <b>half-person</b> 214:16 <b>Han</b> 1:23 15:13,13 44:11 81:17 <b>hand</b> 90:2 92:8 97:14 157:13 173:18 <b>handed</b> 10:6 <b>handful</b> 150:9 <b>handheld</b> 182:21 <b>handle</b> 164:19 165:20 184:8 210:16 <b>handled</b> 59:15 211:8 <b>handling</b> 94:4 <b>hands</b> 87:20,22 <b>handshake</b> 146:2 <b>happen</b> 70:3 77:16 84:5 99:16 102:19 120:4 162:8 165:5 184:10,11 198:5,6 216:15 <b>happened</b> 116:1,9 117:1 118:19 <b>happening</b> 142:9 <b>happens</b> 51:7 101:17 102:7 165:1 167:9			<b>IB</b> 168:1 175:9 <b>IBs</b> 175:8 <b>ICE</b> 19:3 49:5 212:15 <b>idea</b> 42:14 73:6 89:15 100:4 131:5 164:5 172:20 <b>ideas</b> 49:9 131:1 <b>identifiable</b> 43:4 151:4 154:10 <b>identification</b> 47:17 112:2 114:17 122:13 <b>identified</b> 22:19 63:17 71:16 127:20 <b>identifier</b> 22:18,19 22:20,22 23:5 44:3 <b>identify</b> 12:14 89:2 161:12 168:10 <b>identifying</b> 119:11 127:22 <b>ignored</b> 117:18 121:6 <b>II</b> 4:13 52:9 <b>III</b> 4:17	

<b>inadequacy</b> 63:2	73:19 74:3 90:14	<b>instances</b> 22:2 45:4	33:6 40:13 153:2	<b>invested</b> 42:3 81:7
<b>incentive</b> 143:14	113:12 119:21,22	<b>instant</b> 178:2,7	160:7 176:5,6	<b>investigating</b> 152:3
<b>incentives</b> 142:20	126:7 139:11,14	<b>Institute</b> 52:15	218:14	<b>investigation</b>
<b>include</b> 159:13	163:7 183:18	<b>instituted</b> 60:11	<b>interface</b> 78:17	160:18
172:7	192:22 215:17	<b>institution</b> 59:12	182:20	<b>investing</b> 50:11
<b>included</b> 58:16	<b>influenced</b> 208:7	<b>institutions</b> 92:16	<b>interim</b> 22:22	80:22
59:15 68:16	209:16	134:12	23:13 38:5 112:12	<b>investment</b> 56:12
198:13	<b>informal</b> 6:2	<b>instructing</b> 182:14	<b>intermediary</b> 3:4,6	197:10
<b>including</b> 23:7	<b>information</b> 18:11	<b>instructions</b> 36:16	3:10 48:4,6 62:12	<b>investments</b> 90:8
59:20 149:5	20:15,18,21 22:11	<b>instructive</b> 191:17	147:2,18 155:16	144:12
150:19 153:15	23:6,21 24:9 25:2	<b>instrument</b> 138:1	<b>internal</b> 64:3 73:11	<b>investor</b> 136:1
177:19 220:11	25:4,8 26:22	<b>instruments</b> 132:21	77:18 90:8	<b>investors</b> 81:10
<b>inclusive</b> 176:4	27:17 30:1 45:1	<b>insurance</b> 52:17	<b>internally</b> 84:21	<b>invited</b> 146:1
<b>income</b> 82:7	52:19,22 58:14	53:5 73:21 83:15	91:12 180:11	<b>involve</b> 28:18 29:21
<b>incoming</b> 13:20	59:4,10,11 61:16	83:16 85:6	200:10	201:8
200:4,18 201:21	61:19 74:13 79:3	<b>integrity</b> 17:16	<b>international</b> 2:12	<b>involved</b> 18:7,21
<b>incorporated</b>	79:10,17,18,20	43:14 44:8 55:10	15:16 44:2,4,10	21:17 23:18 24:6
152:14	80:3 81:4,7,14,20	148:14,19 151:21	77:13	82:15 150:14
<b>increase</b> 17:15 74:4	82:1,8 84:12	159:1 160:11	<b>internationally</b>	157:20
83:1 85:10 89:20	140:19 141:11,12	186:13 187:8	203:4	<b>involving</b> 159:14
97:20	152:1 159:15	210:6 215:15	<b>interpret</b> 93:3	<b>in-house</b> 56:13
<b>increased</b> 49:17,18	160:1,16 161:10	217:8	<b>interpretation</b> 40:7	<b>Iowa</b> 16:6,9 212:17
118:11	161:20,21 171:5	<b>intel</b> 171:4	<b>interpretations</b>	<b>ironically</b> 178:22
<b>increasing</b> 59:6	201:2 207:3	<b>intelligence</b> 166:9	94:5	<b>issue</b> 12:13,14,18
179:11	216:16,22 217:6	<b>intended</b> 100:21	<b>interpreted</b> 107:11	33:14 36:6,20
<b>Independence</b>	<b>informed</b> 117:5	<b>intense</b> 77:6,10	<b>interpreting</b> 196:6	41:17 47:21 64:12
114:3	157:7	<b>intention</b> 89:8	<b>inter-divisional</b>	64:14 71:16,20
<b>independent</b> 2:6	<b>infrastructure</b>	<b>interconnected</b>	157:22	73:12 76:15,17
15:19 59:21	113:12 127:7	29:9	<b>inter-transfer</b>	79:22 88:9 89:4
<b>Indianapolis</b>	<b>initial</b> 45:9 93:20	<b>interconnectedne...</b>	90:10	94:18 95:18,18,20
166:22	106:22	149:7	<b>intra</b> 106:2	97:3,18 102:7,11
<b>indicate</b> 65:5	<b>initially</b> 178:1	<b>interest</b> 10:2,12	<b>intramonth</b> 54:7	105:13 120:8,14
131:17	<b>initiated</b> 112:4	11:2 12:14 19:16	54:13	128:1,16 146:15
<b>indicated</b> 26:2	157:5	27:11 29:13,19	<b>intra-day</b> 77:1	156:9 157:20
162:16	<b>initiative</b> 28:6	33:9 66:8 72:19	106:1,8	163:9 169:2
<b>indirect</b> 142:18	<b>innovate</b> 214:2	84:18 85:15 88:5	<b>introduce</b> 13:12	175:21 177:11
<b>indispensable</b>	<b>input</b> 8:10 9:14	92:17 121:22	47:4 119:16	183:16 184:16
148:18	62:2 68:10 218:4	131:6 135:9	<b>introduced</b> 114:16	187:12 196:18
<b>individual</b> 78:18	220:10,14 221:20	152:21 172:11,15	135:7	198:11,12 199:15
162:1 164:9 165:2	<b>inputs</b> 121:14	204:11,12 218:11	<b>introducing</b> 6:8	200:22 208:9
<b>individually</b> 56:22	<b>insight</b> 168:13	<b>interested</b> 22:13	148:8 153:10	212:22 220:12
<b>individuals</b> 160:4	<b>insolvency</b> 102:5	38:15 132:18	164:3 175:8	<b>issued</b> 191:21
162:1	<b>insolvent</b> 102:8	135:13 158:14	176:16 187:18	<b>issues</b> 13:3 31:8
<b>industry</b> 28:14	<b>install</b> 113:17	177:10 193:13	<b>introductions</b> 4:4	45:10 57:11 61:17
32:16 36:3,13	<b>installation</b> 157:10	205:20	17:11	70:19 74:1 75:16
37:20 48:10,11	<b>instance</b> 80:5	<b>interesting</b> 122:22	<b>invalid</b> 136:9	75:17 76:6 77:11
49:14 55:20 56:2	202:13	<b>interests</b> 9:4 12:10	<b>invest</b> 109:21	79:4 84:18 85:9

92:6 97:15 105:20 121:21 122:18 128:12,18 135:1,2 138:19 151:6 160:11 163:5 178:5 180:18 198:13,14,15,17 199:12 207:3,16 209:11,12 215:11 216:4 217:16 219:3 220:15 <b>issuing</b> 150:3 <b>items</b> 5:14 <b>It'll</b> 80:20 <b>i.e</b> 165:10	213:15 217:7,7,9 219:1 <b>keeping</b> 51:10 74:16 158:2 174:3 <b>keeps</b> 76:8 <b>Kent</b> 13:16 <b>kept</b> 28:20 45:1 152:6 154:9 <b>Kevin</b> 3:9 4:10 48:5 60:5 69:2,6 76:20 77:3 111:6 <b>Kevin's</b> 62:3 <b>key</b> 10:17 12:9 29:12,13 121:18 122:2 150:9 <b>kick</b> 17:8 <b>kid</b> 218:21 <b>kind</b> 32:15 37:1 38:14 43:3 59:1 72:10,11 73:21 75:2 82:10 85:15 109:19 137:22 140:4 167:14 190:15,19 192:11 211:9 212:8 214:7 215:2,14 216:1 220:15 <b>kinds</b> 189:15 <b>Kingdom</b> 186:15 <b>Kloza</b> 117:5 <b>knew</b> 32:9 107:15 109:19 <b>know</b> 7:19 9:4,9 10:10,22 21:1 24:3 33:7,14 35:2 41:2 42:9 43:1 44:9,16 52:6 53:6 53:22 54:4,21 55:9 64:16 68:13 68:19 72:8 73:10 73:17 75:6 78:12 78:15 79:6 80:15 82:10,21 84:15 88:11 91:14 92:1 92:22 94:6,8 95:19 101:7,14,17 102:20 105:4,22	107:18 108:2,15 109:8,20 110:12 112:2 114:12 128:14 132:15 134:16 138:7 141:13 158:13 163:7 165:6 166:1 167:18 169:12 171:11,18 177:22 178:20 180:3,11 183:19 185:17 186:1 188:14 193:1,3 194:1 198:7 199:5,19 200:19 201:5 204:1 209:21 210:22 211:1,18 213:4,11 214:7 216:7,18 220:5,14 220:15 221:14 <b>known</b> 134:2,17,19 151:5 <b>KOTSCHWAR</b> 2:1 177:9 179:5 188:12,18 192:19	213:1 <b>largely</b> 72:5 <b>larger</b> 132:8 160:6 200:2 <b>largest</b> 40:16 117:9 122:1 139:2 141:9 183:10 <b>late</b> 23:17 55:14 <b>Laughter</b> 88:6 147:12 180:6 188:17 <b>launched</b> 129:3 <b>laundering</b> 67:1 <b>Laurie</b> 3:6 4:6 17:6 26:3,12 31:21 46:17 <b>Laurie's</b> 18:2 <b>law</b> 24:20 84:2 86:8 86:9 92:6 105:21 107:11,15,16,16 107:21,22 108:5 108:14,15,22 114:21 116:7 117:15 123:10 <b>laws</b> 93:4 <b>lawyer</b> 86:10 106:11 <b>lead</b> 129:16 152:20 153:12 <b>leading</b> 190:16 191:1 <b>learn</b> 73:9 <b>learned</b> 156:15 <b>leash</b> 90:20 <b>leave</b> 77:8 <b>leaving</b> 110:12 <b>led</b> 174:22 190:10 <b>Lee</b> 3:4 4:6 17:5 18:4 25:12 31:21 39:18 40:3,3 46:16 <b>left</b> 11:12 13:14 103:13 <b>leg</b> 63:20,22 64:16 <b>legal</b> 22:20 44:3 88:9 106:10 107:5 109:5	<b>legislation</b> 16:22 17:14 <b>legitimate</b> 172:16 <b>legs</b> 62:10 <b>LEI</b> 22:21 23:12 41:21 42:7,15 43:6 44:3 <b>LEIs</b> 44:12 <b>lending</b> 56:14 <b>lessons</b> 181:22 <b>letter</b> 38:10,19 63:2 167:21 206:21 207:1,5,13 <b>letters</b> 24:2 56:3,4 77:20 109:2 206:10 207:6 <b>let's</b> 63:13 91:16 92:8 97:21 101:19 101:21 102:2 108:14 109:14 221:5 <b>level</b> 24:17 25:11 62:14 63:8 90:3 92:9,10 99:10 108:3 128:10,14 166:4 167:11 204:22 205:12 208:18 <b>levels</b> 66:6 98:21 116:3 123:20 124:12 <b>liability</b> 65:21 <b>licensed</b> 164:10 165:3 169:19 170:15 <b>liked</b> 80:4 <b>likelihood</b> 85:18 100:5 <b>Likewise</b> 155:12 <b>liking</b> 176:8 <b>limit</b> 72:11 130:1 <b>limited</b> 140:19 152:19 <b>limits</b> 113:13 159:16 <b>line</b> 8:1 52:6 113:6 116:19,19 119:1
<b>J</b>				
<b>Jablonsky</b> 1:25 14:21,22 <b>jail</b> 115:1 <b>January</b> 119:1 <b>Jennifer</b> 1:23 15:13 <b>Jim</b> 1:18 13:22 <b>job</b> 5:10 12:17 15:3 69:22 74:9 169:20 185:15 217:9 <b>jobs</b> 121:19 <b>John</b> 1:24 2:4 13:18 15:21 <b>join</b> 146:7 189:2 <b>joining</b> 6:12 7:20 <b>joint</b> 67:4 <b>July</b> 1:8 18:15 19:15 57:5 119:4 <b>jump</b> 78:22 205:3 <b>June</b> 18:17 63:14 <b>jurisdictional</b> 172:15				
<b>K</b>				
<b>Kansas</b> 15:10 49:5 166:22 <b>keep</b> 5:11 84:7 88:19 96:7 110:17 116:2 119:11 120:1 150:22 178:6 190:9,13,19 190:22 196:20				
		<b>L</b>		
		<b>Laboratories</b> 113:16 <b>Lachenmayr</b> 3:2 7:4 <b>lack</b> 141:10 162:15 <b>Lafayette</b> 1:12 <b>lagged</b> 74:19 <b>LANCE</b> 2:1 <b>Lance's</b> 191:4 198:13 <b>Lanclos</b> 1:25 13:16 13:16 <b>land</b> 162:11 205:10 <b>landed</b> 44:9 <b>language</b> 171:16 173:2 <b>large</b> 10:11 30:7,7 30:10 66:17 119:5 132:13 142:5 186:9 212:21		

124:9,11 161:22 183:2 205:10 <b>lines</b> 34:16 44:11 65:19 66:3,3 81:19 162:11 182:15,16 205:10 <b>link</b> 207:12 <b>liquid</b> 66:15 <b>liquidate</b> 106:18,22 <b>liquidated</b> 104:3 106:19 <b>liquidating</b> 58:2 106:17 <b>liquidity</b> 60:11 61:21 65:15,17,18 65:22 66:10,12,16 133:22 134:21 <b>list</b> 24:1,22 83:22 <b>listen</b> 40:22 196:22 <b>listening</b> 30:22 41:11 204:4 207:15 <b>literally</b> 159:19 <b>little</b> 6:4,15 25:11 36:13,17 53:17 55:6 56:7 67:18 68:7 71:9 80:8 112:1,9 125:4 128:15 130:19 132:7 142:3 144:16 146:7 163:3,4,12,15 164:5 165:22 167:12,22 171:11 171:18 177:15 183:15 184:16 186:5 188:2 194:15,19 197:21 203:5 219:20 <b>live</b> 19:20 <b>livestocks</b> 164:22 <b>living</b> 36:12 136:12 <b>LLC</b> 3:22 <b>loath</b> 61:10 <b>local</b> 34:21 164:8,8 164:12 166:4,5 167:10 169:8	171:6 213:22 214:5 <b>location</b> 165:4 168:3,4 169:22 170:16 214:7 <b>locations</b> 189:13 <b>lock</b> 214:1 <b>long</b> 44:7,13 110:10 114:18 137:13 180:14,16 189:22 217:10 220:5 221:4 <b>longer</b> 43:9 58:2 80:20 101:6 181:15 <b>look</b> 11:7 22:1,4 24:22 39:8 48:12 48:22 51:5 54:7 60:7,8 62:9 65:6 65:16 72:22 73:5 73:14 74:6,10,11 77:15 81:10,11 84:3 93:12 106:6 108:4 115:14 116:5,16 118:22 120:21 140:19 141:5 145:2 163:17 166:14 171:2 175:22 179:18 180:8 183:9,15 189:21 209:10 211:18 <b>looked</b> 62:18,19 66:22 67:6 73:19 81:17 124:14 168:1 172:20 206:4,7 <b>looking</b> 9:6,12 22:13 49:5 66:1 67:1 74:13 78:6 84:20 93:22 94:4 139:22 142:9 159:6 160:10 161:20 167:21 190:8 201:19 206:12 214:8 <b>lose</b> 208:10,16	<b>loses</b> 99:16 101:21 101:22 <b>loss</b> 100:12 103:2,4 <b>lost</b> 49:19 <b>lot</b> 9:8,9,11 10:18 11:22 12:8 28:5 36:21 37:6 42:22 43:12 44:16 53:7 65:3,4 81:12 92:22 128:18 131:12 135:7 140:21 143:21 164:3 171:8 176:5 177:19,21,22 178:17 179:1 184:1 194:13 203:21 211:19 216:20 <b>lots</b> 75:6 165:1,5 166:3 <b>loud</b> 200:17 <b>Louis</b> 14:4 <b>Louisiana</b> 13:20 <b>low</b> 112:22 143:11 <b>lower</b> 29:8 113:10 123:20 139:16 <b>lowering</b> 11:6 28:10,10,11 30:6 <b>lower-octane</b> 113:9 <b>LSOC</b> 56:20 <b>lubricity</b> 104:16 106:4,5,7 <b>lunch</b> 47:13 144:5 145:20,21 146:1,7 146:8 182:18 <b>Luttrell</b> 2:1 14:15 14:15	151:4 154:7 <b>maintaining</b> 58:5 153:5 <b>maintenance</b> 58:6 <b>major</b> 21:10,14 149:16 155:3,13 156:18 166:21 183:9 <b>majority</b> 169:17 184:2,12 211:7 <b>making</b> 9:18 12:18 30:14 44:20 58:8 64:20 66:13 79:12 108:9 139:4 180:20 183:3 185:9 199:8 204:15 214:14 <b>malfeasance</b> 74:9 <b>manage</b> 30:16 91:12 165:10,18 215:13 216:6 <b>managed</b> 1:23 15:14 138:8 <b>management</b> 1:25 13:17 14:13 29:11 35:6,19 48:17 51:8 61:15 65:21 72:16 73:12 74:5 74:5,7 82:19 166:11 167:10 <b>managing</b> 3:20 47:22 <b>mandate</b> 33:8 45:19 46:10 125:18 <b>mandates</b> 139:22 <b>manipulation</b> 159:18 210:7 <b>manipulative</b> 151:20 160:8 <b>manner</b> 45:3 154:9 <b>manufacture</b> 113:10 <b>manufacturing</b> 29:2 118:13 <b>March</b> 29:16 <b>margin</b> 56:15 58:3	60:17 66:18 82:19 83:2,13 84:18 85:16,19 89:19 91:7,14 93:5,12 93:19,20 94:18 95:1,2,5,6,10,20 96:2,5,8 97:1,10 97:20 99:22 100:8 100:10,11 101:4 101:15,22 102:9 103:20 104:4,10 106:14,22 108:18 109:9,11,18 110:4 110:7 165:20 <b>margin</b> 90:5 <b>margin</b> 90:9 91:15 97:17 <b>margins</b> 142:4 <b>mark</b> 2:22 4:3 7:18 11:12 155:9 <b>market</b> 3:6 9:16 10:21 11:2 17:7 17:15 19:6,8 21:14 25:19 26:6 26:15 27:5,7 29:6 29:7 34:5 35:7,21 41:4 55:11 57:10 66:16 93:12 105:9 119:12 121:15 122:10,12,13,22 123:3 125:13 126:20 128:13,16 129:8,13,19,22 130:11,22 131:4,6 131:16 132:16,19 133:2,2,3,14,15 133:21 134:11,13 135:4,4 136:4 139:9,13,18 141:18,21 142:4,9 142:14 143:3,5,6 148:14,19 151:21 152:2,3,5 159:1 160:6,6,11 166:9 172:9 186:13 187:8 191:21 194:5 195:16,17
--	--	---	--	--

208:8,11 209:14 210:5 218:11 <b>marketers</b> 113:19 118:17 139:3 <b>marketing</b> 36:21 125:9 144:2 199:8 <b>marketplace</b> 26:1,8 28:15 45:21 130:9 130:21 215:19 216:4,14 217:7,8 <b>marketplaces</b> 46:5 <b>markets</b> 2:1 10:2 30:14 44:13,14 45:7 52:16 57:3 70:5 79:14 104:17 122:1,17,19,20 123:2 128:19 131:4 132:15 134:16,21 135:6 135:20 138:18 140:17,21 141:7 142:2 148:9,22 165:7 173:6 177:10 192:10 194:4 213:19 215:5,16 216:21 218:11,12 219:6 <b>market's</b> 204:11 <b>masked</b> 27:1 <b>material</b> 63:1,15 159:14 <b>materiality</b> 211:1 <b>matter</b> 47:9 77:2 98:2,12,13 146:11 195:16 221:22 <b>matters</b> 76:5 159:3 <b>mature</b> 203:6 <b>Maumee</b> 14:18 <b>maximum</b> 126:7 <b>McGonagle</b> 3:7 4:18 147:2,6,7,10 157:14,16 181:4 184:15 193:7 196:12 203:16 205:2 206:8 <b>mean</b> 7:8 35:10 43:3 50:17 66:15	77:4 79:5 83:3,11 84:10 88:20 93:7 94:10 96:21 101:14 104:1 109:7,17 142:8 143:11 161:15 171:7 175:15,20 184:9 186:6,7 187:15 200:16 201:17 202:3,14 202:17 203:11 206:1 210:4 211:17 212:2,2,6 212:16 214:16 <b>meaning</b> 51:20 68:5 94:14 <b>means</b> 7:8 30:10,11 75:11 93:12 114:11 193:4 208:11 213:17 <b>measure</b> 52:4 102:1 107:3 182:14 205:22 <b>measures</b> 209:15 <b>mechanism</b> 59:2 <b>mechanisms</b> 141:21 <b>Media</b> 141:16 <b>meet</b> 57:22 93:11 96:2 100:10 136:18,19 220:17 220:22 221:2 <b>meeting</b> 1:5 5:4 8:14 11:18 31:9 32:8 39:8,9 46:20 216:9 220:11,19 221:8,19 <b>member</b> 4:8,12,15 4:20 85:1 95:22 117:10 153:12 171:13,14 172:9 173:8,10,14 179:6 179:6,8 187:15,16 191:7,12 194:20 195:1,5,15,16 196:5,9,10 <b>members</b> 1:15 6:11	8:10 13:9 41:19 41:20 43:1 44:13 45:3 47:5 112:6 146:1,19 147:20 148:9 150:19 153:8,14,16 175:13 176:14,15 179:1 188:19,19 188:21 192:9 194:3,5 199:19 203:21 <b>membership</b> 8:11 178:10 189:4 192:21 194:14 <b>memberships</b> 188:20 <b>mention</b> 46:18 80:15 192:11 <b>mentioned</b> 40:5 55:13 57:5,8,14 58:14 64:2,7 69:3 69:6 89:9 92:21 185:11 191:22 200:7 209:20 <b>merchant</b> 76:7,22 77:7 87:11,16 187:3 <b>merchants</b> 9:3,19 16:13 86:17 87:7 148:7 187:17 <b>message</b> 178:3 <b>messages</b> 178:7 191:1 <b>messaging</b> 213:13 <b>messed</b> 220:1 <b>met</b> 1:12 61:1 <b>method</b> 58:2,19 193:15,18 <b>MF</b> 57:11 69:12 70:1 71:13 72:1 76:5 82:15 83:12 83:20 86:4 90:10 91:16,20 99:1,3,8 <b>micro</b> 122:18 <b>microphone</b> 5:19 32:4 157:13 <b>middle</b> 41:8 132:1	132:2 188:5 <b>Midwest</b> 117:20 <b>mid-August</b> 10:18 <b>Mike</b> 8:4,4,8,8 31:16,16 218:20 <b>Mike's</b> 31:19 <b>miles</b> 72:12 <b>milestone</b> 34:13 <b>milk</b> 1:22 14:11 37:3,4,4 <b>miller</b> 2:3 16:5,5 90:1 103:16 106:3 142:12 143:13 179:9 180:7 207:15 218:15 <b>millers</b> 1:18 14:1 28:22 213:21 <b>million</b> 53:17 85:22 86:1 117:12 131:11,14 175:10 197:9 <b>mind</b> 28:20 96:7 110:11 122:11 <b>mindful</b> 122:5,19 128:22 134:5 <b>mindfully</b> 135:11 <b>mine</b> 83:12 <b>minimize</b> 73:7 <b>minimum</b> 57:4 59:21 <b>Minneapolis</b> 49:4 <b>Minnesota</b> 118:19 140:21 <b>minor</b> 105:3 <b>minute</b> 47:2 <b>minutes</b> 32:7 47:6 103:13 144:5 170:17 171:1 <b>mirror</b> 60:8 <b>misfeasance</b> 74:8 <b>misleading</b> 68:8 <b>missed</b> 218:22 <b>mission</b> 8:13 55:9 122:3 <b>Missouri</b> 15:19 <b>mistaking</b> 104:15 <b>mitigate</b> 72:17 73:7	74:8 <b>mix</b> 173:17 <b>Mixon</b> 3:8 4:14 112:13 121:9 125:17 126:1,5,16 126:22 127:3 133:11,15 144:21 <b>mobile</b> 162:11 178:14,18 182:3 182:11,12,21 184:18,19 185:1 205:9 <b>models</b> 127:12 <b>Moderated</b> 129:21 <b>modern</b> 75:11 <b>modern-day</b> 27:1 <b>mom</b> 89:1 <b>moment</b> 8:2 31:10 101:20 147:19 <b>Monday</b> 97:19 <b>money</b> 56:21 76:22 78:8 80:22 83:2,4 83:11,13 84:8,9 86:2,12 87:8,12 87:13,17,19 88:3 89:14,21 93:11,15 93:21 94:17 96:12 96:22 97:22 98:1 98:13 99:3,16 100:9,12 102:14 102:15,22 105:22 106:10 108:17 109:19 110:5 165:20 216:1 <b>monitoring</b> 67:8,8 <b>monopolizing</b> 188:13 <b>month</b> 54:9 63:14 116:18 184:11 205:9,10 206:5 209:20 211:12 <b>monthly</b> 50:10 62:16 63:11 64:8 67:8 81:13 82:7 205:8 211:18 <b>months</b> 18:22 54:1 64:4 123:12 135:6
--	--	--	--	--

156:16,22 157:3 182:2 221:1 <b>moot</b> 212:9 <b>Morgan</b> 44:5 <b>morning</b> 5:11 6:7 14:9 15:1 17:2,3,8 47:14,19 48:8 91:2 97:20 117:4 <b>mortem</b> 77:15 <b>motivation</b> 122:12 <b>motor</b> 114:1,7 <b>move</b> 37:4 73:3 93:22 102:21 106:18 109:13 115:21 <b>movement</b> 2:8 16:17 90:13 91:13 <b>moves</b> 98:1 105:9 <b>moving</b> 42:4 44:18 104:18 124:9 165:20 <b>MSPs</b> 19:10 21:18 23:18 <b>multiple</b> 55:19 104:21 149:8 197:5 <b>multiply</b> 211:19 <b>municipal</b> 142:4 <b>music</b> 106:15 <b>M.J</b> 1:17 14:17 86:22 87:1,2,19 87:21 88:3,12 89:5 142:8	14:22 15:2,6,11 57:6 163:8 <b>nature</b> 173:22 174:5 <b>near</b> 182:13 <b>nearly</b> 8:16 <b>Nebraska</b> 15:6 16:3 139:1 <b>necessarily</b> 90:5 110:22 185:13,15 <b>necessary</b> 185:22 190:15 <b>necessity</b> 150:15 <b>need</b> 5:18,20 7:9 28:3 35:13,19,22 37:5,6 42:6 43:7 44:8 46:3 50:8 58:20 68:19 69:18 69:19,22,22 70:17 70:17 74:4,12 89:19 90:12 105:15 108:9 109:13 126:14 151:7 175:21 180:18 187:5,5,11 190:17 193:20 202:17 204:8,18 215:9,9 218:8,8 221:3 <b>needed</b> 55:15 58:3 106:19,20 158:7 <b>needs</b> 31:15 33:1 36:13 97:16 110:20 148:18 <b>negative</b> 94:14 <b>negligible</b> 115:18 126:16 <b>Neil</b> 1:21 14:6 218:9 <b>neither</b> 21:13 169:19 <b>net</b> 56:18 58:1 66:8 66:14,15 81:6 91:14 189:22,22 <b>never</b> 82:14 <b>new</b> 10:18 13:9,9 13:10 17:12,22	35:14 36:11,15 41:4,5 44:19,20 78:18 80:6 93:3 119:18 147:22 153:10 180:3 194:10 202:19 <b>NFA</b> 49:2 50:2,3 51:20 52:15 55:21 64:1,12,20 65:12 75:19 81:7 <b>NGFA</b> 84:22 <b>nice</b> 83:16 171:3 <b>nickel</b> 123:11 128:6 131:19 145:9 <b>night</b> 187:21 188:5 <b>ninth</b> 146:1,3 <b>nobody's</b> 93:7 108:20 118:9 <b>non</b> 102:22 <b>non-bona</b> 159:17 <b>non-clearing</b> 179:6 179:7 188:20 <b>non-financial</b> 28:20 <b>non-intermediari...</b> 150:20 <b>non-intermediary</b> 153:8 <b>non-public</b> 159:15 <b>non-registered</b> 19:14 23:17 <b>non-registrant</b> 172:8 <b>non-U.S</b> 22:2,4 <b>normal</b> 15:3 <b>North</b> 1:18 2:9 13:22 14:3,5 <b>northeast</b> 13:19 <b>northern</b> 15:18 <b>note</b> 99:3 <b>noted</b> 54:11,19 148:12,21 151:16 <b>notices</b> 64:9 65:4 <b>notifications</b> 51:3 <b>notified</b> 78:13 <b>notify</b> 50:21 51:10 <b>noting</b> 191:18	<b>notion</b> 189:7 <b>notional</b> 10:9 36:5 <b>notwithstanding</b> 156:11 <b>November</b> 57:12 120:15 <b>No-Action</b> 20:4 24:1 167:21 <b>NSA</b> 180:5 <b>number</b> 10:13 43:20 48:11 60:22 92:16 114:14 122:13 126:6 135:8,12 151:9 158:16 159:7 161:4 172:5 174:20 203:8 207:22 208:19 210:10 <b>numbers</b> 10:12,16 11:1 43:21 47:17 63:11 112:2 114:17,18 119:9 129:15 131:8 132:8 149:6 206:1 <b>nutshell</b> 61:22 67:15 <b>NYMEX</b> 119:17 <b>N.W</b> 1:13	<b>obtain</b> 23:12 <b>obvious</b> 132:6 <b>obviously</b> 64:17 130:21 221:2 <b>occasional</b> 187:21 <b>occasionally</b> 184:5 <b>occur</b> 130:4,4 162:14 <b>occurred</b> 30:20 73:1 <b>occurring</b> 100:6 <b>octane</b> 112:21 <b>October</b> 28:3 <b>odd</b> 169:11 <b>offer</b> 27:14,15 203:20 <b>offering</b> 164:13 <b>offers</b> 166:10 <b>office</b> 3:4 17:6 40:5 130:2 137:19 164:4 165:16,18 166:17,20 169:13 181:1,13 182:8,16 183:1,20 184:3 185:14,18 201:9 209:11 210:15 211:8 <b>officer</b> 3:2 7:7,14 76:11 <b>offices</b> 163:19 164:1,2,6,16 166:3,13,15,21 167:3,8 168:7,20 168:22 169:4,6,11 176:22 179:13 183:21 187:13 211:9 212:21 213:1,12 214:16 <b>officially</b> 7:6 <b>offsetting</b> 56:17 <b>offshore</b> 58:4 <b>off-the-shelf</b> 157:8 161:16 202:15 205:14 <b>OGC</b> 158:4 <b>oh</b> 7:22 214:10 220:19
<b>N</b>				
<b>name</b> 5:7 86:20 88:14 92:11 147:16 219:22 <b>named</b> 215:18 <b>name's</b> 14:10 <b>narrow</b> 65:9 160:12 <b>narrowed</b> 150:4 176:7,12 <b>National</b> 1:17,19 1:21,21,22,25 2:1 2:5 14:7,11,16,19				

<b>Ohio</b> 14:18	167:16 217:21	189:21	190:17	124:17
<b>oil</b> 112:20 119:11 119:21,22 120:5 143:3	<b>opposed</b> 42:14 89:10 91:5,10	<b>overarching</b> 148:13	<b>papers</b> 127:21	<b>parting</b> 216:11
<b>okay</b> 16:18 17:2 21:6 32:2,21 46:16 55:6 77:16 78:21 87:1 95:1 100:14 111:5,11 111:20 121:9,10 127:2 147:13 190:9 219:15 221:15,17	<b>optimal</b> 221:16	<b>overlay</b> 132:20	<b>parameters</b> 173:16	<b>partly</b> 132:19
<b>old</b> 180:8	<b>optionality</b> 36:22 37:7 38:4	<b>overly</b> 153:6	<b>paraphrase</b> 86:11	<b>parts</b> 45:21 118:20
<b>older</b> 192:7	<b>options</b> 40:1 209:14 221:14	<b>oversee</b> 70:5	<b>part</b> 10:1 11:17 18:16,17,17 20:9 21:8 22:16 26:14 27:3 33:20 37:15 38:2 55:11 57:20 57:22 61:12,14 93:2 103:17 119:21 122:11 128:21 149:10 159:8 166:17 171:9 183:11 185:2 186:19	<b>party</b> 43:19 201:16 201:22 202:1,9 203:14
<b>once</b> 40:18 43:14 43:16 44:9 53:1,4 165:13 184:11,11 221:10	<b>oral</b> 147:22 148:11 148:17 150:13 152:18,19 153:5 153:11 154:15,21 155:7 156:4,19 162:21 166:16 168:21,22 174:2 174:18,21 175:17 177:13 189:7,8 198:1 202:11	<b>overshoot</b> 140:17 141:7	<b>participant</b> 21:11 21:14	<b>pass</b> 83:17 171:5
<b>ones</b> 64:2 184:10 199:16	<b>order</b> 35:15 37:1 69:18 110:22 130:1 149:7 165:15,18,19 181:2,14	<b>overshooting</b> 141:8	<b>participants</b> 19:7,9 24:5 26:6 34:5,18 55:20 57:10 121:15 129:8 130:7 133:16,21 134:11 149:17 155:3,14 156:18 219:11	<b>passed</b> 18:14 114:1 116:4,8 126:18 161:2 204:6
<b>one-person</b> 169:13 213:11	<b>orders</b> 199:1 210:16,19	<b>oversight</b> 3:4,6,6 3:10 17:7 28:12 48:4,6 62:7,9 63:20 64:19 67:14 74:14 78:16 147:2 147:18 155:16 164:11 165:19 191:21	<b>participate</b> 17:4	<b>passing</b> 118:17 139:6 140:22 192:12 200:8
<b>one-way</b> 7:22	<b>ordinary</b> 34:3	<b>overstate</b> 70:10	<b>participating</b> 49:4 76:4 220:7	<b>Paul</b> 2:5 15:9
<b>ongoing</b> 165:11 215:7	<b>organization</b> 50:1 164:12	<b>overview</b> 4:5 16:21 18:13	<b>participation</b> 219:13	<b>pause</b> 7:22
<b>online</b> 22:9 75:14 207:18	<b>organizations</b> 9:11 49:3 52:12 75:10	<b>over-the-counter</b> 168:7	<b>particular</b> 8:15 12:11 36:19 37:15 46:8 64:12 65:3,8 134:20 142:20 145:17 149:2 161:21,22,22 178:12 183:19 202:8 206:20 207:3,5 208:10	<b>pay</b> 42:15 53:12 198:8
<b>open</b> 31:22 67:22 119:16 135:9 146:20	<b>organizing</b> 75:2 219:10	<b>Owen</b> 2:4 13:18,18	<b>particularly</b> 9:2 33:5 90:15 91:18 114:22 121:20 122:21 131:18 160:8 179:12 208:1 218:9	<b>paying</b> 177:15 192:22 193:5
<b>Opening</b> 4:2	<b>orientation</b> 72:21 74:7,15,18	<b>o'clock</b> 146:9	<b>parties</b> 28:21	<b>payroll</b> 88:22
<b>operate</b> 36:18 164:2	<b>origin</b> 218:17	<b>O'Malia</b> 2:21 7:19 68:15 69:4 78:9 80:10,14 98:5,8 98:22 99:18,21 100:14 107:8 111:9,13 140:3 204:19 219:8 221:7,12		<b>pays</b> 96:14 119:5
<b>operating</b> 36:16 63:6 73:13	<b>original</b> 203:10	<b>O'Malia's</b> 101:12		<b>peering</b> 10:3
<b>operation</b> 42:3	<b>originally</b> 152:15			<b>Penner</b> 2:5 15:9,9 198:19 210:14
<b>operations</b> 200:9	<b>ought</b> 116:15			<b>penny</b> 131:21
<b>operators</b> 153:16	<b>outgoing</b> 200:4 201:1,5			<b>pens</b> 68:5,6,9
<b>opinion</b> 63:3 204:8	<b>outlined</b> 205:5			<b>pens-down</b> 61:7
<b>OPIS</b> 117:5	<b>outlines</b> 206:9			<b>people</b> 6:3,6,6 33:10 34:1,13 53:7 69:8 70:19 72:13,18 73:10,17 80:6,17 106:1 107:15,21 115:1 120:5,6 128:18 133:14,17 134:16 169:19 170:4 171:20 193:5,5 194:8 197:15 207:22 213:1 214:22 220:6
<b>opportunities</b> 142:22 203:9	<b>outside</b> 6:21 24:18 51:21 61:18 75:21 98:10 130:5 167:21 199:15			<b>perceived</b> 135:2
<b>opportunity</b> 6:3 21:4 41:18 71:20 121:11 136:15 147:22 163:2	<b>overall</b> 10:21			<b>percent</b> 29:5,6 31:7 50:21 70:15 76:9 99:7 113:14 114:11 115:20 116:10,22 117:18

117:19 119:2,2 126:9 131:21 132:4 136:17 137:9 <b>percentage</b> 114:15 116:20 132:12 210:18 <b>Peregrine</b> 69:12 70:2 71:13 72:1 75:5,17 91:16,20 107:6 <b>perfect</b> 73:21 <b>perfectly</b> 203:15 <b>perform</b> 64:3 65:1 <b>period</b> 43:9 60:20 99:4 104:12 144:5 151:14 154:14 156:5 175:11 194:4 195:20 202:11 <b>permitted</b> 39:20 153:19 <b>person</b> 7:9 22:1,2 62:11 104:13 153:13 165:3 170:15 187:13 193:22 201:8,10 <b>personal</b> 160:19 162:14 185:12 <b>personally</b> 122:4 <b>personnel</b> 69:19 70:21 <b>persons</b> 22:4 153:20 154:2 162:13 175:15 <b>perspective</b> 12:11 43:1 53:10 64:15 109:17 122:15 172:19 178:5,6 179:11 185:22 207:17 <b>pertain</b> 174:4 <b>pertaining</b> 161:12 <b>pertains</b> 174:2 <b>petroleum</b> 113:12 139:3,11,14 <b>PFG</b> 53:16	<b>phase</b> 19:18 45:9 52:9 70:15 <b>phased</b> 19:8 26:11 <b>phase-in</b> 19:11 22:21 <b>phasing</b> 26:12,19 29:15 <b>Phillip</b> 3:22 4:14 112:8 121:8 135:19 146:6 <b>phone</b> 5:15 7:12,13 7:21 43:21 166:8 177:20 178:1,8,15 178:21 181:9,18 183:16 184:3,14 185:2,12 187:21 188:9 190:22 199:3 200:21 201:1 211:12,15 211:21 212:7,10 <b>phones</b> 162:14 167:13 178:13 184:18,20 205:9 207:2 <b>phrased</b> 172:6 <b>physical</b> 168:4 <b>Piccoli</b> 3:9 4:10 48:5 62:5 77:9 81:2 <b>pick</b> 63:19 <b>picture</b> 10:20 145:16 <b>pictures</b> 169:12 <b>piece</b> 28:9 66:12 105:3 106:12 190:17 <b>pieces</b> 62:8 75:3 <b>piggyback</b> 188:2 <b>pile</b> 213:8 <b>piling</b> 188:13 <b>pink</b> 141:18 <b>pitchforks</b> 217:1 <b>PKVerleger</b> 3:22 112:9 <b>place</b> 13:11 18:20 18:22 26:10 27:15 28:4 30:14 42:16	49:10,12 50:14 83:2 86:9 98:3 100:6 109:10 165:13,16 166:2,9 168:14 181:2,14 184:12 203:2 217:10 <b>placed</b> 172:18 210:1 <b>places</b> 24:21 208:20 209:3 <b>planting</b> 143:10 <b>plants</b> 134:1 <b>platform</b> 22:6 27:8 27:13 212:15 <b>platforms</b> 41:6 <b>played</b> 122:7 <b>players</b> 19:4 40:16 40:17 41:4 160:5 200:2 <b>please</b> 5:15 32:3 33:6,13 67:22 204:1 218:7 219:1 219:7 <b>plenty</b> 157:9 <b>Plus</b> 152:5 <b>point</b> 7:10 37:12 39:1,18 46:12 53:19 54:2 59:5 69:9 77:1,2 79:17 83:5 85:20 94:1 95:21 96:20 97:2 98:9 104:19 109:9 113:11,21 119:4 124:8 137:11 151:9 156:20 168:6 177:19 188:2,9 191:5,16 191:17 197:4 199:9,13 208:15 209:5 212:9 216:3 220:18 221:18 <b>pointed</b> 28:19 97:5 <b>pointing</b> 45:19 172:3 <b>points</b> 60:15 132:12 136:4	179:9 <b>policies</b> 58:5 128:16 162:20 <b>policy</b> 69:16 76:6 88:9 178:20 190:12 191:16 192:13 198:22 <b>pollution</b> 114:19 <b>pony</b> 95:22 <b>pool</b> 153:16 <b>pops</b> 46:21 67:13 <b>popular</b> 112:21 <b>Pork</b> 1:21 14:7 <b>portfolio</b> 46:8 <b>position</b> 86:13 93:13 97:16,19 104:2,4,7,11 106:17,18,18 190:1,3 <b>positioned</b> 69:10 70:12 <b>positions</b> 52:20 90:18,21 91:10 94:22 97:10 102:22 110:8 <b>possible</b> 23:21 60:5 103:1 185:7 206:6 <b>possibly</b> 9:12 87:8 169:3 213:2 <b>post</b> 60:17 77:15 130:12 <b>potential</b> 48:22 51:9 52:17 53:8 59:10 93:5,11 134:2 152:8 184:10 206:17 <b>potentially</b> 49:19 86:2 160:5 <b>powers</b> 80:5 <b>practical</b> 97:15 183:17 <b>practicalities</b> 97:5 <b>practicality</b> 110:18 111:1 197:17 <b>practice</b> 30:13 86:18 90:14 <b>practices</b> 74:21	151:20 <b>preamble</b> 148:22 150:11 191:19 <b>preceding</b> 175:11 <b>preexisting</b> 192:5 <b>preliminary</b> 129:6 <b>prepare</b> 161:7 <b>prepared</b> 61:2 157:12 <b>preparing</b> 23:19 62:20 152:3 <b>PRESENT</b> 1:15 2:17 3:1,18 <b>presentation</b> 69:3 168:11 <b>presentations</b> 55:2 146:20 <b>presented</b> 46:19 <b>presenters</b> 17:1,3 32:12 138:16 <b>preserves</b> 160:16 <b>president</b> 14:13,16 15:4,11 16:10 <b>presiding</b> 1:14 <b>Preston</b> 2:6 16:14 16:14 40:11 45:17 199:18 200:16 201:13,19 203:20 <b>pretty</b> 10:13 16:20 29:20 36:5 43:3 138:22 159:2 210:4 212:8 <b>prevent</b> 56:13 <b>preventing</b> 210:6 <b>previous</b> 120:16 <b>previously</b> 107:12 <b>pre-funding</b> 85:19 <b>price</b> 18:10 20:15 26:16,21 112:22 113:5,6 115:22 117:1,22 118:4,8 118:8,11,22 119:1 119:3 120:20 123:8 128:5 138:22 139:6,16 140:12,16 141:2,6 143:11,14,20
---	---	--	--	---

144:9 214:1	119:21	<b>programs</b> 162:4	55:18	53:11 60:13 62:8
<b>prices</b> 115:17	<b>procedures</b> 58:6	205:15	<b>proud</b> 121:21	68:6,20 73:13
116:15 118:10	62:19 68:22	<b>projected</b> 114:8	<b>provide</b> 23:20 24:3	83:11,22 86:15
123:16 124:9,11	162:20	116:3	59:9 61:19 62:14	87:13 89:11,21
124:14 131:5,16	<b>process</b> 9:6 13:9	<b>projection</b> 114:10	70:22 80:3 82:9	94:16,22 96:11
137:2 141:14,16	22:21 23:9,10	<b>promote</b> 17:15	220:14	97:16,19 101:16
159:17	30:21 53:2,6	148:14 158:22	<b>provided</b> 23:22	108:8 126:10
<b>price-setting</b>	61:12 62:4,7,19	187:8	25:3 79:12 153:22	128:18 145:13
144:22	65:21 67:2 77:19	<b>proper</b> 65:20	156:1 207:2	192:16 193:3
<b>primarily</b> 27:10	157:5 166:8	<b>property</b> 108:17	<b>provides</b> 63:8	210:5,11 217:14
150:8	<b>processes</b> 6:18 8:15	109:11	141:11	221:5
<b>primary</b> 5:10 64:2	67:2	<b>proposal</b> 57:7	<b>providing</b> 22:11	<b>puts</b> 83:13 96:19
183:21	<b>produce</b> 123:9	86:16 150:1 153:1	25:8 63:3 66:10	105:14 110:11
<b>principal</b> 112:8	143:14 156:9	<b>proposals</b> 61:3	<b>provision</b> 21:20	<b>putting</b> 80:22
<b>principally</b> 176:14	214:2 215:13	73:15	186:22	87:17 92:2 105:5
<b>principle</b> 72:4 75:2	<b>producer</b> 13:19	<b>propose</b> 81:21	<b>provisionally</b> 19:2	<b>P-R-O-C-E-E-D-...</b>
<b>principles</b> 72:6	15:7 16:8 82:13	<b>proposed</b> 45:22	<b>provisions</b> 40:4	5:1
<b>prior</b> 125:16	83:8 88:18 139:2	46:6 49:13 56:6	194:12	<b>p.m</b> 146:12,13
129:12 145:8	185:8 204:5 205:7	57:12 58:16 59:16	<b>public</b> 18:9 24:9	221:22
150:2 156:12	218:16	60:1,12,20 74:3	26:15 59:21 72:2	
<b>pro</b> 98:9,19 100:1	<b>producers</b> 1:21,22	78:19 87:15 93:9	76:6 79:12 88:8	<b>Q</b>
100:18,21 103:3,7	9:3,19 14:7,11	95:13 134:7	152:13	<b>quantified</b> 210:3
103:19	28:21 42:22 121:1	149:13 150:4,7,18	<b>publication</b> 155:10	<b>quantities</b> 141:13
<b>probably</b> 10:22	217:1	151:3,15 152:15	<b>publicly</b> 20:14,16	<b>quarter</b> 130:17
31:8 34:10,11	<b>Producer's</b> 13:21	152:17 154:16	20:20 21:2 23:4	221:10
37:14 38:20 51:19	<b>producing</b> 113:1	160:3 172:6 173:2	<b>published</b> 148:4	<b>quarterly</b> 221:9
70:11 77:10 83:6	<b>product</b> 124:6	176:2	149:20 156:22	<b>question</b> 21:6
91:3 106:21	<b>production</b> 142:21	<b>protect</b> 55:12 56:8	<b>pull</b> 76:9 171:16	22:14 33:18,20
116:18 164:18	143:21 162:4	80:6 99:22 110:7	207:10	38:1,9 41:21 42:5
165:14 167:19	<b>products</b> 9:20 35:7	148:15,19 159:1	<b>pump</b> 118:2	42:21 46:14 75:5
168:9 176:7	35:14 39:13,14	165:8 197:9 213:2	<b>pumps</b> 113:17	76:13 78:11 84:20
178:19 180:1	82:18 125:10	213:6	<b>pun</b> 124:3	89:8 90:1 98:6
184:1 185:11	129:11 135:12	<b>protected</b> 56:22	<b>purchase</b> 153:13	99:13 101:13
199:16 211:8	162:9 168:9 177:5	60:19 110:13	<b>purchasers</b> 134:3,4	102:3,10 106:11
212:18	<b>profess</b> 201:12	<b>protecting</b> 204:11	<b>purpose</b> 62:13	107:5 138:16
<b>problem</b> 65:6,8,22	<b>Professor</b> 219:9	208:13	98:20 148:13	143:9 144:7,15
74:8 79:12,20	<b>profile</b> 164:6	<b>protection</b> 4:9 9:8	157:19 158:22	167:5 172:17
82:15 90:6 92:3	166:13	12:15 13:4 47:7	187:22	185:16 199:18
97:11 98:17	<b>profiles</b> 213:6	47:14,20 49:7	<b>purposes</b> 32:7	203:10 204:22
103:18 117:8	<b>profit</b> 139:5	55:8 57:2,14 66:7	<b>pursuit</b> 152:8	210:15,21
119:10 141:9	<b>profits</b> 152:10	78:19,19 81:18	<b>push</b> 5:18 13:14	<b>questions</b> 23:7
178:9,10 186:1,2	<b>program</b> 14:14	92:11 125:20	<b>pushed</b> 59:1	24:13 25:5 32:1
200:20	115:8 119:7 121:4	133:18 138:11,13	<b>pushing</b> 117:14	32:10 33:16 34:2
<b>problems</b> 32:2 45:8	158:20 202:20	160:10 186:7,10	211:14	39:14,21 40:2,10
54:11,19 60:4	212:4	217:14 219:4,20	<b>put</b> 26:3,12 48:12	55:3 70:18,18,22
65:3 73:4 79:8,18	<b>programming</b>	220:12	48:15,19,22 49:2	71:4 146:21 161:4
91:17 92:9 99:11	52:10	<b>protections</b> 48:14	49:10,12,20 53:10	196:15

<b>Questions/Discus...</b> 4:8,12,15,20 <b>quick</b> 5:13 23:10 37:22 46:14 144:15 209:19 212:8 214:5 <b>quickly</b> 49:11 56:9 57:16,18 81:4,8 81:16 172:4 174:11 194:14,16 203:19 <b>quit</b> 83:6 <b>quite</b> 18:13 34:14 36:17 45:5 84:8 120:10 135:8,9 177:11 181:9 185:21 221:14 <b>quo</b> 125:6,8 <b>quotes</b> 53:5 <b>Q&amp;As</b> 24:13	<b>rate</b> 10:12 11:2 19:16 27:11 29:13 29:19 33:9 88:5 115:20 126:10 218:11 <b>rates</b> 10:2 <b>ratio</b> 204:7 <b>raw</b> 161:14 <b>RBOB</b> 113:6 <b>reached</b> 55:17 137:19 219:16 <b>react</b> 212:13 <b>reaction</b> 62:2 <b>reactions</b> 67:20 <b>read</b> 48:18 82:20 220:2 <b>readily</b> 152:7 161:11 <b>reading</b> 37:8,10 205:3 <b>ready</b> 31:18 39:19 90:2 165:8 <b>real</b> 49:11 67:17 79:9,21 97:5 128:1 140:10 214:22 215:11 <b>reality</b> 214:19 <b>realize</b> 139:7 219:19 <b>realized</b> 107:20 <b>Realizing</b> 217:8 <b>really</b> 6:16,19 8:12 8:20 9:18 11:5 22:10 25:13 28:20 31:4,15 37:18 41:15 62:13 68:2 68:11 71:22 80:9 91:4 105:12,14 128:7,21 129:13 130:2,19 141:17 163:11 166:10 176:14 183:16 187:16 189:10 197:19 208:8 214:15 218:1,19 219:1 <b>realtime</b> 79:18	95:16 <b>rear</b> 60:7 <b>reason</b> 70:20 115:18 188:22 189:1,5 199:2 215:9 <b>reasonable</b> 156:5 <b>reasonably</b> 131:22 162:20 <b>reasons</b> 32:5 <b>rebound</b> 120:20 <b>receive</b> 64:7 <b>received</b> 24:17 50:7 50:12 51:2 52:18 85:17 149:22 152:10,13 161:4 200:9 207:1,14 <b>recess</b> 47:2 <b>recognize</b> 8:3 183:8 <b>recognized</b> 162:18 <b>recognizing</b> 215:21 <b>recommend</b> 48:18 58:21 <b>reconstructions</b> 152:4 <b>reconvene</b> 146:9 <b>record</b> 47:9 68:22 85:3 146:12,13 148:10 151:3,14 158:1 167:1 174:2 177:18 178:8 185:4 186:18 190:5,21 195:2,12 196:7,11 198:2,18 200:20 211:6 <b>recorded</b> 162:12 180:5 181:3 183:3 185:20 197:6 204:15 <b>recording</b> 4:17 32:6 146:16,16 153:6 154:21 162:15 167:6 168:21,22 176:21 177:13 178:21 180:16 182:3,12 183:16 189:8,8	191:9 198:1 201:14,15 202:2,5 202:10 208:1 213:2,5 219:4 <b>recordings</b> 162:10 179:21,21 186:20 <b>records</b> 76:8 148:11,17 150:22 152:6 153:22,22 154:2,3,9,15 161:12 174:4 189:9 190:9,13 192:9 193:9,12 194:6 195:10,20 <b>record-keeper</b> 161:11 <b>record-keeping</b> 18:1,3,18 22:15 22:17 148:1 149:14,15 150:13 152:18 155:7 156:4,19 158:5 175:17 186:19 194:2 <b>recover</b> 152:10 <b>red</b> 5:18 71:15 116:19 126:3,18 <b>redressing</b> 38:22 <b>reduce</b> 17:14 100:5 117:15 152:16 <b>reduced</b> 154:14 <b>reduction</b> 153:1 <b>reference</b> 159:8 206:15 <b>referenced</b> 185:6 <b>referred</b> 38:4,8 158:1 <b>referring</b> 159:13 206:22 <b>refiners</b> 112:21 113:3 117:9,14 119:11 123:9 134:1,15 <b>refining</b> 113:7 <b>reflect</b> 122:17 <b>reflecting</b> 129:15 <b>reflection</b> 34:3	<b>reform</b> 9:17 25:14 31:5 <b>refresh</b> 44:8 <b>refuse</b> 199:1 <b>reg</b> 193:4 <b>regard</b> 103:19 180:13 <b>regarding</b> 18:11 56:12 59:7,14,17 <b>regards</b> 38:17 90:13 <b>regime</b> 18:1 44:2,4 <b>register</b> 23:5 28:3 137:14 148:4 149:21 155:11 207:10 <b>registered</b> 19:2 24:11 150:21 153:17,17 164:10 165:2 175:14,14 179:4 <b>registering</b> 27:22 30:8 <b>registrant</b> 154:1 173:15,22 195:8 202:6,8 203:12 <b>registrants</b> 77:17 153:21 154:4 155:6,18 <b>registration</b> 23:9 30:11 <b>regression</b> 67:10 <b>regs</b> 193:2 <b>regular</b> 118:5 <b>regularly</b> 84:6 218:5 <b>regulate</b> 122:2 <b>regulated</b> 17:21 <b>regulates</b> 17:18 <b>regulating</b> 30:6 <b>regulation</b> 8:17 24:20 113:14 124:10 137:15 141:10 148:1 149:15,17 150:8 155:5,8 174:7 <b>regulations</b> 18:14
--	--	---	---	---

## R

**RADHAKRISH...**

3:12 94:20 95:17  
96:13,15 102:2  
103:4 107:13  
108:13  
**raise** 15:8 90:2  
**raised** 44:19 57:11  
87:22 91:22 92:14  
92:15 98:8 151:7  
**raises** 39:18 175:21  
**raising** 38:1 59:20  
**rancher** 166:4  
218:16  
**ranchers** 9:3,19  
28:21 213:21  
**Randall** 1:13,17  
**Randy** 5:7 6:13 7:1  
7:12 8:7 11:8  
217:21 220:20,21  
**range** 151:8 159:21  
164:17  
**rapidly** 180:9  
**rata** 98:10,19 100:1  
100:18,21 103:3,7  
103:19

18:20 54:10 84:4 86:3 94:16 120:11 121:18 124:15 125:7 136:13 137:8,12 145:4 148:5 180:20 <b>regulator</b> 77:14 <b>regulators</b> 20:12 26:2,7 56:1 57:9 158:8 <b>regulatory</b> 8:15 17:13 20:10 31:7 51:16 53:21 63:4 63:7 79:11 108:4 <b>reiterate</b> 46:4 <b>related</b> 145:16 152:21 172:11 <b>relates</b> 9:2 33:6 218:10 <b>relationship</b> 164:7 192:2 <b>relationships</b> 66:2 134:14 <b>relative</b> 41:19 124:12,16 <b>relatively</b> 90:18 182:13 <b>relax</b> 137:20 <b>release</b> 148:22 151:17 203:18 <b>released</b> 45:4 <b>relevant</b> 10:13 11:5 <b>reliance</b> 62:17 <b>relief</b> 20:4 23:15 24:1,5,6,15 160:11 177:13,17 178:16,21 <b>relies</b> 159:22 <b>rely</b> 141:15 <b>relying</b> 20:4 63:10 203:13 <b>remain</b> 25:6 119:20 <b>remaining</b> 12:10 157:4 <b>remarks</b> 4:2,22 157:12 <b>remember</b> 5:21	30:4 75:21 88:14 176:17 187:1,19 <b>remembered</b> 5:14 <b>reminder</b> 122:9 <b>remiss</b> 45:18 <b>removed</b> 154:5 <b>renegotiate</b> 120:6 <b>renewable</b> 47:16 112:1 114:6,16 120:2 121:1 122:13 <b>renewal</b> 43:10 <b>renewed</b> 43:7 <b>repeal</b> 120:2 <b>repeatedly</b> 203:8 <b>replace</b> 115:3 <b>replaced</b> 178:3 <b>report</b> 20:2 35:1 49:21 51:6 52:2 120:22 <b>reportable</b> 20:14 20:20 23:12 90:18 90:20 91:9 <b>reported</b> 26:19 35:13 197:3 <b>reporting</b> 10:17,19 18:1,3,8 19:6,11 19:13,15,19 20:4 20:9,10 21:7,11 21:16 22:15,16 24:4,14,15 25:7 52:5 63:4,5,7 159:18 <b>reports</b> 21:7 50:6,7 50:10 51:5 58:8 130:16 <b>repositories</b> 10:4 26:4,5 43:13 45:2 45:12 <b>repository</b> 10:8,19 18:9 27:18 <b>represent</b> 15:19 40:13 41:15 46:4 92:16 124:4 163:22 188:6 <b>representative</b> 198:21	<b>representatives</b> 158:4 <b>represented</b> 12:8 <b>representing</b> 14:10 14:19 15:2,6 16:7 <b>represents</b> 16:12 84:22 126:5 152:22 <b>Republicans</b> 120:5 <b>repurchase</b> 56:14 <b>request</b> 161:19 162:2 <b>requests</b> 151:10,12 151:13 155:22 162:6 <b>require</b> 61:14,15 69:8 81:21 95:1 114:13 148:6 <b>required</b> 34:14 35:1 56:15 115:3 115:22 149:9 153:17,21 166:18 171:12 175:14 188:8 191:6 192:8 192:18 194:6 195:20 202:8 210:18 <b>requirement</b> 60:11 83:9 95:5,6 100:8 100:10 101:5 109:12 116:11 150:13,16 151:3 152:6,19 153:2,10 154:6,12 156:5,19 171:6 173:20 174:3 175:17 176:21 180:8,16 195:11 <b>requirements</b> 57:4 57:19 59:17 96:3 97:21 115:16 125:7 146:17 148:1 149:14,16 150:15 155:4,8 166:16 179:19 191:14 <b>requires</b> 17:18,20	22:16 154:8 156:7 <b>requiring</b> 50:5 57:21 59:9 85:19 <b>research</b> 16:6 121:13,16 129:5 135:17 <b>reserve</b> 66:7 <b>residual</b> 12:14 66:8 84:18 85:15 <b>residuals</b> 67:5 <b>resolve</b> 79:21 98:18 <b>resources</b> 22:9 70:8 70:20 <b>respect</b> 9:16 13:5 18:7 19:1,6,16,19 19:20 22:15 108:21 138:17 142:7 154:20 160:4,18,20 161:3 161:7 173:6 <b>respectfully</b> 192:20 <b>respond</b> 204:22 <b>responding</b> 162:2,5 <b>response</b> 37:22 38:11 141:2 150:1 150:5 <b>responses</b> 42:18 71:5 <b>responsibilities</b> 69:21 78:16 203:22 <b>responsibility</b> 203:12 215:5 <b>responsive</b> 40:22 <b>rest</b> 32:5 47:4 58:4 74:17 110:8 167:15 168:12 <b>result</b> 91:15 99:6 107:19 <b>resulted</b> 91:15 <b>results</b> 85:8 <b>resumed</b> 47:10 <b>retail</b> 28:22 148:7 149:6 <b>retain</b> 148:10 153:21 193:12,20 195:20 196:11	216:17 <b>retained</b> 153:22 <b>retaining</b> 154:3 202:10 <b>retention</b> 151:14 154:14 192:8,17 <b>retrospective</b> 77:15 <b>return</b> 47:2 <b>revenue</b> 164:17 168:3 175:9 <b>reversed</b> 118:7 <b>review</b> 21:4 64:3,8 67:4 73:12 92:21 177:8 <b>reviewed</b> 50:8,13 <b>reviewing</b> 52:21 160:2 <b>reviews</b> 54:20 <b>revised</b> 94:4 <b>revisit</b> 197:20 <b>Reynolds</b> 2:6 15:17 15:17 <b>re-file</b> 39:5 <b>re-payment</b> 42:7 <b>RFEDs</b> 194:4 <b>rice</b> 2:4 13:19,21 <b>right</b> 7:5,5,15 22:21 43:19,20 52:8,9 66:1,2 72:6 74:3 81:9,13 83:2 88:4,7,11 93:13 94:13 95:4,16,17 95:22 96:13,19 97:14 98:3 105:18 106:20 109:6 110:3 137:20 140:1 141:6 142:15 169:16 170:10 172:1 173:20 175:20 191:2 193:19 197:16 212:14 218:21 <b>RIN</b> 115:10,11 118:13 119:10 122:12 123:22 128:5 132:21
--	--	---	--	--

136:4,15 138:22 139:5,8,18 140:12 142:8 143:10,13 143:22 144:2,14 219:6 <b>RINs</b> 47:16,16 112:2,4,10 114:22 115:3,9,17 117:2 117:12 118:10,13 123:8 124:3,18,19 124:19 125:1,2 126:15 127:8,14 129:4,10 131:9,11 131:14,18 133:6 134:3,8,9 135:20 136:2,7,10,22 137:4,9 139:16,21 140:5 142:16 143:20 145:8 <b>rise</b> 128:17 <b>risen</b> 117:2,6 <b>risk</b> 3:13,16 11:6 13:16 14:5,13 17:14 28:10,10,12 29:9,11 30:6,17 35:6,19 58:4 60:14 61:14 63:6 72:15,18 73:8,10 73:12,13,14 74:4 74:5,7,12 82:18 83:12,14 86:2 89:21 94:10 104:8 104:12,13,22 105:6 106:14,21 107:3,4,5 110:11 134:4 135:1 165:10 166:11 167:10 183:18 213:6,18 214:1 215:13 216:6 218:15 <b>riskier</b> 92:11,12 <b>risks</b> 59:7 85:11 <b>risk-based</b> 64:3 74:18 <b>risk-benefit</b> 204:10 <b>road</b> 25:19 27:15	181:8,19 182:7,18 201:7 211:20 212:9 <b>ROBERT</b> 2:12 3:14 <b>robust</b> 29:11 <b>role</b> 65:11 <b>romanettes</b> 174:9 <b>room</b> 61:1 163:16 184:1 214:19,22 <b>rough</b> 10:7 <b>roughly</b> 86:14 116:10 137:13 <b>round</b> 19:13 <b>roundtables</b> 55:19 <b>routed</b> 182:22 <b>routine</b> 69:16 <b>rule</b> 22:7 25:22 38:3 50:14 55:8 56:6,12,21 57:12 57:14,16 58:11,16 59:16 60:21 61:7 68:17 75:1 86:16 87:15 98:10 99:22 100:17,17,20 103:9 105:14 134:7 148:5,13,22 149:13,21 150:3 150:11,18 151:17 154:8,20 155:11 156:7,22 157:19 158:10,21,22 160:3,13,22 161:5 161:9 163:3 166:14 167:22 168:22 172:6 173:2,3 174:12 177:7 184:17 191:19 192:6 193:7 203:18 204:21 206:8 208:1,2 209:6,9 209:16 <b>rulemaking</b> 12:15 24:22 44:16 49:14 61:12 98:11 155:1 <b>rulemakings</b> 13:5	219:13 <b>rules</b> 9:7,13 12:10 19:5 24:10 25:7 25:16,18 27:14 29:11,11,12 30:12 30:13,16 31:17 34:4 37:15 49:12 57:18 61:3 70:13 72:5,7 78:20 81:18 84:4 90:9 93:3,9,16 94:5 99:9,10,12,13,15 103:8 113:15 120:8,15 138:14 149:10 151:17 180:12 207:10 <b>ruling</b> 103:18 <b>run</b> 162:3 167:12 217:22 <b>running</b> 36:20 52:13 161:13 170:18 <b>rural</b> 15:18 <hr/> <b>S</b> <hr/> <b>s</b> 87:21 88:3,12 89:5 <b>Sachs</b> 44:5 197:5 197:14 198:7 204:14 <b>safe</b> 162:17 221:20 <b>sale</b> 153:13 190:16 <b>sales</b> 30:13 118:19 118:20 119:6 159:17 190:11 <b>salient</b> 179:10 <b>Sam</b> 115:6 <b>sand</b> 105:14 <b>Sandy</b> 64:13 67:3 <b>satisfy</b> 91:1 145:5 210:19 <b>saw</b> 55:14,15 77:21 120:1 131:19 132:3,19 133:21 <b>saying</b> 32:21 41:12 85:4 95:8,10,16 107:2,3 108:14	109:5 128:7 133:14 170:2 186:17 190:9 192:5 193:4,21 <b>says</b> 72:11 88:18 108:22 115:5 125:20 126:7,14 135:3 196:2,4 213:3 <b>scale</b> 26:7 169:7 170:19 183:17 204:17 211:5 214:21 215:4,5 <b>scenarios</b> 24:4 <b>schedule</b> 155:22 185:5 221:5,6 <b>schedules</b> 82:2 155:17 <b>School</b> 5:8 <b>scope</b> 26:8 65:9,11 160:12 <b>Scott</b> 1:19 2:21 3:8 4:14,19 15:2 94:13,20 96:21 101:6,9,13 110:15 112:13 121:8 125:15 135:19 140:16 147:3 168:16,17 170:14 172:2 175:21 176:19 185:11,14 199:11 210:14 214:10 <b>Scott's</b> 96:8 101:14 183:7 187:12 198:11 <b>scratch</b> 202:19 <b>screen</b> 23:22 46:21 163:21 165:15 <b>SDR</b> 20:11,16,16 20:19 30:2 <b>SDRs</b> 19:2 24:11 <b>SDR's</b> 20:22 <b>search</b> 161:14 <b>searchability</b> 161:3 161:8 162:7 178:6 <b>searchable</b> 148:17	154:10 167:1,13 <b>seat</b> 179:14 <b>SEC</b> 67:4 74:17 77:13 158:8 <b>second</b> 18:15 26:14 28:9 62:6 63:22 112:18 113:11 115:14,15 123:22 139:1 145:10 150:17 153:4 172:3 173:21 174:10 <b>secondly</b> 38:17,20 138:19 <b>secret</b> 146:2 <b>section</b> 68:21 <b>sector</b> 12:2 <b>secure</b> 86:12 87:8 87:14,17 96:5 97:1 105:21 106:9 108:18 <b>secured</b> 58:9 82:3 <b>securities</b> 52:1 <b>security</b> 36:7 114:3 203:21 <b>see</b> 7:22 8:4,8 10:5 20:17 21:5 22:8 26:7,16,21 31:16 46:19 47:5 60:4 65:2 66:16 67:12 70:4 75:11,12 77:12 83:10,18,19 85:7,18 87:20 94:6 103:14 113:4 116:19 118:2,5 119:10,19 122:7 124:13 125:11 127:21 128:3,8 130:7,8,9,21,22 131:16 132:10,16 141:1,1,14,19 145:6 159:7,21 163:5,20 164:17 166:7 167:16,17 186:8 189:21 197:4 204:10,13 204:13,17,18
--	--	---	---	--

206:14 212:2,7 216:7 218:20 <b>seeing</b> 32:16 82:22 93:17 101:2 116:9 118:20,21 119:5 120:1 131:6,7 138:19 143:18 204:5 206:16 <b>seek</b> 185:5 <b>seeking</b> 34:5 152:9 <b>seemingly</b> 182:9 <b>seen</b> 31:5 36:2 40:15 42:2 45:10 87:22 118:18 120:7 123:15 131:11,13 134:12 139:3,10 182:1 205:19 <b>SEF</b> 153:9,12,15 195:16 <b>SEFs</b> 150:19 175:13 <b>seg</b> 58:9 73:6,8,16 73:18,22,22 82:5 82:5 96:20 <b>segregated</b> 50:16 50:17 60:18 90:11 91:13 104:9 110:6 <b>segregation</b> 48:20 49:22 81:5 82:3 102:12 103:6 159:15 <b>seg's</b> 79:6 <b>self-police</b> 72:16 <b>self-regulatory</b> 9:10 49:3 50:1 75:9 <b>sell</b> 118:14,15 126:9 165:9 170:20 <b>selling</b> 118:2 136:16 189:15,17 <b>semi</b> 50:9 <b>send</b> 27:17 73:2 77:19 83:4 84:9 84:12 105:4 131:4 174:13,15 199:6	<b>sending</b> 56:18 <b>sends</b> 161:19 196:8 <b>senior</b> 50:22 76:11 <b>sense</b> 10:7 42:22 140:6,7 168:19 169:14 214:15 220:22 <b>sent</b> 20:16,19 <b>Senter</b> 2:8 16:16,16 <b>separate</b> 113:17 154:7 <b>separately</b> 151:4 <b>separation</b> 72:16 <b>September</b> 29:16 30:3,4 52:14 <b>serious</b> 46:6 <b>seriously</b> 151:21 <b>serve</b> 216:13 <b>service</b> 75:21 111:16 169:8 <b>services</b> 164:14 214:2 <b>serving</b> 5:9 7:6 <b>session</b> 47:15 <b>set</b> 21:8 22:7 37:15 39:8 55:8 56:6 57:12,14,16 58:16 59:16 60:21 75:1 80:18 125:19 128:16,16 129:20 149:17 181:20 182:15 184:9 200:5 <b>sets</b> 21:20 25:22 161:9 <b>setting</b> 218:4 221:12 <b>settlement</b> 104:19 <b>setup</b> 101:18 200:13 <b>seven</b> 156:22 <b>seventh</b> 37:15 60:10 <b>seven-part</b> 38:7 <b>shaken</b> 70:5 <b>shape</b> 36:7 <b>share</b> 31:19 39:2	107:6 129:7 206:4 206:6 216:16 217:5 <b>shares</b> 125:9 <b>sharp</b> 217:22 <b>sheet</b> 82:6 141:18 199:6 <b>sheets</b> 24:14 131:4 <b>She'll</b> 48:2 <b>shift</b> 6:22 <b>Shippers</b> 2:2 16:11 <b>shoes</b> 8:6,7 <b>shore</b> 66:4 <b>short</b> 47:15 76:12 93:13 104:11 116:22 189:22 <b>shortage</b> 53:15 <b>shorter</b> 99:4 151:14 <b>shortfall</b> 102:12 103:5 116:10 <b>shortly</b> 27:4,8 <b>show</b> 9:1 54:5 71:13 87:20 102:14 116:6 119:3,8 123:10,18 137:2 <b>showing</b> 156:10 <b>shown</b> 37:19 <b>shows</b> 115:15 136:6 197:7 <b>shut</b> 89:1 <b>side</b> 55:21 135:17 187:10 <b>sides</b> 40:13 41:16 45:13 90:17 104:22 194:1 195:11 <b>sign</b> 43:5 199:6 <b>signal</b> 6:6 208:22 <b>signature</b> 76:11,11 188:8 <b>significant</b> 54:19 104:22 114:20 119:19,21 149:1,6 150:5 151:10 152:17	<b>significantly</b> 11:1 151:18 154:14,17 <b>similar</b> 27:1 85:3 85:13 86:4 155:12 167:19 168:1 185:10 186:22 194:17 <b>Similarly</b> 136:21 <b>simple</b> 126:18 143:9 171:1 212:6 <b>simply</b> 104:10 <b>single</b> 50:8 52:3 184:14 <b>sir</b> 34:19 42:19 179:3 <b>sitting</b> 185:13 198:9 212:17 <b>situation</b> 22:3 53:14 78:4 86:4 96:17 105:10 137:17,21 181:18 183:19 <b>situations</b> 49:18 80:2 167:19 <b>six</b> 115:9 <b>size</b> 10:7,17 11:1 169:7 176:17 183:17 187:18 211:5 218:13 <b>sizes</b> 46:4 <b>skepticism</b> 33:20 <b>slice</b> 130:22 <b>slide</b> 127:4 <b>slides</b> 46:19 <b>slightly</b> 132:9 <b>slow</b> 131:10 <b>small</b> 6:22 10:11 15:18 35:11 36:5 39:19 82:12 83:8 88:18,21 90:15,19 126:15 135:9,9 153:7,10 160:5 175:7 204:12,16 <b>smaller</b> 132:7,9 133:22 134:1 151:12 168:2 171:8	<b>smallest</b> 40:17 <b>software</b> 29:1 162:4 205:14 <b>sold</b> 141:13 178:1 <b>solely</b> 174:22 <b>solicited</b> 149:22 <b>solution</b> 205:8 <b>solutions</b> 167:20 168:9 182:10 <b>solve</b> 91:19 103:18 105:13 186:2 <b>solved</b> 91:20 <b>solving</b> 209:10 <b>somebody</b> 5:20 87:8 100:15,16 109:12,21 118:16 143:9,17 178:4 185:18 187:9,20 198:8 208:14 <b>somebody's</b> 100:2 104:7 106:14 207:20 <b>someplace</b> 180:5 <b>soon</b> 12:16,22 28:1 34:7 39:1 185:7 <b>sooner</b> 71:16 221:3 <b>sophisticated</b> 84:14 <b>sore</b> 92:1 <b>sorry</b> 88:13 101:10 106:16 125:16 132:2 147:8 214:11 220:19 <b>sort</b> 17:8 43:20 60:6 67:14 76:18 88:19 129:16 158:12 165:21 187:11 <b>sorts</b> 41:14 75:1 <b>sought</b> 38:6 149:12 <b>sound</b> 121:4 211:13 <b>sounded</b> 88:20 <b>sounds</b> 106:6 131:22 199:22 <b>sources</b> 65:17 <b>southeast</b> 16:3 <b>southern</b> 16:8 <b>soy</b> 138:18 143:10
---	---	---	--	---

<b>soybean</b> 2:11 13:19 16:2 143:3,5,6	129:13	<b>starting</b> 27:4 34:1 132:20 206:13	208:6 216:5	120:14 122:17
<b>soybeans</b> 15:8 16:3 16:8 135:14	<b>spring</b> 132:3 149:19	<b>starts</b> 208:6 211:17	<b>structures</b> 128:17	<b>sure</b> 9:18 12:18
<b>soybean-based</b> 124:6	<b>squeeze</b> 126:20 127:1	<b>State</b> 5:9	<b>struggle</b> 80:1	18:13 30:16 32:3
<b>so-called</b> 56:20 154:11	<b>SRO</b> 59:18 78:2,15	<b>statement</b> 59:20	<b>struggled</b> 79:2	36:17 37:3 43:18
<b>space</b> 13:4 38:13,14 122:1	<b>SROs</b> 55:20 57:4,9 61:18	<b>statements</b> 65:5 82:7	<b>struggling</b> 189:10	44:18,20,22 45:13
<b>span</b> 123:12	<b>St</b> 14:4	<b>states</b> 36:8 189:16	<b>stuck</b> 80:3	48:9 52:6 54:8,17
<b>speak</b> 5:17,21 32:4 39:16 41:18 48:2	<b>staff</b> 3:1 39:12,18 40:7,21 41:18	<b>stations</b> 139:12	<b>study</b> 52:17 71:12	62:5 64:20 66:13
72:3 96:18 107:14 112:14 163:2	<b>stand</b> 8:6 31:18 211:3	<b>status</b> 16:22 19:8 125:6,8	<b>stuff</b> 163:13 190:19 197:2	70:1 74:13,16
<b>speaker</b> 146:22	57:3 58:21 61:6	<b>statute</b> 103:11 108:16	<b>subject</b> 30:12,15 47:6 58:4 90:8	90:12 91:17 92:8
<b>speakers</b> 145:22	64:17 68:5,9	<b>stay</b> 74:20 83:7 85:13	117:13 154:22 191:13	93:10 96:4 98:7
<b>speaking</b> 5:19 6:3 32:4 86:14 187:7	69:19,22 70:1,21 92:19 94:2 95:19	<b>stemmed</b> 57:7	<b>submission</b> 42:7	99:14,15,20 100:9
<b>special</b> 36:12	96:18 101:3	<b>step</b> 128:20	<b>submitted</b> 112:16 206:11	103:10 108:5,9
<b>specific</b> 59:10 76:5 79:16 99:19	107:14,14 146:3	<b>STEPHEN</b> 2:9	<b>subpoena</b> 161:19	111:14 183:3
102:10 113:22	176:12 183:14	<b>Steve</b> 2:11 14:2 16:1	<b>substantive</b> 69:16	185:19,22 190:11
114:14,14 168:4 210:10	218:3 219:9 220:8	<b>stock</b> 113:7	<b>substitute</b> 124:21	194:8 199:16
<b>specifically</b> 6:12 47:16 65:7 78:16	<b>staffing</b> 65:10	<b>stool</b> 62:10 64:16	<b>substitution</b> 124:22 141:3,5 143:2	210:4 221:14
155:19 174:2	<b>staff's</b> 41:10	<b>stop</b> 80:6 187:20	<b>success</b> 182:5	<b>surplus</b> 87:21
<b>specifics</b> 33:5 159:4	<b>stand</b> 8:6 31:18 211:3	<b>stopgap</b> 182:14	<b>sudden</b> 126:19	<b>surprise</b> 54:3,14 120:9
<b>speculative</b> 159:16	<b>standard</b> 107:12 136:5 137:21	<b>stops</b> 106:15	<b>suddenly</b> 139:20	<b>swap</b> 3:3,5,9 11:2
<b>speculator</b> 186:8	221:9	<b>store</b> 180:14	<b>suffering</b> 215:16	17:18,21 18:8,8
<b>speech</b> 162:10	<b>standardized</b> 17:19 17:20	<b>stored</b> 180:17	<b>sufficient</b> 34:8 57:21 70:8 72:14	19:10,17 20:13,14
<b>speed</b> 34:14 72:11	<b>standards</b> 59:18,21 221:12	<b>story</b> 125:6 134:10 140:4	72:15 73:11 104:2	21:9,9,10,13,18
<b>spelled</b> 174:6	<b>standing</b> 8:7	<b>strangers</b> 218:7	104:8 156:10	22:19 23:11,18
<b>spend</b> 62:6 117:11 216:1	<b>standpoint</b> 67:13 143:20 158:18	<b>stream</b> 164:17 168:3	<b>sufficiently</b> 72:1	27:9,20,21,21
<b>spending</b> 11:22 12:1	198:20 200:13	<b>Street</b> 1:13 141:18	<b>suggest</b> 42:21 49:6 131:8 145:20	28:6,15 29:19,20
<b>spends</b> 111:16	<b>stands</b> 7:4 39:19	<b>stress</b> 79:8 156:21 207:4	217:4,13,14 220:21	31:3 32:19 35:3
<b>spiked</b> 123:10	<b>Stanley</b> 44:5	<b>stretched</b> 199:14	<b>suggesting</b> 33:20 108:22	38:2 45:1,11 48:3
<b>Sponsor</b> 2:19	<b>start</b> 5:12 6:5,7 13:11,13 16:21	<b>strict</b> 184:13	<b>suggestions</b> 49:12	48:5 147:1,17
<b>sponsoring</b> 6:21 219:17	21:8 27:22 71:4	<b>strictly</b> 175:16	<b>summarize</b> 112:18	148:9 149:16,16
<b>spot</b> 143:5 209:21	79:19 94:13	<b>strike</b> 160:15	<b>summary</b> 61:2 82:6	155:2,3,13,13,15
<b>spread</b> 131:20	139:20 147:5	<b>strikes</b> 103:16	<b>supervise</b> 159:16	156:17,18 182:2,3
<b>spreads</b> 132:3,9,11	162:4 205:2	<b>strings</b> 129:14	<b>supply</b> 122:16 127:14	183:6,11 186:21
<b>spreadsheet-based</b>	209:22	<b>strong</b> 2:9 14:2,2 85:18 176:19 199:11	<b>support</b> 24:12 58:18 73:20 81:20 89:15	218:11
	<b>started</b> 6:1,9 30:8 43:2 51:13 75:20	<b>structure</b> 27:6 122:20 181:21	<b>supposed</b> 54:4,17	<b>swaps</b> 9:16 10:8,12 10:14,15,21 11:4 17:13,22 25:20 27:11,12,12,14 29:13,14 35:9,17 36:4 37:9 40:17 43:2 44:14 46:8 50:19 55:11 56:21 82:4,4
	125:4 127:22			<b>sweep</b> 65:13 84:6
	128:8 218:18			<b>system</b> 17:16 26:17 29:9 60:3 67:10 73:16,22 74:2

75:9 76:19 104:17 129:21 130:3,5,6 130:15 153:6 191:11 202:20 206:18 215:12 216:17 <b>systemic</b> 218:13 <b>systems</b> 73:18 200:13	183:20 184:17 217:16,17 <b>talking</b> 35:11 62:7 72:4,6 79:5 84:19 90:4,5 93:4,5 94:19 103:20,21 104:6 108:7,8 124:1 173:19 178:4 181:17 182:6 195:4,14,21 197:2,8 204:12 209:22 213:4 <b>talks</b> 171:19 193:8 <b>tangled</b> 191:12 <b>tape</b> 27:2 166:18 168:20 171:21 <b>taped</b> 159:10 160:1 <b>tapes</b> 158:18 <b>taping</b> 157:19 158:10,17,22 160:20 166:16 206:18 <b>target</b> 142:16 <b>targeted</b> 65:7 67:5 <b>Task</b> 158:2 <b>team</b> 39:12,12 51:8 68:11 <b>technical</b> 78:22 <b>technically</b> 166:16 167:4 <b>technological</b> 149:4 200:10 <b>technologically</b> 156:2,13 <b>technologist</b> 43:14 <b>technology</b> 75:11 125:14 127:7 178:5 180:3 182:11,12 185:3 187:4 200:1,3,7 200:20 201:12 203:6 206:5,7 208:17 210:17 212:2 214:7 <b>telephone</b> 43:20 181:6 <b>telephones</b> 162:12	<b>tell</b> 67:18 76:21 104:20 160:19 181:2 196:21 208:19 218:22 <b>tend</b> 113:19,19 142:4 183:21 <b>tended</b> 118:8 132:4 <b>tension</b> 79:9 <b>term</b> 7:13 44:3 68:4 182:13 <b>terms</b> 6:2 31:9 41:12,13 80:19 122:2,15 129:18 131:15 135:16 137:13 156:17 200:18 205:22 207:4 210:3,12,15 <b>test</b> 38:4,7 <b>testifying</b> 12:5 <b>testimony</b> 92:22 <b>testing</b> 157:10 <b>text</b> 178:2 180:2 190:22 191:9 193:18 196:3,8,11 208:3 209:1,2 213:13 <b>texting</b> 178:13 208:20 <b>texts</b> 179:15 180:4 196:1 199:1 <b>thank</b> 5:3 6:10,11 6:13 7:17 8:3 12:7 13:1,2,6 16:18 18:4 25:9 39:10 46:16 47:7 47:11 55:4,5 67:16 76:14 80:13 110:14 111:5,6,19 121:6,7,9 135:18 146:9 147:19 157:17 162:22 163:1 179:8 196:13 198:19 204:3 214:10 217:19,20,21 219:7,8,10,13 220:4 221:19	<b>thankful</b> 161:1 <b>thanks</b> 11:15,16,16 31:20 62:5 168:15 170:11 196:12 200:16 214:15 219:14,16 220:6 <b>theirs</b> 139:17 <b>they'd</b> 44:6 46:15 <b>thing</b> 30:1 32:15 35:4 36:9 43:3 44:17 46:18 47:18 48:17 49:20 51:18 53:20 54:1 73:9 79:5 81:18 83:19 104:5 110:19 123:6 165:21 167:1,14 168:2 171:3 197:20 211:9 <b>things</b> 11:10 30:20 32:14,16 33:21 34:9,12,17 35:2 42:1 61:11 62:2 72:17,18,21 75:1 77:5 78:18 80:7,9 81:3 82:20,21 85:9 97:12 108:3 113:2 129:1,14 136:14 137:7 144:12 167:17,19 174:4 178:17 179:12,16,20,22 180:13,17 200:8 210:7 214:21 215:22 218:21 <b>think</b> 6:1 7:20 10:16 11:3,12 12:3,16 13:7 26:12 27:10 28:1 29:22 31:14 34:10 34:11,16 35:16 38:11,22 39:17 40:15 41:1 42:21 43:14 44:6 45:9 48:16,21 49:15 59:6,13 61:9,13 65:18 68:18 69:10	70:10 72:3 75:15 75:18 76:11,13 77:9 78:10,15 80:19 81:15,19,22 82:7 83:3,20 84:2 89:7 90:12 91:8 91:21 92:13,15 93:2,5 96:18 97:3 102:18 104:15 105:12,15,20 106:13 107:4,13 110:19 119:8 120:3 122:12 124:17 128:21 130:1 132:14 135:22 137:15 138:21 139:1,18 139:21 140:10 143:20 146:2 147:4 160:14,21 161:10 163:15 169:16,18 171:19 171:20,22 176:3,4 178:19 179:9 180:7,18 184:21 187:1 191:16,17 192:20 193:16 194:13,16 197:14 197:16 200:17 201:3,4 207:21 211:4 212:13,14 214:13,18,21 215:6,16,20 216:13 217:3,6,15 217:18 218:2 220:16 221:16 <b>thinking</b> 135:16 181:7 194:9 <b>third</b> 27:3 64:16 66:12 113:21 151:2 154:5 201:16,22 202:9 203:13 <b>thirteen</b> 132:1 <b>thou</b> 86:11 105:21 106:9 <b>thought</b> 42:13 62:6
<b>T</b>				
<b>table</b> 12:4 31:2 33:11 46:16 115:15 151:11 <b>tabs</b> 25:2 <b>TAC</b> 221:8 <b>tag</b> 167:14 <b>tagging</b> 151:5 154:11 <b>take</b> 6:13 7:2 8:2 17:8 25:11 39:9 46:14 47:1 53:3 60:22 77:15 78:3 85:9 88:5 94:10 96:9 121:5 147:19 165:13 175:22 176:21 179:18 181:10 189:3,12 190:1 205:1 209:10 211:15 219:3 <b>taken</b> 180:18 <b>takes</b> 85:12 99:1 105:14 109:10 119:18 146:2 166:9 184:12 <b>talk</b> 18:2 47:19 55:6 56:6 61:10 82:19 112:1,7,9 130:11,18 146:15 163:3,11,18 165:7 170:14 171:18 200:14 201:6 211:11,12 220:1 <b>talked</b> 20:8 73:18 110:18 129:7,9 158:5 159:2 160:9				

158:5,6 160:7 214:14 <b>thoughtful</b> 121:17 <b>thoughts</b> 39:3 140:8 142:11 <b>thousand</b> 132:1 <b>three</b> 1:12 17:2 19:21 25:13 26:4 32:12 55:18 62:10 66:5 131:21 132:4 140:13 143:6 146:18 151:9,13 168:20 211:9 <b>threshold</b> 173:16 210:22 211:2 <b>throw</b> 31:22 103:13 146:20 <b>Thursday</b> 1:8 87:5 <b>tick</b> 56:9 57:15 58:12 <b>ticker</b> 27:2 <b>tie</b> 54:14 <b>tie-breaker</b> 21:19 22:3 <b>tighter</b> 83:5 90:20 <b>till</b> 72:5 <b>time</b> 5:11,12 8:15 8:19 9:5,14 12:1 20:1,2,6 26:20 31:16 34:1,16 35:15 38:12,22 39:19 41:10 42:16 43:9,15,18 44:7 44:14 46:13,17,22 53:3 66:17 68:9 68:11 80:2 83:6 86:9,19 95:21 96:1,3,20 99:4 104:12,19 110:10 151:11 154:18 155:2 156:5,21 157:9 158:3 171:6 177:16 187:5 188:13 189:18 193:2 202:12 210:21 215:15 217:15 220:5,17	221:5,16,20 <b>timely</b> 31:10 53:13 120:8,12 152:7 199:8 <b>times</b> 58:22 59:4 96:22 98:4 137:13 165:1,5 166:3 181:7,8 <b>time-delayed</b> 26:18 <b>timing</b> 74:1 85:11 120:21 <b>titles</b> 128:4 <b>today</b> 5:17 6:1,12 7:19 8:4,19 11:17 14:11 16:20 25:3 46:19 93:17 94:16 94:17 95:13 111:16 112:7 113:2 114:5 115:10 121:22 151:8 157:13 166:14,19 177:7 177:21 205:17 211:6 212:18 <b>today's</b> 120:19 <b>told</b> 43:15 78:5 120:5 134:11 202:15 203:8 <b>Tom</b> 117:5 <b>tomorrow</b> 105:5 <b>tone</b> 26:3 <b>tool</b> 79:11 118:12 <b>tools</b> 35:6,15,20 148:18 <b>top</b> 51:11 66:11 83:7,10,22 85:16 132:21 169:16 <b>topic</b> 5:11 13:13 71:8 103:13 109:14 <b>topics</b> 47:12 157:19 219:6 220:11,15 <b>top-down</b> 122:15 128:15 <b>torches</b> 217:2 <b>total</b> 57:22 116:20 164:20 175:10	<b>totality</b> 71:8 <b>totally</b> 87:12 104:5 209:8 <b>touch</b> 157:18 188:9 217:5 221:15 <b>touched</b> 25:4 <b>tough</b> 80:9 <b>toy</b> 122:7 <b>track</b> 194:17 196:20 <b>tracked</b> 144:10 <b>tracking</b> 212:1 <b>tracks</b> 114:18 <b>traction</b> 134:22 135:8 <b>tractor</b> 91:6 179:14 212:17 <b>tradable</b> 114:16 123:9 <b>trade</b> 19:3 41:6 45:4 82:13 112:4 119:14 120:18 122:19 129:1 130:12 131:11,14 165:16 183:22 186:9 207:18 212:1 213:4,7 <b>traded</b> 17:21 114:19 <b>traders</b> 153:15 175:12 <b>trades</b> 30:18,19 115:12 133:5 164:19 165:13 185:9 210:20 211:22 <b>trading</b> 1:1 5:6 27:13 50:18,18,18 59:8 79:15 90:21 131:19 134:20 137:22 149:8 161:20 184:4 189:3 <b>traditional</b> 114:12 123:2 129:2,22 132:16 <b>traditionally</b>	172:14 <b>trail</b> 197:7 212:19 213:10,16 <b>transact</b> 27:16,20 <b>transacted</b> 184:2 <b>transacting</b> 175:4 <b>transaction</b> 20:14 21:10 22:5 45:14 111:2 129:21 152:20 154:6,10 161:13 172:12 175:1 176:20 177:6 181:15 185:19 188:5 194:7 197:6 212:19 <b>transactional</b> 104:12,16 106:3,7 <b>transactions</b> 18:11 19:17 22:3 26:17 130:4,8,14 151:1 152:22 153:3 158:15 160:20 168:8 171:19 172:8,10 173:4,13 173:19 175:3 179:12 180:2 186:18 190:6,7 194:11 198:5 204:16 212:11 <b>transaction-by-tr...</b> 20:18 <b>transcript</b> 68:20,21 <b>transcription</b> 129:17 <b>transfer</b> 78:7 91:7 <b>transfers</b> 110:21,21 143:22 <b>transformation</b> 149:1 <b>transition</b> 71:19 <b>transparency</b> 17:15 18:6 25:21 25:22 26:1,14,15 27:3 28:6 49:17 130:12 <b>transparent</b> 141:22	<b>transportation</b> 146:5 <b>travel</b> 220:5 <b>traveling</b> 181:9 <b>travels</b> 221:20 <b>treat</b> 197:13,14 <b>treatment</b> 151:12 155:12 <b>tremendous</b> 149:5 <b>trend</b> 67:11 116:6 116:19 <b>trended</b> 123:17 <b>trends</b> 73:4 <b>trials</b> 133:16 <b>tried</b> 74:22 140:10 160:15 176:1 <b>trigger</b> 173:20 <b>trillion</b> 10:16,22 11:5 <b>tripled</b> 118:20 <b>tripped</b> 193:15,17 <b>tripping</b> 48:4 <b>trivial</b> 117:13 <b>true</b> 108:2 186:14 <b>trued</b> 89:14 <b>true-up</b> 99:22 <b>truly</b> 29:6 218:13 <b>trust</b> 84:10 215:18 216:17 <b>trusted</b> 166:5 <b>try</b> 5:10,21 6:2 35:21 60:4 62:1 74:11 99:13 102:21 136:14 187:20 190:22 213:16 221:8 <b>trying</b> 5:12 23:20 33:21 34:15 35:7 60:8 63:19 68:3 68:12 73:16 75:21 88:8 92:2 97:4 101:18 103:17 105:12,18 138:10 143:11 178:6 186:1,3 191:16 197:9,16 203:17 213:8,9 217:9
---	---	---	--	---

218:20  
**Tuesday** 87:4  
 101:14  
**tune** 144:13  
**turn** 5:15,17,20,21  
 5:22 11:8 59:5  
 62:1 67:17,21  
**turned** 80:4  
**tweaks** 31:12  
**two** 17:1 21:18,18  
 21:18 32:5 34:9  
 47:12 49:8 55:2  
 64:2 66:9 71:18  
 85:9 90:22 98:21  
 101:20 105:20  
 107:19 112:6  
 132:1,11 136:8  
 140:13 151:11  
 166:20 169:18,18  
 171:2 172:2  
 173:11,17 183:21  
 187:12 211:9  
 215:17  
**twofold** 62:14  
**two-tenths** 131:20  
**type** 36:6 65:14  
 124:6,7 130:3  
 167:1 168:2,8  
 179:18 181:18  
**types** 115:9 124:5  
 125:9 142:21  
 159:12 173:19  
 179:16 180:17  
**typical** 205:5  
**typically** 132:14

---

**U**


---

**UL** 113:16  
**ultimate** 203:11  
**ultimately** 142:19  
 190:7 208:9  
 213:18  
**unable** 178:17  
**uncertain** 141:16  
**uncertainty** 120:17  
 141:10  
**uncommitted** 66:3

**underfunded** 69:20  
**undergone** 149:1  
**underlying** 192:13  
**understand** 12:12  
 12:19 23:16 33:21  
 80:17,21 86:11  
 90:13 92:5 101:18  
 122:14 129:8  
 130:3 133:19  
 134:7 139:8  
 143:12 183:6  
 198:4 213:11  
**understanding**  
 33:2 34:15 37:14  
 132:18 145:3  
 152:4 201:11  
**understatement**  
 77:10  
**understood** 84:17  
 125:5 128:15  
 205:5,13  
**undertake** 71:1  
**underway** 157:2  
**under-funded**  
 104:11  
**under-margined**  
 103:22 104:1,14  
**unduly** 209:16  
**unexpected** 217:4  
**unfortunate** 84:5  
 107:20 110:9  
**Unfortunately**  
 177:14  
**unhappy** 48:10  
**unilaterally** 138:14  
**unintended** 209:8  
**Union** 1:25 14:22  
**unique** 22:18  
**uniquely** 69:10  
 70:11  
**United** 36:8 186:15  
**University** 5:9  
**unusual** 152:5  
 216:15  
**update** 9:17  
**updated** 81:14  
**upset** 97:12,12

**upstairs** 122:6  
**upstream** 98:1  
**urge** 38:19  
**urged** 85:12  
**USA** 2:4 13:21 85:2  
**USDA-Risk** 1:25  
**use** 9:20 29:3,8  
 33:11 35:15 43:2  
 44:2 51:16 52:4  
 54:15 56:13 63:20  
 68:4 71:12,22  
 72:9 75:20 82:18  
 83:18 84:13 86:12  
 91:1 95:9 101:1  
 105:21 106:9  
 108:16 114:9  
 126:11,22 127:9  
 137:11 139:12,15  
 139:22 144:2  
 162:8 165:10  
 184:18 185:1,3  
 186:17 207:17  
 212:17 213:17  
 216:18,19  
**useful** 12:9 81:12  
**user** 23:16 30:2  
 32:22 41:7 110:3  
 153:8  
**users** 23:20 29:18  
 122:9 150:20  
 205:18 216:14  
**uses** 15:7 82:13  
 96:17 109:21  
 144:1 160:1  
**utilities** 36:15  
**utility** 23:3 38:13  
 40:2  
**utilized** 210:17  
**U.S** 1:1 16:12 22:1  
 30:7 50:18 199:15

---

**V**


---

**vague** 36:17 37:11  
**Valero** 115:5 117:8  
**validate** 134:8  
**validation** 134:9  
**valuable** 127:17

131:18 145:12  
 169:8  
**valuation** 142:18  
 142:18  
**valuations** 144:17  
**value** 126:15 128:7  
 136:17 142:16,17  
 144:14,18 145:6,9  
 145:9 166:1 210:1  
 220:7  
**variation** 213:14  
**various** 25:22  
 26:20 27:16 30:12  
 30:13,18 31:7  
 176:13 207:16  
**vary** 171:7 209:3  
**varying** 182:5  
 203:4  
**vast** 10:1 218:13  
**Vault** 19:3  
**vendor** 51:21 202:9  
 203:14  
**vendors** 157:6  
**Verleger** 3:22 4:14  
 112:8,15 136:3  
 140:9  
**version** 76:13  
 192:7  
**versus** 22:1 90:14  
 160:6 171:13  
 194:22 208:4  
**vibrate** 5:16  
**vice** 15:11  
**view** 7:10 31:19  
 60:8 107:21,22,22  
 109:5 192:15  
**views** 9:18 76:2  
**viii** 174:10  
**Vince** 3:7 4:18  
 147:2,6 157:14  
 168:16 202:4  
 204:19 206:2,22  
 214:9 219:22  
**Vince's** 176:8  
**violate** 72:18  
**violated** 79:6  
**violation** 77:3

**violations** 72:22  
 133:17 152:8  
**virtue** 192:15  
**visit** 181:1  
**visited** 34:20  
**vitality** 152:9  
**voice** 4:17 146:16  
 146:16 179:21  
 180:9 186:20  
 208:21 213:1  
 219:4  
**volatile** 139:19  
**volatility** 123:18  
 128:10 131:13  
 140:7 141:20  
**volume** 18:10  
 20:15 26:16,22  
 113:22 210:20  
 211:7  
**volumes** 141:12  
 186:9  
**volumetric** 36:22  
 37:6 38:4 40:1  
 119:6  
**volunteer** 87:19  
**voting** 31:17

---

**W**


---

**waiting** 221:1,4  
**wake** 67:3  
**walk** 24:16 163:14  
 174:10 180:22  
**wall** 126:4 136:6  
 137:18 141:18  
**want** 6:12 7:11,17  
 7:21 8:2 12:7  
 13:1 21:4 23:3  
 27:19 33:17 39:5  
 39:7,11 43:15  
 44:22 46:12 54:21  
 55:6 60:1 69:13  
 70:4 77:21 87:4  
 88:2 91:4 96:16  
 96:16,16 97:15  
 99:14 100:8  
 110:22 145:1  
 163:4,11,14,18

165:7 168:10	196:6 197:13	22:21,22 25:5,6,8	178:9 182:1,1	202:20 215:14
173:17 176:2	198:5,6 211:6,16	30:5 31:6,8 32:6	186:2 189:1 190:9	<b>world</b> 27:8 74:17
188:12 192:14	212:13 215:14	32:16 36:9,11,17	194:16 198:10	197:18 216:7
193:18 194:8	220:14	36:20 37:1,2	202:15 213:12	<b>worry</b> 147:10
199:3,4,5 201:6,7	<b>ways</b> 27:16 48:13	40:15 45:5 47:12	216:22 219:15	<b>worse</b> 137:16
203:20 204:15,20	49:6 55:17 69:14	47:18 50:4 51:19	<b>whatnot</b> 203:15	<b>worth</b> 208:15
216:8	70:6 84:3 140:13	54:6 58:20 60:8	<b>whatsoever</b> 84:13	<b>worthless</b> 136:11
<b>wanted</b> 58:17 69:1	152:17 168:11	61:4,22 63:13,19	<b>wheat</b> 2:5 15:12	<b>wouldn't</b> 126:22
69:8 94:8 101:7	<b>weaknesses</b> 55:15	67:1,19,20 68:2	16:4	<b>wrapped</b> 189:6
167:15 193:15	<b>wealth</b> 23:6	70:14,15 74:16	<b>wholly</b> 202:19	<b>write</b> 40:4
217:11	<b>web</b> 159:6	77:4 79:5 84:20	<b>wide</b> 131:22,22	<b>writing</b> 36:4 188:7
<b>wanting</b> 81:10 89:9	<b>website</b> 20:17,22	85:7 90:4,5 91:17	132:5,12 176:3	<b>written</b> 58:5 93:9
<b>wants</b> 37:3 87:18	23:4,6 24:3,7,10	91:22 92:1,2,8	<b>willing</b> 7:2 40:22	93:16 148:17
87:21 88:13 96:21	81:9 112:17	93:4,5,17 94:19	209:13	166:14 174:4
101:7 102:5	119:15 207:8,20	95:8,10 97:4 99:5	<b>winded</b> 217:11	177:7 189:9 190:5
<b>Ward</b> 3:5 4:18	<b>websites</b> 21:1	103:17,21 104:6	<b>window</b> 74:10	192:1,9,17 211:6
146:22 147:5,16	<b>week</b> 12:2,5 69:4	104:15 105:18	85:13	<b>wrong</b> 74:11 78:13
157:17 168:15	117:4 119:15	108:13,21 111:8	<b>wire</b> 91:6 110:20	92:1 102:20
185:6 203:16	120:1 140:6	111:22 116:22	110:21 140:4	107:22 109:6
204:20 214:9	184:11	118:20,21 122:18	<b>wise</b> 136:1	147:13 202:5
<b>Ward's</b> 159:2	<b>weeks</b> 12:20 28:2	128:22 135:10,13	<b>wisely</b> 109:22	
205:3	68:13,14 112:3	139:1 144:4	<b>wish</b> 11:10 27:4	<b>X</b>
<b>warning</b> 60:3 79:4	<b>weigh</b> 68:8	146:14 147:4	111:14	<b>X</b> 72:12
79:7	<b>weighing</b> 68:7	161:20 166:18	<b>wishes</b> 27:13	
<b>wash</b> 159:16	<b>Wellman</b> 2:11 16:1	178:22 179:5,6	<b>withdraw</b> 96:21	<b>Y</b>
<b>Washington</b> 1:13	16:1 144:8 185:8	180:20 186:1	<b>wonderful</b> 169:12	<b>year</b> 28:8 29:16,17
5:8 15:22 114:13	<b>went</b> 47:9 74:17	188:20,22 189:10	<b>word</b> 48:5 106:2	30:9 38:3 39:5
<b>wasn't</b> 92:3,3	75:19 105:11	190:1,4,6,8,11,17	127:1 186:18	43:16 44:9 51:12
106:22 184:20	146:12,12	190:20 191:2	<b>words</b> 62:3 98:3	52:13 60:21 62:11
208:13	<b>weren't</b> 134:2	193:9,12 194:18	100:7	63:9,16 80:16,20
<b>Wasserman</b> 3:14	137:18 177:15	196:16,19 198:14	<b>work</b> 9:10,11,21	114:5,10 115:17
94:7 97:3 98:7,20	210:2 213:8	209:7 212:11	26:9 43:9 44:15	117:3,12 120:15
99:2,20 100:3,20	<b>Wetjen</b> 2:22 4:3	214:5 215:16	104:17 119:9,18	126:12 132:2
101:19	7:18 11:12,14,15	218:10	138:8,10 140:12	137:5 138:3
<b>watching</b> 135:10	33:17 37:21 39:22	<b>we've</b> 11:22 18:21	140:18 141:4	140:12 141:6
<b>water</b> 47:3	41:2 69:1 92:20	19:1,4,4,13 22:10	184:8 196:17	154:16 155:9
<b>way</b> 30:5 35:17	<b>Wetjen's</b> 39:3	24:13 25:2,21	200:19	159:7 164:18,20
36:6 43:6 56:22	<b>we'll</b> 6:2,5,6 9:17	28:19 30:21,22	<b>workable</b> 182:9	176:2 211:14,17
70:5 71:11 72:10	9:17 47:2,15 53:4	36:2,10,10,15	<b>worked</b> 30:22 33:1	<b>years</b> 28:14 40:18
76:8 77:21 82:9	63:18 65:6,12,13	37:18 44:12 49:12	39:12 189:8	48:11 69:21 74:18
93:8,16 95:13	109:15 112:14	50:12 51:12 52:18	<b>working</b> 6:16 31:11	82:14 86:19 99:1
107:11,16 114:12	121:2 146:19	56:2 60:22 61:1	31:12 38:12 44:21	111:15 112:20
124:22 127:6	165:18,19 189:14	65:14 73:18 74:19	45:8 61:4 71:7	116:14 117:11,22
128:22 143:17	189:15,17 190:2	80:2 85:2,12 98:9	114:13 140:20	119:17 120:16
165:9 166:14	199:6 219:3	109:1 123:15	157:2 176:11	123:4 127:15
177:7 184:7,7	221:15	131:2 138:22	<b>works</b> 48:20 83:4	129:12 136:2,2,8
190:4 194:18	<b>we're</b> 7:1 16:19,20	139:3,10 177:14	111:1 124:22	136:10,13 141:8
				149:3 154:15

157:21 158:10 159:20 176:3 194:5,7 214:21 216:10 221:1 <b>yesterday</b> 72:7 111:15 <b>Yonkers</b> 2:12 15:15,15 <b>young</b> 133:2 135:4	209:20 211:12 <hr/> <b>0</b> <b>0.75</b> 118:13 <b>09</b> 192:16 <hr/> <b>1</b> <b>1</b> 19:15 170:3 174:8 <b>1,000</b> 85:1 <b>1,500</b> 50:12 <b>1.31</b> 148:5 <b>1.35</b> 4:17 148:2,6 150:8 155:8 192:6 192:7 194:3 <b>1.35(a)</b> 149:15 174:7 <b>1:00</b> 146:9 <b>1:06</b> 146:13 <b>10</b> 20:5 112:3 113:14 115:19 126:9 131:11 136:17 183:9 <b>10:14</b> 47:9 <b>10:30</b> 47:2,10 <b>100</b> 99:7 131:13 164:20 <b>11</b> 4:3 114:11 <b>112</b> 4:14 <b>1155</b> 1:13 <b>12</b> 4:4 <b>12:08</b> 146:12 <b>120</b> 28:14 <b>121</b> 4:14 <b>125</b> 56:3,12 <b>135</b> 4:15 <b>14</b> 57:12 <b>147</b> 4:18 <b>15</b> 47:1,5 54:1 60:21 64:4 117:18 170:17 171:1 183:9 <b>15,000</b> 50:7 <b>157</b> 4:18 <b>16.5</b> 114:7 <b>162</b> 4:19 <b>168</b> 4:20 <b>17</b> 4:6 <b>18</b> 4:6 18:22	<b>18-digit</b> 114:17 <b>183</b> 114:9 <b>19</b> 19:20 26:13,20 <hr/> <b>2</b> <b>2</b> 28:2 91:4 170:3 176:3 197:10 216:10 221:1 <b>2.6</b> 131:9 <b>2:19</b> 221:22 <b>20</b> 114:5 116:10,21 117:10 119:1 131:3 137:9 170:17 189:16 211:14 <b>200</b> 141:8 <b>2004</b> 114:2 <b>2005</b> 116:21 <b>2006</b> 116:8 <b>2007</b> 114:3 <b>2009</b> 158:11 191:21 193:16 <b>2010</b> 129:12 133:4 <b>2011</b> 18:16 133:4 136:16,17 216:20 <b>2011-2012</b> 55:15 <b>2012</b> 18:17 57:6,12 123:13 131:10,17 136:18,21 137:1,2 137:4,9 148:3 149:19 207:11 <b>2013</b> 1:8 50:6,12 51:1 126:18 134:7 136:20 137:1,3,10 155:9 156:6,13 <b>2014</b> 127:16 137:6 137:10 <b>2015</b> 137:11 <b>21</b> 148:3 155:9 156:6,12 207:11 <b>21st</b> 1:13 177:19 191:22 <b>217</b> 4:22 <b>23.202</b> 149:17 155:5 <b>25</b> 1:8 50:20 76:9 111:15 131:3	<b>25-30</b> 194:7 <hr/> <b>3</b> <b>3</b> 69:21 83:3 87:2,5 87:7 88:13 99:1 106:8 168:22 170:2 197:10 <b>3-day</b> 85:13 106:2 <b>3-year</b> 175:11 <b>30</b> 57:20,22 61:14 82:14 93:14 116:14 <b>30-35</b> 88:21 <b>31</b> 4:8 <b>36th</b> 5:4 <b>360</b> 51:21 <b>38-digit</b> 129:14 <hr/> <b>4</b> <b>4,000</b> 164:20 197:12 <b>43</b> 18:17 19:1 <b>45</b> 18:16 19:1 20:9 21:8 22:16 <b>46</b> 18:17 <b>48</b> 4:9 <hr/> <b>5</b> <b>5</b> 28:2 40:18 103:12 131:11 <b>5's</b> 144:20 <b>5,000</b> 189:19 197:12 <b>50</b> 25:15 140:5 <b>55</b> 4:10 <hr/> <b>6</b> <b>6</b> 4:2 68:14 144:20 221:1 <b>6-7</b> 74:18 <b>60</b> 25:15 169:10 170:3 <b>60-some</b> 176:22 <b>60-70</b> 123:16 <b>61</b> 169:3 <b>62</b> 4:10 <b>64</b> 163:22 168:20	<hr/> <b>7</b> <b>70</b> 4:12 119:15 132:3 <hr/> <b>8</b> <b>80</b> 51:2 119:2 141:5 <b>85</b> 117:19 139:5 <hr/> <b>9</b> <b>9</b> 53:22 64:4 <b>9:30</b> 1:13 <b>9:31</b> 5:2 <b>90</b> 29:5,6 31:7 70:14 117:6 140:14 141:5 <b>91</b> 206:14 209:22
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C E R T I F I C A T E

This is to certify that the foregoing transcript

In the matter of: Agricultural Advisory Committee

Before: US Commodity Futures Trading Commission

Date: 07-25-13

Place: Washington, DC

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