PARTICIPANTS:
Commission Members:

TIMOTHY G. MASSAD, Chairman
MARK P. WETJEN, Commissioner
SHARON Y. BOWEN, Commissioner
J. CHRISTOPHER GIANCARLO, Commissioner

First Staff Presentation: Proposed Rule -- Residual Interest Deadline for Futures Commission Merchants:

THOMAS J. SMITH
Division of Swap Dealer and Intermediary Oversight

PHYLLIS DIETZ
Division of Clearing and Risk

M. LAURA ASTRADA
Division of Clearing and Risk

Second Staff Presentation: Proposed Rule -- Records of Commodity Interest and Related Cash or Forward Transactions:

KATHERINE DRISCOLL
Division of Swap Dealer and Intermediary Oversight

AUGUST A. IMHOLTZ, III
Division of Swap Dealer and Intermediary Oversight

LAUREN BENNETT
Division of Swap Dealer and Intermediary Oversight

Third Staff Presentation: Proposed Interpretation -- Forward Contracts with Embedded Volumetric Optionality:

ELISE PALLAIS
Office of General Counsel
ALSO PRESENT:

CHRISTOPHER KIRKPATRICK
Secretary of the Commission

WILLIE CHARLIE
Assistant Secretary

* * * * *
CHAIRMAN MASSAD: Good morning. This meeting will come to order. This is a public meeting of the Commodities Futures Trading Commission. I would like to welcome members of the public, market participants, and members of the media, as well as those listening to the meeting on the phone or watching the webcast.

Today we are considering three matters that all involve fine-tuning our rules to make sure they work as intended. These are all adjustments to previously issued rules and they are appropriate to make sure our rules do not impose undue burdens or unintended consequences, particularly for the nonfinancial commercial businesses that use these markets to hedge commercial risks.

Now, this is a natural process for any regulatory agency and it is particularly appropriate in our case and that is because our responsibilities were increased dramatically as a
result of the worst financial crisis this country has faced since the Great Depression. We were given the responsibility to oversee the over-the-counter derivatives market, a $700 trillion market that was largely unregulated prior to the crisis.

As we know, excessive risks related to this market were one of the causes of the crisis. The CFTC developed and published many new rules to implement that responsibility and it updated certain other related rules in the course of doing so. With reforms as significant as these, it is inevitable that there will be a need for some minor adjustments and that is what we're doing today.

The changes that we are proposing help ensure that as we regulate the potential for excessive risks in these markets, we makes sure that the commercial businesses, whether they are farmers, ranchers, manufacturers, or others who rely on these markets to hedge routine risks and continue to do so efficiently and effectively.
The first item we are considering is a proposed amendment to Regulation 1.22. This rule helps ensure that the funds deposited by customers with Futures Commissioned Merchants, or FCMs, remains safe. The rule prohibits and FCM from using customer funds of one customer for the benefit of another customer. Last fall the Commission amended Regulation 1.22 to further enhance the safety of such funds by making sure that customer accounts have sufficient margin.

On any day when a customer is required to post additional margin, but has not yet done so, the FCM must maintain its own capital, often referred to as the FCM's residual interest in customer segregated accounts to make up the difference. These amendments provided that the FCM must deposit the additional funds by a specified deadline. Specifically, the amendment said that as of November 14, 2014, the deadline would be 6:00 p.m. Eastern Time on the settlement date. Now the deadline for the FCMs to post their own capital affects the deadline for customers to
increase their own funds.

The amendments passed last fall also provide that the Commission will conduct a study and solicit public comment, including by way of a roundtable concerning the practicability for both FCMs and their customers, of moving that deadline from 6:00 p.m. to the morning daily clearing settlement cycle, or the time of settlement. For convenience, I will refer to that today as 9:00 a.m.

The amendment said the Commission would decide within nine months after publication of the report whether to move the deadline to 9:00 a.m. and, finally, the amendment said that if the Commission failed to take any action, the deadline would automatically move to 9:00 a.m. As of December 31, 2018.

Today we making a minor, but important change. We are proposing to eliminate the provision that says the deadline will automatically move to 9:00 a.m. as of December 31, 2018. The deadline will still move to 6:00 p.m.
as of November 14th of this year and we will still
conduct a study of the practicability of making
the deadline earlier. An earlier residual
interest deadline better protects customers from
one another, in line with the statute. And we
want to make sure we move deliberately so that the
model works best for customers, in light of all of
their interests. Since the deadline will affect
how much margin customers post, have to post, and
when. Today's proposal will make sure that
customers will have an opportunity to not only
review the study, but give us input when we
consider whether to accelerate the deadline.

The second item today consists of
proposed amendments to Regulation 1.35. This
regulation requires various types of market
participants to keep written and oral records of
transactions. This record is very important to
our efforts to police the markets and ensure
integrity and transparency. Regulation 1.35 has
been on the books since 1948 and we have updated
it from time to time, in light of changes in
marketplace practices, as well as the scope of our jurisdiction.

After the Commission amended the rule in December of 2012, and the staff observed implementation of those changes, the staff determined that the cost of complying with certain aspects of the rule for some market participants might exceed the potential benefits, and the staff granted No Action Relief.

Specifically, the staff said that regarding written records members of DCMs or SEFs that are not registered with the Commission do not have to keep text messages or store their other records in a manner that is identifiable and searchable by transaction. Regarding oral communications, staff said that commodity trading advisors do not have to record oral communications regarding their swap transactions. Cost of maintaining records, there are rules that require market participants to keep, will ultimately be reflected in the transaction costs incurred by all customers.
So we must always keep the costs in balance with the benefit to market oversight.

Today we are simply proposing to revise the rule so that it reads consistent with that staff No Action Relief, and to provide a slight expansion of some of that relief so that CTAs do not have to record oral communications. We are also proposing to clarify one aspect of the rule that has generated confusion, and this pertains to the requirement that records must be identifiable and searchable by transaction, and what identifiable and searchable means.

The third item we are considering pertains to forward contracts that have what is known as embedded volumetric optionality, generally speaking, contracts to buy or sell a nonfinancial commodity for deferred delivery, that provide for variations in delivery amount. In certain situations, commercial parties are unable to predict at the time a contract is entered into the exact quantities of the commodity that they may need or be able to supply, and the embedded
volumetric optionality offers them the flexibility
to vary the quantities delivered accordingly.

The CFTC put out an interpretation
consisting of seven factors to provide clarity as
to when such contracts would fall within the
forward contract exclusion from the swap
definition. Some market participants have felt
that this interpretation, in particular the
seventh factor, was hard to apply. In some cases,
two parties would reach different conclusions
about the same contract.

Today we are proposing clarifications to
the interpretation that I believe will alleviate
this ambiguity and allow contracts with volumetric
optionality that truly are intended to address
uncertainty with respect to the party's future
production capacity or delivery needs and not for
speculative purposes or as a means to obtain
one-way price protection to fall within the
exclusion. I note also that because this proposed
interpretation pertains to the definition of a
swap, we are coordinating with the SEC on this.
With respect to all three proposals today, if adopted, there will be an opportunity for public comment before we take any action. I want to thank in advance the Commissioners and all of the staff for their hard work and contributions on these proposals.

And with that I would like to recognize my fellow commissioners for their opening statements, beginning first with Commissioner Wetjen.

COMMISSIONER WETJEN: Thank you. Good morning, Chairman Massad and Commissioners Bowen and Giancarlo. I want to thank Chairman Massad for convening this meeting and moving quickly to fine tune the Commission's Dodd-Frank rulemakings and provide needed clarity and relief to the commercial end-user community.

Likewise, I want to thank Commissioners Bowen and Giancarlo for their constructive approach and willingness to collaborate on these releases. And, of course, the staff deserves thanks for their continued work on these complex
and important matters.

A few things were clear to me at the time that Congress considered Dodd-Frank and the view that commercial firms were not responsible for the credit crisis. New swaps rules, therefore, should not place additional costs and compliance burdens on firms operating in the real economy unless necessary to achieve the purposes of the post-crisis reforms.

In formulating and supporting Dodd-Frank rules since joining the Commission, I've tried to keep this principle in mind. Along these lines I've strived to move policy in a direction that, when implemented, will avoid introducing unnecessary complexity to the operation of firms and that takes into account practical considerations related to compliance.

Today's releases recalibrate previous work by the Commission and generally move its policy further in the aforementioned direction. I, therefore, intend to support them.

Today's proposal further clarifying the
definition of forward contracts with embedded volumetric optionality, or EVO, is intended to provide commercial firms the regulatory clarity they have sought since the original release of the seven-part test in August of 2012.

The definition of a swap in the Commodity Exchange Act includes commodity options, but excludes from that definition forward contracts. There is a policy reason for this and at its route was a desire to ensure that Dodd-Frank captured many swaps and swap-like contracts that were structured to be similar to options, while also ensuring that a new regulatory regime was not inadvertently and inappropriately extended into certain physical markets.

The broad definitional language in question was designed to ensure that financial, as opposed to physical, contracts could not be structured or recharacterized to avoid the new market structure. While the swap definition does not expressly exclude options on energy and agriculture commodities, it does exclude both
futures and forwards. I'm confident Congress did not intend to pull contracts that have historically have been treated as forwards into the new swap regime solely because of optionality and the amount of the physical commodity delivered under the contract.

As a policy matter, Congress surely recognized that the swap definition had to reflect a long-held Commission belief that contracts that are physically settled and where delivery is required do not pose the same systemic threats to the financial system as contracts used for speculative purposes. Moreover, Congress expanded the Commission's fraud and anti-manipulation authority over markets where forward contracts are traded, and left intact the Commission surveillance authority to issue special calls to market participants for all positions and transactions related to a commodity.

As mentioned, in resolving to adopt the appropriate regulatory treatment of forward contracts with EVO, the Commission also must
weight the operational and compliance consequences of that treatment. Indeed, the Commission should bring a heightened sensitivity to these considerations in the context of the power sector because affordable electricity and heat are such fundamental needs of modern life.

The Commission's 2012 interpretation, while intended to be helpful, contains certain ambiguities in the seven-part test that created confusion among commercial end-users. Last spring the Commission learned at a public roundtable that some market participants may have withdrawn from the market due to those ambiguities, resulting in inferior execution for commercial firms. It is difficult to measure the exact impact of this phenomenon, but apparently it has not been a positive one for consumers of electricity and gas.

In discussing the seven-part test, commentators zeroed in on two primary issues. First, many of the roundtable participants noted that the exercise or non-exercise of volumetric
optionality depends on a number of factors, some of which will be outside of the control of the parties and some that will not. Many also noted that parties could reasonably disagree on whether, and the degree to which, a factor is outside of the control of the parties.

For example, having choice among more than one source of supply or selecting from those sources the lowest priced contract, to some commercial firms cause the contract to fail the seventh prong. This ambiguity contributed to a second issue. Market participants stated that they often do not know the exact reasons that optionality will be exercised until the time of exercise. In other words, parties are uncertain about how to characterize contracts at the time of execution and intent, at the time of exercise or non-exercise, might affect that analysis.

The seventh factor's ambiguity has caused a host of problems. For instance, parties have been asked to provide vague and possibly unenforceable representations and agreements.
Parties also often disagree about the proper
categorization of a transaction, resulting in them
"agreeing to disagree" and considering the same
transaction to be, at the same time, a swap, trade
option, or a forward with EVO.

This has had the unintended consequence
of distorting transaction data reported to the
Commission. The bottom line is that such
uncertainty in the seven-part test increased
transaction costs for commercial firms and limited
their access to an effective risk management tool.

Today's proposal appropriately modifies
and clarifies the interpretation of the seventh
prong. First, it clarifies that concluding
whether the seventh prong is met should be
determined by looking to the intent of the parties
at the outset of contract initiation.

Second, the new proposal also deletes
language dealing with physical or regulatory
factors being outside of the control of the
parties. Deleting this ambiguous language helps
clarify that parties having some influence over
factors affecting their demand for a nonfinancial commodity will not, per se, cause a contract to fail the seventh prong.

In that vein, the proposal also notes that parties may take a variety of factors into consideration when determining whether to exercise volumetric optionality so long as the intended purpose was to address physical factors or regulatory requirements influencing the demand for or supply of the commodity.

Prongs one through six of the test are also appropriately crafted to ensure that the EVO does not undermine the four contracts overall purpose. Prongs two and three help achieve those purposes by requiring the predominant factor to be actual delivery and prohibiting the embedded optionality from being severed and marketed separately from the overall agreement. Prongs four and five also helped to deter the potential for abuse of these contracts by requiring that the seller under the contracts intends to deliver and the buyer intends to receive the underlying
commodity. Today's proposal should go a long way towards providing commercial firms adequate guidance, but I look forward to comments on whether it is adequate enough.

Today's rulemakings also include an amendment to the phase implementation schedule for the Residual Interest Rule that was promulgated one year ago. I supported the rule last year because the implementation schedule would provide the Commission an appropriate amount of time to investigate and consider the practicability of moving the deadline to the time of settlement. Meanwhile, the automatic nature of such a move would incentives FCMs to improve their margin collection and risk management processes.

Today's amendment would provide that the residual interest deadline will remain at 6:00 p.m. on the date of settlement, absent a Commission rulemaking. This has the effect of increasing certainty to FCMs that any further change to the deadline would occur only following the robust procedures associated with a
rulemaking, in addition to the already required study and roundtable, which is an outcome I support. The resulting certainty provided to the FCM community outweighs the potential value of incentivizing FCMs to improve their margin collection practices to comply with a future-time settlement deadline.

This release does, however, highlight a continued policy tension concerning the need to balance risk management incentives for FCMs against considerations related to appropriate accessibility to the derivatives markets. Clearly, while the Commission must weigh the cost to FCMS of its risk management requirements, it need not scope them to ensure that every FCM that exists today has systems and practices in place to comply with them.

Going forward, the Commission should strive to ensure adequate accessibility to the marketplace, knowing its importance to market liquidity, but remain vigilant in enforcing current FCM requirements under its rules.
Finally, I'm also supporting today's proposal amending the recordkeeping requirements under Regulation 1.35. The same staff roundtable mentioned earlier also addressed this topic, particularly the technological challenges and cost associated with complying with the rule.

Similar to the residual interest release, this proposal tries to balance certain Commission regulatory prerogatives -- in this case the need to efficiently monitor the derivatives markets and enforce or rules -- against considerations related to accessibility to the derivatives markets, more generally, and certain trading venues, more specifically.

I look forward to comments on these proposed changes. In closing, I want to reiterate my thanks to Chairman Massad, to Commissioners Bowen and Giancarlo, and the staff for their constructive work on all three of these proposals.

Thank you very much.

CHAIRMAN MASSAD: Thank you. Let me turn to Commissioner Bowen.
COMMISSIONER BOWEN: Good morning. I want to echo the chairman's remarks and offer my thanks and appreciation to my fellow commissioners and to the staff for working on these two proposed rules, and the proposed interpretation on volumetric options.

Let me first talk about these two rules. They are tweaks to past Commission actions, but they are important all the same. I firmly believe that we need to get the little things right to get the big things right. And I feel that we've gotten these small changes right today. I'm proud to vote in favor of these two proposed rules.

One of the rules in front of us today is a proposed revision of the very important recordkeeping rule, Rule 1.35. The current proposal is in response to a request from a number of parties. First, many affected market participants, including non-registrants, requested clarity on the meaning of searchable and identifiable in the context of free execution trades. Second, non-registrants sought relief
from the obligation to collect text messages.

Third, CTAs asked for relief from the oral recordkeeping requirements.

In our proposed rule, the staff ably attempts to provide relief to market participants, including small end-users from burdensome requirements, while also ensuring that our enforcement staff is able to perform it vital function. We invite comment on the degree to which the proposal accomplishes this goal.

About the residual interest deadline, I understand that the market is now adjusting to the 6:00 p.m. deadline that goes into effect in two weeks. The staff study about that deadline and any further changes to it are a couple of years in the future, so today's proposal would remove the December 2018 endpoint to this process. I look forward to hearing from the public about whether it makes sense to remove this endpoint in the context of this particular rule.

Following, I want to talk briefly about the proposed interpretation on embedded volumetric
optionality. I appreciate that a number of our participants and end-users want clarity regarding which options qualify for it and, therefore, exclude it from our jurisdiction. I am sympathetic to these concerns and agree that we should try to make guidance on this point clearer.

Yet, I worry that the current proposal as written goes too far and would cause too many options to be incorrectly regarded as forwards. I think the trade option exemption provides a much clearer and cleaner approach to address the issues raised regarding volumetric optionality. I hope the Commission can revise our trade option regulation soon.

With regards to the proposed interpretation before us today, however, I firmly believe that we need to receive public comment and whether this potential change makes sense. In my concurring statement I will lay out my concerns in more detail.

I also want to note that the Federal Register notice contains several questions. I
hope that the public will consider and respond to these questions. I believe that your responses will provide some critical guidance about whether the Commission should make changes to our propose guidance on this subject. Thank you.

CHAIRMAN MASSAD: Thank you.

Commissioner Giancarlo?

COMMISSIONER GIANCARLO: Thank you, Chairman, for calling today's meeting. We are addressing three rule set that have been particularly problematic for participants in markets over seen by this Commission. I thank you for making these issues a priority of the Commission and of its staff.

I thank my fellow Commissioners, their staffs, my own staff, and the CFTC staff for the hard work in preparing today's proposals. With your consent, Mr. Chairman, I'd like to hold off making specific comments on each of the three rule proposals until we begin each discussion, at which point I'll give my particular remarks.

CHAIRMAN MASSAD: Thank you. For each
of the items on today's agenda, the staff will make presentations to the Commission. After each presentation the floor will be open for questions and comments from each of the commissioners. Following these discussions, the Commission may take votes on the recommendations as presented. All final votes conducted in this public meeting shall be recorded votes and the results of those votes will be included in their relevant Federal Register releases.

At this point, I ask unanimous consent to allow staff to make technical corrections to the documents voted on today prior to sending them to the Federal Register?

Without objection, it is so ordered. At this time I would like to welcome Thomas J. Smith from the Division of Swap Dealer and Intermediary Oversight and Phyllis Dietz and Laura Astrada from the Division of Clearing and Risk to present the proposal on the residual interest deadline for Futures Commission merchants.
MR. SMITH: Thank you and good morning.

The Divisions of Clearing and Risk and Swap Dealer and Intermediary Oversight recommend that the Commission publish for public comment a proposed amendment to Regulation 1.22. Regulation 1.22 provides, in relevant part, that an FCM may not use the funds of one customer to margin the positions of another person. In order to comply with this restriction, each FCM is required to compute the total aggregate under-margin amount for customer accounts as of the close of business each day.

Each FCM is further required to ensure that it deposits its own capital, otherwise known as the FCM's residual interest in customer segregated accounts in an amount sufficient to cover the full under-margin amount by the residual interest deadline. Regulation 1.22 defines the residual interest deadline as the time of the clearinghouse settlement on the next business day.

In adopting the residual interest requirement the Commission established a phased-in
compliance period for the residual interest deadline. Commencing November 14, 2013, the residual interest deadline will be 6:00 p.m. Eastern Time the next business day. The regulation further requires staff, by May 16, 2016, to publish for public comment a report addressing to the extent is reasonably available. The practicability for both the FCM and its customers of moving the residual interest deadline from 6:00 p.m. to the time of the clearinghouse settlement or another point in time.

The regulation also requires staff to host a public roundtable and to solicit comments regarding specific issues to be covered by the report. If the Commission takes no further action after publication of the report, the regulation provides that the residual interest deadline will change from 6:00 p.m. to the time of settlement on December 31, 2018.

Staff recommends that the Commission amend Regulation 1.22 to remove the December 31, 2018, automatic termination date. Instead, under
the proposal, the residual interest deadline would remain 6:00 p.m. Eastern Time on the next business day, pending a Commission rulemaking to alter the timeframe. The regulation would continue to require staff to publish a report to solicit public comment and host a public roundtable on the residual interest deadline. Staff believes that the amendment is appropriate in order to provide the Commission with a greater degree of flexibility to access the issues and all relevant data associated with revising the residual interest deadline, including information obtained from the report, without the constraints of an established regulatory deadline for Commission action.

The proposed amendment would also ensure that the public would have an opportunity to review and comment on any future proposal to revise the residual interest deadline. Prior to concluding, I would just like to acknowledge the significant contributions of our colleagues in the Office of the General Counsel and the Office of
Chief Economist.

Thank you and we'll be happy to answer any of your questions.

CHAIRMAN MASSAD: Thank you. To begin the Commission's consideration of this rulemaking, I will now entertain a motion to adopt the proposed rule as presented by the staff.

COMMISSIONER WETJEN: So moved.

COMMISSIONER BOWEN: Second.

CHAIRMAN MASSAD: Thank you. With that I will ask for the Commissioners if they have any questions or comments? I'll start with Commissioner Wetjen.

COMMISSIONER WETJEN: Just one quick question, Mr. Chairman, thank you. And thank you to the staff for presenting today and being with us.

Tom, I presume you might be in the best position to speak to this, although maybe I shouldn't presume, but I'm just kind of curious, in the last year now, if you can say, what would you predict would be the sorts of impediments that
might make a time of data settlement, i.e., 9:00 a.m. data settlement residual interest requirement, difficult to pull off, even several years down the road? Just give the public and the Commission some sense of what the key challenges there might be.

MR. SMITH: It's always hard to predict, but in our discussions with some of the FCMs and market participants to date, some of the issues that we're hearing, particularly from the agricultural community and smaller customers, is the ability that they have to move funds. Many of these entities do not want to maintain a sufficient amount of excess margin funds with FCMs. They sort of use more of a real-time financing of their margin positions and they also do not -- as we learned with our recent interpretation for automated clearinghouse transactions -- they do not monitor the markets on a real-time, moment-to-moment basis because of the nature of their own personal businesses.

So, in order to meet this deadline they
would have to -- certainly after 6:00 p.m., they would have to make sure that they have access to liquidity from whoever their financial institutions are -- banking entities -- and be able to move that money within the period of time specified.

COMMISSIONER WETJEN: But there have also been some concerns raised about time zone changes and the fact that you've got customers located in different parts of the globe with FCM operations in another part of the globe, so give us a sense of what kinds of challenges that situation poses.

MR. SMITH: Yeah, there could be issues for non-U.S.-based customers who would have to meet a margin call by a U.S.-based FCM. Oftentimes those margin calls will go out at the end of the day or overnight. They would be received by the customers in Asia particularly later the next business day. If they issue instructions to their bank to move funds to the U.S. there could be a delay in those funds
arriving. It may take more than one business day for those funds to be moved.

COMMISSIONER WETJEN: I'll just end by making one comment, there has been such considerable innovation in recent months and years concerning the payment system and how money moves from one place to another. Perhaps the most recent example is Apple's product that they offer on their smartphones. I'm not suggesting that margin calls would be made with an Apple phone, per se, but the point is that there are all sorts of technological advancement in this area. And so I continue to believe today as I did a year ago, the notion that the solution to this, whether it's a 6:00 p.m. date of settlement deadline or even 9:00 a.m., if we get to that point somewhere down the road, that the solution would be pre-funding with the FCM by the customer.

That doesn't seem necessary in light of what we're seeing by way of these innovations that I mentioned. And I would expect and hope -- and maybe I won't predict, either, Tom -- but I would
expect and hope those sorts of innovations will be brought to this space, as well, and help solve this issue around getting collateral and making margin calls in a timely basis, but, at the same time, making sure we've got the proper risk management processes at these FCMs. So, thank you very much.

CHAIRMAN MASSAD: Commissioner Bowen?

COMMISSIONER BOWEN: No questions.

CHAIRMAN MASSAD: Okay, Commissioner Giancarlo?

COMMISSIONER GIANCARLO: Thank you, Chairman, and thank you, Tom, Laura, and Phyllis. I support the issuance of the proposed rule before us. Without it the so-called, and perhaps misnamed, Customer Protection Rule finalized in October of 2013 would likely result in significant harm to the core constituents of this Commission, and that is the American agricultural producers who use futures to manage the everyday risks associated with farming and ranching.

As it stands, the rule will cause
farmers and ranchers -- without modification it will cause them to pre-fund their futures margin accounts due to the onerous requirements forcing FCMs to hold large amounts of cash in order to pay clearinghouses at the start of trading on the next business day.

Without revision, the increased cost of pre-funding accounts will likely drive many small- and medium-sized agricultural producers out of the marketplace and would likely force a further reduction in the already strained FCM community that serves the agricultural community.

Last week I visited a grain elevator in Southern Indiana and a family farm in rural Kentucky. I shared lunch in a barn shed with around a dozen small family farmers, some of whom use futures products to manage price and production risk. Simply put, these Kentucky farmers could not fathom why the CFTC would adopt a rule requiring them to pre-fund margin accounts. They saw our rule as ensuring that they would actually lose more of their money, not less, in
the event of another failure of the likes of MF
Global or Peregrine Financial.

So I believe that today's rule proposal
will be well received by the farmers I met with
and I commend the Commission for today's action.
I'm also satisfied that the concerns of my staff
were addressed so that any change to this deadline
only take place after a rulemaking, following a
public comment period. As noted in the proposal,
this approach will allow the Commission to better
understand the market impacts and operational
challenges before moving on the residual interest
deadline.

This approach is especially important
given the potential impact on smaller futures
commission merchants and end-users. But while on
the subject of automatic adjustments, I call on
the Commission to take the same deliberative
approach in other areas where there are automatic
adjustments to Commission rules. Specifically,
the Commission should revisit the de minimis
exception to the swap dealer definition and revise
this definition so that the de minimis level does
not automatically adjust from $8 billion to $3
billion absent a rulemaking with proper notice and
comment.

Like today's proposal, the Commission
should only adjust the de minimis threshold after
it has considered the data and weighed public
concerns. As for today's rule on residual
interest, I'm pleased to support it.

CHAIRMAN MASSAD: Thank you,
Commissioner Giancarlo. Just to clarify, Tom,
with respect to the study, I assume the study will
address the sorts of technological developments
that Commissioner Wetjen was referring to. In
other words, we wouldn't just look at what the
FCMs are able to do, but rather what should they
be able to do potentially, in light of
technological advances as we go forward in
payments.

MR. SMITH: That is correct.

CHAIRMAN MASSAD: Great. So again, I
just want to underscore that all we're doing today
is saying that the deadline will not move automatically. And again, I think given that our purpose is in large part to protect customers, I think that is why this is appropriate, so that customers will have an opportunity to comment. If there are no other questions? I would again like to thank the staff for their work in the presentations today. Would any commissioner like to make any further statements before we proceed to the -- okay. If the commissioners are prepared to vote, I would call on Mr. Kirkpatrick to call the roll.

MR. KIRKPATRICK: The motion now before the Commission is on the adoption of the Notice of Proposed Rulemaking on the residual interest deadline for Futures Commission merchants. Commissioner Giancarlo?

COMMISSIONER GIANCARLO: Aye.

MR. KIRKPATRICK: Commissioner Giancarlo, aye. Commissioner Bowen?

COMMISSIONER BOWEN: Aye.

MR. KIRKPATRICK: Commissioner Bowen,
aye. Commissioner Wetjen?

COMMISSIONER WETJEN: Aye.

MR. KIRKPATRICK: Commissioner Wetjen, aye.

aye. Chairman Massad?

CHAIRMAN MASSAD: Aye.

MR. KIRKPATRICK: Chairman Massad, aye.

Mr. Chairman, on this matter the ayes have 4, the noes have 0.

CHAIRMAN MASSAD: Thank you. The ayes have it and the motion to adopt the proposed rule is approved. Thank you again to the staff.

At this time I would like to welcome Katherine Driscoll, August Imholtz, and Lauren Bennett from the Division of Swap Dealer and Intermediary Oversight to present a recommendation concerning proposed amendments to Rule 1.35 on records of commodity interest and related cash or forward transactions.

MS. DRISCOLL: Good morning, Mr. Chairman, good morning, Commissioners. Before I start I just wanted to thank and call out my colleagues in OGC, Carlene Kim and Paul
Schlichting, for being incredibly helpful during this process leading up to this proposal. We also consulted with Gretchen Lowe in Enforcement, Steve Sherrod and Duane Andresen in DMO, and Steve Kane, of course, in OCE.

Our focus today is on Regulation 1.35, which is records of commodity interest and related cash or forward transactions. Under the rule, with some exceptions, each FCM, RFED, IB, and member of a DCM or SEF must keep records relating to its business of dealing in commodity interests and related cash or forward transactions. Included in those records are all oral and written communications that lead to the execution of a transaction. And all records must be kept in a manner that is identifiable and searchable by transaction.

The proposed rule would amend 1.35 by doing two main things. The first thing is to clarify and amend the form and manner requirements identifiable answerable by transaction. The second thing that the proposed rule would do is
I'll start with the proposed changes to the form and manner requirement. The first change to that is regarding search ability. Under the proposal, all records kept pursuant to this rule must be searchable. This means both the records of a transaction and the records of the communications that lead to a transaction.

Regarding the requirement that records be identifiable by transaction, we would propose to amend the rules so that that language now reads, "Allows for the identification of a particular transaction, with one notable exception. Records of the communications that lead to the execution of a transaction," so pre-trade communications, "would not have to be kept in this form and manner that allows for the identification of a transaction. These pre-transaction communications, however, would still have to be searchable."

Shifting from form and manner to current
No Action Relief, we are also proposing to amend 1.35 by codifying Commission Letter 1472. This letter granted No Action Relief from DSIO and DMO to unregistered members of DCMs and SEFs, from the written recordkeeping requirements to retain text messages and to keep your records in a particular form and manner.

The second codification would be of Commission Staff Letter 1460, which applies to members of a DCM or SEF that are registered as CTAs. As the chairman pointed out, the No Action Letter applies to CTAs with regard to their swap transactions. We would propose that it applies to CTAs with regard to all transactions. So, under the proposal, CTAs would not have to keep oral communications.

The release asks a number of questions intended to elicit comments and we welcome any questions that you may have at this time.

CHAIRMAN MASSAD: Thank you, Katie. I will now entertain a motion to adopt the proposed rule as presented by the staff.
COMMISSIONER WETJEN: So moved.

COMMISSIONER BOWEN: Second.

CHAIRMAN MASSAD: Thank you. And I will now turn to the commissioners for any comments or questions. Let me start with Commissioner Wetjen?

COMMISSIONER WETJEN: I don't have any questions on this, thank you.

CHAIRMAN MASSAD: Commissioner Bowen?

COMMISSIONER BOWEN: No questions.

CHAIRMAN MASSAD: Commissioner Giancarlo?

COMMISSIONER GIANCARLO: Thank you. I'm certainly disappointed with the final form of today's proposed revisions to Rule 1.35. In 2012, the CFTC revised the rule, the changes required the keeping of all oral and written records that led to the execution of a transaction in a commodity interest and related cash or forward transaction in a former manner "identifiable and searchable by transaction."

This recordkeeping must be done with certain carve-outs by most futures commissions
merchants, retail foreign exchange dealers, introducing brokers, and members of designated contract markets and swap execution facilities. As with the seven-factor volumetric optionality test, which we're also discussing shortly, the revised Rule 1.35 has proven to be simply unworkable.

Publication of the rule was followed by requests for No Action Relief. At a public roundtable held in this room, market participants voiced their inability to tie all communications leading to the execution of a transaction to a particular transaction or transactions. And user exchange members pointed out that business that was once conducted by telephone had moved to text messaging, so the carve-out in the rule for oral communications had little utility. They pointed out that it was simply not feasible technologically to keep pre-trade text messages in a form and manner identifiable and searchable by transaction.

The revisions to Rule 1.35 that the
Commission is proposing today do go a long way
towards addressing the rule's difficulties. Unfortunately, they do not go far enough. The
proposed rule text raises unanswered questions. It continues to contain provisions that may be
difficult or over burdensome in practice for certain covered entities. In my opinion, many of
the problems stem from imprecise construction and definition in the legal drafting.

Rule 1.35, on the one hand, identifies the particular records that must be kept, while
Rule 1.31, on the other hand, sets the form and manner in which such records must be maintained
and produced. But the proposal mixes things up by adding in Rule 1.35, where they don't belong, new
requirements regarding form and manner.

For example, that the records allow for identification of a particular transaction and be searchable, a term that is not defined. While it's likely that electronic records kept in their native file format can be easily produced in a searchable form, it is not clear what "searchable"
means when it comes to paper records, such as
cancelled checks, signed account agreements, and
paper orders. Does this mean that a record of a
wire transfer received by a FCM to cover margin
for multiple positions be kept in a form and
manner that allows for identification of each
potential transaction? Will a small FCM embedded
in a grain elevator, for example, have to keep the
cancelled checks received from farmers in sort of
searchable format tied to specific transactions?
What if the farmer's check mistakenly
references the wrong transactions and the FCM
doesn't catch it? Is the FCM now in breech of our
requirements for searchability? Do they need to
hire a whole paper record searchability team just
for records of individual transactions, and to
search them in the event, but not the certainty,
that some day the CFTC will want those records?
And at what cost to them and to American markets
and end-users?

All right, let me come up from the weeds
for a minute and look at the forest from the
trees. FCMs are vital to the functioning of America's commodity futures markets. They're essential intermediaries between farmers, manufacturers, and other end-users, and the markets in which they hedge the risks and costs of production. Without healthy FCMs serving their customers, the everyday costs of groceries and winter heating fuel will rise for America's families, yet today we have about half the number of FCMs serving our farmers than we did just a few years ago. FCMs, particularly small FCMs, are being squeezed in the current low interest rate environment and the increased regulatory burdens being placed on them.

They are barely breaking even. We should not be squeezing them further with increased compliance costs if we can avoid it and still effectively oversee the markets. Getting these rules and getting these definitions precise and clear is critical. In implementing the Dodd-Frank Act, I'm conscious that the stated purpose -- in fact, the official name of the law
-- is to reform Wall Street. Instead, I'm afraid we're burdening Main Street by adding new compliance costs onto our country grain elevators, farmers, and small FCMs. Rather than facilitating the collection of useful records to use in investigation enforcement actions, the underlying rule and the lack of sufficient clarity will instead result in senseless cost increases.

The one refrain that I heard again and again last week in Illinois, Indiana, and Kentucky, was that Washington does not listen to ordinary American farmers, energy producers, coal miners, and manufacturers. They say that Washington imposes rules and regulations without regard to their everyday impact on American people.

Well, here we have a chance to listen and act accordingly. So I encourage all affected parties to give us detailed comments on this proposal with emphasis on the intersection between Rule 1.35 and Rule 1.31, and how the proposed searchability and identification by transaction
requirements will work in practice.
I encourage the public to make us listen once again to their concerns that have already been expressed about costs and benefits of this particular rule set. And I'm hopeful that after thoughtful consideration of comments on this proposal, the Commission will promulgate a final rule that better and more clearly balances the legitimate demands of market regulation and enforcement with these burdens being placed on American agriculture and manufacturing. Thank you.

CHAIRMAN MASSAD: Thank you. Okay, I don't believe I have any questions for the staff. I would note that what we're doing today, obviously, is a way to receive public comment and it's also, I think, not actually adding new compliance costs. If anything, we are lessening them. So I would hope that we could move forward with this. If there's no other questions or comments?

COMMISSIONER WETJEN: Mr. Chairman?
CHAIRMAN MASSAD: Yeah.

COMMISSIONER WETJEN: If I could make just one comment. I appreciated listening to Commissioner Giancarlo's remarks. I also alluded to this issue of concentration among FCMs in my own prepared remarks. And so I think I agree with you, I think we've identified an issue that we have in our markets at the moment and probably for the shorter, medium term we've got a confluence of impacts on the FCM community, whether it's monetary policy or new regulation, whatever the case might be.

There are other factors, as well. But the long and short of it is that it's more expensive to profitably run an FCM and the question is, what does that mean for the number of FCMs that we have? And what does that mean for hedgers and their ability to access these markets? And so I think that's something we really need to keep our eyes on. So I look forward to comments in response to this release, as well, in that regard.
CHAIRMAN MASSAD: Okay, if there are no other questions, I would like to again thank the staff: Katie, Lauren, and August, and everyone else who worked on this. I appreciate your work. If there are no other comments or statements, I would like to proceed to a vote.

Mr. Kirkpatrick, will you call the roll?

MR. KIRKPATRICK: The motion now before the Commission is on the adoption of the Notice of Proposed Rulemaking on Records of Commodity Interest and Related Cash or Forward Transactions.

Commissioner Giancarlo?

COMMISSIONER GIANCARLO: No.

MR. KIRKPATRICK: Commissioner Giancarlo, no. Commissioner Bowen?

COMMISSIONER BOWEN: Aye.

MR. KIRKPATRICK: Commissioner Bowen, aye. Commissioner Wetjen?

COMMISSIONER WETJEN: Aye.

MR. KIRKPATRICK: Commissioner Wetjen, aye. Chairman Massad?

CHAIRMAN MASSAD: Aye.
MR. KIRKPATRICK: Chairman Massad, aye.

Mr. Chairman, on this matter the ayes have 3, the noes have 1.

CHAIRMAN MASSAD: Thank you, Mr. Kirkpatrick. The ayes have it and the motion to adopt the proposed rule is approved, thank you.

At this time I would like to welcome Elise Pallais from the Office of General Counsel and Carlene Kim to present the staff recommendation concerning the proposed interpretation regarding Forward Contracts with Embedded Volumetric Optionality.

MS. PALLAIS: Good morning and thank you. In the 2012 products release, in which the Commission and the SEC jointly issued rules and interpretations that further define, among other things, the "term swap," the Commission provided an interpretation with respect to forward contracts that provide for variations in delivery amount, also termed "contracts with embedded volumetric optionality."

Consisting of seven elements, the
interpretation identified when an agreement contractor transaction containing embedded volumetric optionality would fall within the forward contract exclusions from the swap and future delivery definitions of the Commodity Exchange Act. Understanding from commenters that commercial parties have experienced challenges in applying the interpretation, the Commission is proposing to clarify the interpretation by, one, modifying the fourth and fifth elements of the interpretation to clarify that the interpretation applies to embedded volumetric optionality in the form of both puts and calls; and, two, clarifying the seventh element requires that the embedded volumetric optionality must be primarily intended at the time the parties enter into the agreement, contract, or transaction to address physical factors or regulatory requirements that reasonably influence demand for or supply of the nonfinancial commodity.

The Commission is also proposing to clarify that electric response agreements may be
properly characterized as the product of a
regulatory requirement within the meaning of the
seventh element. The Commission seeks public
comment on any aspect of its proposed
interpretation and has included specific
questions.

In accordance with Section 712(d)(4) of
the Dodd-Frank Act, this proposed interpretation
is being issued jointly with the SEC. We thank
the Division of Enforcement and Market Oversight
for their guidance and assistance in preparing
this proposed interpretation and we're happy to
entertain any questions you might have for us.

CHAIRMAN MASSAD: Thank you, Elise. To
open the Commission's consideration of this
proposed interpretation, I will now entertain a
motion to adopt the proposed interpretation as
presented by the staff.

COMMISSIONER WETJEN: So moved.

CHAIRMAN MASSAD: Is there a second?

COMMISSIONER BOWEN: Second.

CHAIRMAN MASSAD: Okay, thank you. With
that let's begin the discussion. I'll turn again
to Commissioner Wetjen?

COMMISSIONER WETJEN: Thank you, Mr.
Chairman. I don't have any questions. I just
want to thank the staff and OGC and DMO and
Enforcement for their efforts and work on this
matter over the last number of weeks. And I
appreciate your cooperation and willingness to
consider some of the views of my office.

I think we've got this release in pretty
good shape now. There are a few items of
clarification I thought we could have included,
but in the interest of moving the ball forward and
soliciting comment, I'm comfortable supporting it
as it's drafted. So I appreciate everyone's work
and am looking forward to the comment period.

Thank you.

CHAIRMAN MASSAD: Thank you.

Commissioner Bowen?

COMMISSIONER BOWEN: Yes, just one brief
question. Per the text of this proposal, this
would not exempt these options. Instead they
would exclude them from our jurisdiction. Could you briefly explain the difference between the two?

MS. PALLAIS: The interpretation speaks to forward contracts which are excluded from the Commission's jurisdiction under both the future delivery and swap definitions. The interpretation speaks to forward contracts that provide for some optionality in the delivery amount, meaning that they are still forward contracts, but provide for some variation.

So, to the degree that the contracts do not fit within the interpretation, they could be considered options within the Commission's jurisdiction.

CHAIRMAN MASSAD: Commissioner Giancarlo?

COMMISSIONER GIANCARLO: Thank you, Chairman. Thank you, Elise, and thank you, Carlene. Risk management contracts that allow for an adjustment of the quantity of a delivered commodity are important to America's economy.
They provide farmers, manufacturers, and energy companies with an efficient means of acquiring the commodities they need to conduct their daily business at the right time and in the right amounts.

They are widely used in everyday business and do not pose a threat to the stability of financial markets. They should not be regulated the same as financial derivatives. These forwards are expressly exempted from the definition of a swap under the Commodities Exchange Act, yet the CFTC's guidance on how to apply the definition using the seven factor test has been burdensome, unnecessary, and duplicative. The Commission captured a large swath of transactions that are not and should not be regulated as swaps, including these products, as Commissioner Wetjen well explained earlier.

The regulation of these transactions will actually have the effect of increasing company's cost of doing business. It will force some businesses to curtail market activity and
thereby consolidate risk in the marketplace rather than transfer and disperse it. That will ultimately raise costs for consumers.

Such costly and unnecessary regulations thwart the intent of Congress under the Dodd-Frank Act. Recently I had the pleasure of seeing firsthand how important EVO forward contracts are to America's energy utilities to ensure a stable and affordable supply of electricity. I visited a Kentucky aluminum smelter whose massive operations require the same amount of daily electricity as the city of Louisville to meet customer demand.

In times of stress to the electricity grid, such as during a very cold winter as we had last year or during intense summer heat, these contracts help the utilities ensure that this manufacturing plant's 24-hour-a-day operations do not cease. The aluminum from this smelter makes its way into everything from beer cans and automobiles to the production of U.S. fighter aircraft currently protecting our freedom around the globe. Without the use of these contracts,
this Kentucky smelter would incur increased
production costs compared to its overseas
competitors in Saudi Arabia, China, and Brazil.

Our American economy is so complex and
interconnected, we must not turn a blind eye to
the impact of our actions here in Washington. We
cannot afford to make it harder or more costly for
our manufacturers and utilities to manage risks of
supply. Increased cost to our American
manufacturing base represent an economic -- and in
this case, in the case of this Kentucky smelter --
a strategic and national security risk to our
country.

So today's proposed interpretation of
the seven-prong test benefits from thoughtful
review by my fellow commissioners. It provides a
good start to providing some sensible relief from
the problems arising from the seven prong test.
Although I would prefer a proper change to the
underlying product definition, today's proposal,
at least in the short term, should provide relief
through clearer interpretation of the rules.
Thank you very much.

CHAIRMAN MASSAD: Thank you. If there are no more questions, I would like to thank Elise and Charlene, as well as the rest of the staff who worked on this, for their efforts and the excellent presentation. Thank you.

Would any Commissioner like to make any further statements before we proceed to a vote? If not, Mr. Kirkpatrick, will you call the roll?

MR. KIRKPATRICK: The motion now before the Commission is on the adoption of the proposed interpretation concerning Forward Contracts with Embedded Volumetric Optionality. Commissioner Giancarlo?

COMMISSIONER GIANCARLO: Yes.

MR. KIRKPATRICK: Commissioner Giancarlo, yes. Commissioner Bowen?

COMMISSIONER BOWEN: Aye.

MR. KIRKPATRICK: Commissioner Bowen, aye. Commissioner Wetjen?

COMMISSIONER WETJEN: Aye.

MR. KIRKPATRICK: Commissioner Wetjen,
aye. Chairman Massad?

CHAIRMAN MASSAD: Aye.

MR. KIRKPATRICK: Mr. Chairman Massad, aye. Mr. Chairman, on this matter the ayes have 4, the noes have 0.

CHAIRMAN MASSAD: Thank you, Mr. Kirkpatrick. The ayes have it and the motion to adopt the proposed is interpretation is approved.

Is there any other Commission business? There being no further business, I would entertain a motion to adjourn the meeting?

COMMISSIONER WETJEN: So moved.

COMMISSIONER BOWEN: Second.

CHAIRMAN MASSAD: All in favor?

GROUP: Aye.

CHAIRMAN MASSAD: Thank you. Meeting is adjourned.

(Whereupon, at 11:34 a.m., the PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Carleton J. Anderson, III, notary public in and for the District of Columbia, do hereby certify that the forgoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

(Signature and Seal on File)

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Notary Public, in and for the District of Columbia

My Commission Expires: March 31, 2017