

UNITED STATES OF AMERICA  
COMMODITY FUTURES TRADING COMMISSION

OPEN MEETING ON THE EIGHTH SERIES OF  
PROPOSED RULEMAKINGS UNDER THE DODD-FRANK ACT

Washington, D.C.

Thursday, December 16, 2010

## 1 PARTICIPANTS:

## 2 Commission Members:

3 GARY GENSLER, Chairman

4 BART CHILTON, Commissioner

5 MICHAEL V. DUNN, Commissioner

6 JILL SOMMERS, Commissioner

7 SCOTT D. O'MALIA, Commissioner

## 8 Presenters:

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9 Division of Market Oversight

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12 PHYLLIS DIETZ  
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16 ED RICCOBENE  
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19 Also Present:

20 DAVID STAWICK, CFTC

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

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(9:33 a.m.)

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CHAIRMAN GENSLER: Good morning. This meeting will come to order. This is a public meeting of the Commodity Futures Trading Commission to consider issuance of the following proposed rulemakings under Dodd-Frank Wall Street Reform and Consumer Protection Act.

Before I start, I just want to make sure that Commissioner Dunn is actually tied in. I see a thumbs up.

COMMISSIONER DUNN: I am, sir.

CHAIRMAN GENSLER: Great. Commissioner Dunn is in our Chicago office today and we're doing this with all five of us. We will be considering four proposed rules today: Confirmation, portfolio reconciliation, and portfolio impression requirements for swap dealers and major swap participants, which will be the first team reporting; the second is risk management requirements for derivatives clearing organizations; thirdly, rules related to swap

1 execution facilities; and fourth, positions limits  
2 for physical commodity derivatives.

3 Before we hear from staff, I'd like to  
4 thank Commissioners Mike Dunn, Jill Sommers, Bart  
5 Chilton, and Scott O'Malia for their thoughtful  
6 work in the implementation of Dodd-Frank and their  
7 ever-present and excellent comments on these rules  
8 as we've been moving through.

9 I'd like to welcome members of the  
10 public, market participants in the media today, as  
11 well as welcome those listening in on the phones  
12 and the live webcast. Now this is the eighth  
13 public meeting to consider Dodd-Frank rulemakings  
14 and it's been a very active year for the  
15 Commission and the staff of the CFTC. And I think  
16 the commissioners and the staff have shown  
17 extraordinary commitment to public service. The  
18 staff has organized these eight Dodd-Frank rule  
19 meetings, in addition to four other public  
20 meetings, so we've had a total of 12 public  
21 meetings this year. We went back and checked the  
22 calendar, open meetings is actually more than

1 we've had in the aggregate from 2000 to 2008. So  
2 we've had more this year than we've had in nine  
3 total years.

4 In addition to working on rulemakings,  
5 the CFTC staff was closely engaged in the  
6 legislative process to enact the Dodd-Frank Act.  
7 Staff worked many weekends to provide technical  
8 assistants to Capitol Hill and serve as a resource  
9 to lawmakers. And in the 148 days since the  
10 President signed the Dodd-Frank Act -- but who's  
11 counting -- the staff of the CFTC has continued to  
12 work tirelessly. They have had more than 475  
13 meetings with the public on rulemakings, had more  
14 than 300 meetings with other regulators, and  
15 organized 7 public roundtables. And including the  
16 rules that the Commission will consider here  
17 today, the staff has recommended 34 proposed  
18 rulemakings, 4 advanced notices of proposed  
19 rulemakings, 2 interim final rules, and 1 final  
20 rule to implement the Dodd-Frank Act.

21 I feel it's a little bit like that  
22 holiday song, but --

1                   This work is in addition to all the work  
2                   the staff has done over the past year to oversee  
3                   the futures market: Coordinating with the SEC to  
4                   review the May 6 market events; successfully  
5                   standing up to new advisory committees -- I thank  
6                   you Commissioner O'Malia on the Tech Advisory  
7                   Committee; and bring greater transparency to the  
8                   market through enhanced commitment and traders'  
9                   reports and index investment reports, just to name  
10                  a few things.

11                  And also this year, with the help of  
12                  Congress and successful recruiting by the  
13                  divisions and our Human Resources Department, we  
14                  finally have gotten our staffing levels back to  
15                  the number of people we had in 1999; bring on, I  
16                  think, this past year approximately 100 people.  
17                  Again, just to finally get back to where we were  
18                  10 years ago. So I'm continually impressed by the  
19                  knowledge, effectiveness, and camaraderie and  
20                  dedication of the CFTC staff and commissioners.

21                  Now, I will return to the business of  
22                  today's meeting. Today's meeting will be the last

1 one we have this year, so I look forward to  
2 completing the meeting so that everyone can have a  
3 much deserved break to celebrate the holidays with  
4 friends and family. We'll actually start  
5 celebrating today with some holiday parties in the  
6 building and I look forward to spending time with  
7 my colleagues.

8 But we will be back at this in January.  
9 And today we'll be voting on two meeting dates in  
10 January to consider additional Dodd-Frank  
11 rulemakings. We'll announce the rulemaking  
12 proposals that the Commission will consider, as we  
13 have in the past, one week in advance of the  
14 meetings. The staff has worked very hard on the  
15 four rulemakings that we're considering today.  
16 They'll present thoughtful recommendations for how  
17 the Commission can best comply with the Dodd-Frank  
18 Act, and I'm going to turn to a couple of these  
19 now.

20 One of those obligations is to promote  
21 transparency in the swaps markets. And economists  
22 and policymakers have for decades recognized that



1 market transparency benefits the public. The more  
2 transparent a marketplace is, the more liquid it  
3 is, the more competitive it is and the lower the  
4 cost for hedgers, borrowers, and ultimately, their  
5 customers in the American public.

6 And transparency in the securities  
7 markets, we know, allows companies that need to  
8 raise and borrow capital to see and rely upon  
9 where other companies have priced their  
10 securities. We also know that transparency in the  
11 futures markets allows hedgers and speculators to  
12 see where futures trade in the marketplace and to  
13 get best pricing. And the Dodd-Frank Act brings  
14 similar transparency to the standardized part of  
15 the swaps market.

16 The bill promotes pre-trade transparency  
17 in the swaps market by requiring that the standard  
18 part of the market -- what I'll call standardized  
19 swaps, other than block trades -- be traded on  
20 regulated exchanges or swap execution facilities.  
21 And exchanges and SEFs allow buyers and sellers to  
22 meet in an open, competitive marketplace where

1 market participants have the ability to make bids  
2 and offers to multiple participants in the  
3 marketplace and where prices are made publicly  
4 available. I believe the proposed rule on SEFs  
5 today that the Commission will consider will  
6 fulfill Congress' intent to bring transparency and  
7 partial access to the swaps market.

8 Another important rulemaking the  
9 Commission will consider today relates to position  
10 limits. And when the CFTC set position limits in  
11 the past, the agency sought to ensure that markets  
12 were made up of a broad group of market  
13 participants with a diversity of views.

14 At the core of our obligation is  
15 promoting market integrity, which the agency's  
16 historically interpreted to include insuring  
17 markets do not become too concentrated, and the  
18 Dodd-Frank Act expanded the scope of this  
19 Commission's mandate to set position limits now to  
20 include certain swaps, those economically  
21 equivalent to the futures market.

22 And, importantly, the proposed

1 rulemaking reestablishes what's called  
2 single-month and all-months combined position  
3 limits for energy and metals markets. So that the  
4 rules that we're going to consider today would  
5 fulfill Congress' mandate to set these aggregate  
6 position limits across futures and certain swaps.

7 We'll also take up two other important  
8 proposed rulemakings that would help lower risk to  
9 the entire derivatives market, the first relating  
10 to risk management in clearinghouses, including  
11 and ensuring that these clearinghouses provide a  
12 more inclusive membership through fair and open  
13 access as Congress called for it.

14 The second relates to some critical  
15 business conduct standards for swap dealers. We  
16 look forward to receiving the public comments on  
17 all of this and each of these rules, as well as  
18 factsheets and Q&As, will be posted on our  
19 website. They may actually be up there now, I'm  
20 not sure of the exact timing.

21 Before I turn to my fellow  
22 commissioners' open statements, I'd also like to

1 wish everybody a joyous holiday and a happy new  
2 year.

3 Commissioner Dunn from Chicago? It's  
4 not connected. We're not hearing him. Try it  
5 again.

6 COMMISSIONER DUNN: Thank you, Mr.  
7 Chairman. Can you hear me now? Okay.

8 I would be remiss if I didn't point out  
9 that it appears we're making real progress in the  
10 appropriations. It's something that I have been  
11 harping on for -- ever since Dodd-Frank has passed  
12 and I'm very hopeful that Congress will enact on  
13 those appropriations, so we can go forward and  
14 have the imminent fiscal resources that need to  
15 implement this bill.

16 At the close of the Commission's energy  
17 position limit and hedge fund exemption hearing on  
18 August 5th of 2009, I stated that the CFTC does  
19 not have the authority to set speculative position  
20 limits in all of the venues that may be affected  
21 by excessive speculation, specifically  
22 over-the-counter markets and on foreign boards of

1 trade. Unilateral Commission action in only the  
2 markets we currently regulate would not have the  
3 desired effect of reigning in excessive  
4 speculation in the futures markets. Without  
5 similar steps with over-the-counter markets and  
6 foreign boards of trade, those seeking to evade  
7 the limits would simply move to venues outside of  
8 our authority.

9           What a difference a year makes. With  
10 the passage of Dodd-Frank, the CFTC is now --  
11 clearly has now not only the authority, but a  
12 mandate to set position limits on commodity  
13 markets and over-the-counter markets if we  
14 determine that position limits are appropriate to  
15 diminish, eliminate, or prevent the undue burdens  
16 of excessive speculation. While I'm voting on  
17 today's notice to propose rulemaking for position  
18 limits, I am still trying to understand the "as  
19 appropriate" clause of Dodd-Frank regarding  
20 position limits. And I'm interested in public  
21 comments on this topic.

22           Although we currently have the authority

1       domestically to set decision limits, we are  
2       dealing with open markets. There are discussions  
3       with international regulators regarding position  
4       limits. I think we are making progress with  
5       foreign boards of trade, but still have concerns  
6       in this area. Before we can make an effective  
7       rule, we must understand the entire universe of  
8       the market. At this time, we do not have that  
9       (inaudible) position.

10               In 2000, the Congress prohibited the  
11       CFTC from regulating the swap markets. A decade  
12       later, after a global financial meltdown, it is  
13       apparent that this was not a wise decision.  
14       However, it is impossible to turn back the clock  
15       and, over the course of the last decade, the swap  
16       markets have grown to accommodate the services  
17       they provide.

18               I believe the SEF rule provides a  
19       framework for providing pre-trade transparency  
20       while taking into account the way the swap market  
21       has developed over the past decade. I believe  
22       that there is balance between transparent markets

1 and open and competitive markets. I think this  
2 proposed rule is a step forward in striking the  
3 appropriate balance between these interests. I  
4 look to the public comments to help me determine  
5 whether the rule provides the best framework for  
6 achieving these goals.

7           Again, I would like to thank the staff  
8 of the CFTC for all their hard work in regards to  
9 these important rules. I know we're in the middle  
10 of the holiday season this month and many of them  
11 have worked weekends and holidays and will  
12 probably be doing so through the beginning of the  
13 year. I appreciate their effort and I, too, wish  
14 them all Seasons Greetings.

15           CHAIRMAN GENSLER: Thank you,  
16 Commissioner Dunn. Commissioner Sommers?

17           COMMISSIONER SOMMERS: Thank you, Mr.  
18 Chairman. And to echo everyone's thanks to the  
19 staff, particularly all the teams that are here  
20 today, thank you for all your hard work. And when  
21 we go through these weeks leading up to the public  
22 meetings that we have, there's lots of different

1        comments, and I'm sure in many cases conflicting  
2        comments, on the rules that you're putting  
3        together. So we really appreciate all you do to  
4        take into consideration our views.

5                    In previous meetings I have explained  
6        that I would not support proposed regulations that  
7        I thought were too broad or amounted to  
8        overreaching by the Commission or that too  
9        narrowly construed the language of Dodd-Frank.  
10       While in the past I believe that we've certainly  
11       overreached, today my objections to the proposed  
12       regulations for swap execution facilities and to  
13       the proposed position limits stem from our overly  
14       narrow reading of the statute.

15                    Dodd-Frank defines a SEF as a trading  
16        system or platform in which multiple participants  
17        have the ability to execute or trade swaps by  
18        accepting bids and offers made by multiple  
19        participants in the facility or system through any  
20        means of interstate commerce, including any  
21        trading facility. As I have pointed out in many  
22        of my public speaking engagements over the past



1 few months, the term "trading facility" is defined  
2 in the Commodity Exchange Act that the terms  
3 "trading system" or "platform" are not.

4 By introducing these new, undefined  
5 terms into the act and by specifying that SEFs  
6 should facilitate the trading of swaps through any  
7 means of interstate commerce, I believe that  
8 Congress intended a broad model for executing  
9 swaps on SEFs, both cleared, uncleared, liquid, or  
10 bespoke. The goals identified by Dodd-Frank for  
11 registering SEFs are to promote the trading of  
12 swaps on swap execution facilities and to promote  
13 pre-trade price transparency in the swaps market.

14 In my view, the best way to achieve  
15 these twin goals is to adopt a model that provides  
16 the maximum amount of flexibility as to the method  
17 of trading. Unfortunately, our proposal today  
18 does not do that. Section 37.9, which governs the  
19 type of execution methods that SEFs may offer, is  
20 a key provision in this proposed regulation.  
21 While it permits alternative methods of execution,  
22 such as the trading facility model and the

1 request-for-quote model, it also requires that to  
2 be registered as a SEF, and applicant must -- at a  
3 minimum -- provide market participants with the  
4 ability to post both firm and indicative quotes on  
5 a centralized electronic screen, accessible to all  
6 market participants who have access to the swap  
7 execution facility.

8 In my view, this provision is not  
9 mandated by Dodd-Frank and may limit competition  
10 by shutting out applicants who wish to offer RFQ  
11 systems without this type of functionality. I  
12 believe this interpretation of the statute and  
13 other requirements within this section are far too  
14 restrictive.

15 As a result of my concerns, we have  
16 worked throughout this past week to include  
17 alternative language for Section 37.9 in the  
18 proposal. I believe this alternative language  
19 complies with Dodd-Frank and would promote both  
20 pre-trade price transparency and the trading of  
21 swaps on SEFs, including the alternative would  
22 have given the public an opportunity to comment in

1 accordance with the Administrative Procedures Act  
2 on both the alternative language and the language  
3 contained in the proposed rule.

4 I'm deeply disappointed that despite a  
5 commitment to a transparent process in  
6 promulgating the Dodd-Frank rules, the alternative  
7 language is not included in the proposal today and  
8 we are not giving the public an ability to comment  
9 on it. I will, therefore, include a separate  
10 statement in the Federal Register notice with the  
11 alternative language and hope that the public will  
12 comment on it. I will also post the alternative  
13 language today on my page at CFTC.gov.

14 I would like to also take a moment to  
15 comment on position limits. It's no secret that I  
16 have not supported imposing position limits in the  
17 past and my views have not changed. Our  
18 authorizing committee gave us the word "necessary"  
19 and the word "appropriate," both of which should  
20 be critical components of our analysis. But, as  
21 you all know, they have not been. But even if we  
22 had made the finding that they were appropriate,

1       today we do not have the data we need to  
2       effectively set position limits.

3               Moreover, in the absence of any data,  
4       the limits that we set will be completely  
5       unenforceable, and I think it's bad policy to  
6       promulgate regulations that are not enforceable.  
7       Those challenges aside, I'm also concerned about  
8       an issue that was brought up in yesterday's  
9       hearing and that we have never considered, which  
10      is whether limits should apply differently to  
11      different groups or classes of traders, a  
12      distinction that Section 4(a) of the act allows us  
13      to make.

14             I believe that we should be able to have  
15      these different considerations when we're looking  
16      at position limits and look forward to being able  
17      to ask the team some questions today. I also have  
18      questions on the other proposals, but, again, want  
19      to thank the staff for all of their hard work on  
20      the proposals today.

21             CHAIRMAN GENSLER: Thank you,  
22      Commissioner Sommers.

1 Commissioner Chilton?

2 COMMISSIONER CHILTON: Thanks, Mr.  
3 Chairman. I'll be pretty brief. You know, a lot  
4 of times you sort of figure out, well, what's the  
5 right way to do things? And, you know, sometimes  
6 on social issues, sometimes on these policy issues  
7 it's like, well, what do I do? You get this, you  
8 get that. On limits for me it's, you know, pretty  
9 clear. Everybody knows where I am. I've been  
10 calling for this thing for years.

11 We all received this letter yesterday  
12 from Senator Harkin. And right in the first  
13 paragraph it says, "The requirement is mandatory,  
14 rather than permissive and has a specified  
15 deadline." So, you know, people can disagree.  
16 That's okay. I mean, what we heard yesterday on  
17 the Hill, Mr. Chairman, is that, you know,  
18 Congress maybe didn't even really mean this. I  
19 mean, it was their bad. I mean, maybe we didn't  
20 have to do it at all.

21 That's not my reading of it. And that's  
22 okay, people can disagree and people can have

1 legitimate concerns. But for me I sort of got a  
2 compass on this and it's true north and I know  
3 where I'm going, and so I look forward to a robust  
4 proposal on limits. I know that people have done  
5 good work on this and there's some good things in  
6 it -- I'm not saying I agree with it, but there  
7 are things that are very good and I look forward  
8 to discussing other proposals to ensure that we  
9 not only protect American consumers, but market  
10 integrity. Thank you.

11 CHAIRMAN GENSLER: Thank you,  
12 Commissioner Chilton.

13 Commissioner O'Malia?

14 COMMISSIONER O'MALIA: Mr. Chairman, you  
15 hit it on the head. This is the last rulemaking  
16 of this year and I am grateful. (Laughter) We  
17 don't -- I look forward to next year, obviously.

18 We've done 30 proposed rulemakings, 4  
19 advanced notices, and 1 final rule. I recognize  
20 that we are only halfway through the process and  
21 probably this has been the easiest part. The next  
22 step is to digest the mountain of comment letters

1       that I strongly encourage the industry, the market  
2       participants, the public, members of Congress to  
3       submit and to include in our record, so we can  
4       make correct decisions based on the facts in the  
5       market.

6                 We obviously are asking a lot of the  
7       industry to make all these comments. While each  
8       rulemaking has 30 days, there's a cumulative  
9       effect. Thousands of pages of 30-day, 60-day  
10      comment periods. It's a mountain of work and  
11      we've asked hundreds of questions, all of which we  
12      expect a timely response to. And I think we do  
13      need to be very flexible in taking in these  
14      responses and hearing from the public. And there  
15      may be a point when they don't have enough time to  
16      respond and we should think about that and be very  
17      sensitive to their needs. We shouldn't move  
18      forward without good comment.

19                Well, since I shared Macy's list last  
20      week -- the towel rack, the warming rack -- towel  
21      warming rack -- I'm going to share my list just  
22      before the holidays to make sure I get everything

1 I want from Santa.

2 My first wish is that the Commission  
3 will take the opportunity to reorganize the  
4 rulemaking process in a manner that will build  
5 derivatives regulation on strong foundation. I  
6 think this begins with strong definitions in  
7 trying to solve all the definitions first, moving  
8 onto the trading platform criteria in governance.  
9 The next layer will involve clearing, block trades  
10 reporting, and swap data repositories to follow.  
11 And then finally, capital margin, business conduct  
12 standards, and, finally, the position limits based  
13 on actual data. And the proposed trading  
14 practices should come at the end.

15 My second wish is a close first, but  
16 technology. Well, working to establish the OTC  
17 structure, we can't lose sight of the fact that  
18 organizing the Commission around technology is  
19 paramount, and we have a massive challenge to  
20 integrate all the forms and the filing in a fully  
21 electronic database that removes the human element  
22 from the reporting requirements.



1           And we must invest in automated trade  
2           surveillance to see across all markets in a way  
3           the fastest algo shops trade today. It is my goal  
4           to establish an Office of Market Data Collection  
5           and Analysis that has a data-related technology as  
6           its primary mission, and a budget that does not  
  
7           include laptops, BlackBerry, and toner as part of  
8           its competing interests.

9           My third wish is to improve our  
10          interface with the public. We need to respond in  
11          a timely manner to all the questions and concerns  
12          they're going to raise. And we need to assist  
13          them in understanding the avenues for timely  
14          recourse to solve disputes with registrars.

15          My last wish for this agency is that we  
16          will contribute to resolving the federal budget  
17          deficit. It appears Congress will not leave us  
18          with a lump of coal this year. That's the good  
19          news. But that does not solve our budget  
20          situation. The CFTC, I believe, is the best  
21          investment for taxpayers on an hourly basis,  
22          especially after the rulemakings, but we must do

1 our part to recommend savings where we find waste,  
2 a feature that is endemic with every federal  
3 agency.

4 On to today's rulemakings. I'd like to  
5 associate myself with Commissioner Sommers'  
6 comments and concerns about the SEF. I am pleased  
7 to report that we have not wasted the week from  
8 the last SEF rulemaking. We have used the time  
9 well to develop a compromise solution that will  
10 bring transparency to the dark and the markets of  
11 the OTC space.

12 I'm mindful, as Commissioner Sommers  
13 noted, that the statute provides flexibility and  
14 does not envision that the Commission will direct  
15 the swaps market to become a clone of the futures  
16 market. By and large, this market remains  
17 illiquid by futures standards and trades in  
18 significantly larger block sizes. Rather than  
19 reorganizing the market, I prefer to facilitate  
20 the trading on execution platforms with a goal of  
21 increased competition and better pricing and  
22 transparency.

1           The compromise solution we have today  
2           does not mandate a limit order book, but will  
3           allow participants to use a variety of trading  
4           systems and platforms, including order books,  
5           requests-for-quotes systems, and voice-based  
6           systems. I believe this proposal preserves the  
7           ability of the end user on the buy side to  
8           transact large sizes in a currently opaque and  
9           illiquid markets. While I'm pleased to have  
10          established sensible definitions, there are  
11          elements of this rule I have concerns with and I  
12          hope the public will provide comments.

13                 First, the open access provisions in the  
14          preamble in the rule seem in conflict. Second,  
15          will this proposal continue to serve all markets  
16          and assets in a manner that's transparent and  
17          improve liquidity rather than fracture it?  
18          Finally, I question the relevance of the mandate  
19          to require traders to be reminded of firm quotes,  
20          which they previously ignored in an RFQ system  
21          before executing their order.

22                 Now, position limits. Last week I was

1 helping Macy learn more about our Founding Fathers  
2 and we spent a considerable amount of time  
3 discussing Thomas Jefferson. In supporting  
4 today's release of the proposed rulemaking  
5 regarding position limits I believe we may fall  
6 into one of Thomas Jefferson's one liners, "Delay  
7 is preferable to error."

8           As the staff wrestled with this  
9 rulemaking, I've been constantly reminded that the  
10 exchanges already impose and enforce specific  
11 position limits in the spot month based on either  
12 hard limits or a 25 percent of deliverable supply.  
13 These limits, of course, only apply to futures  
14 markets and those contracts deemed to be  
15 significant price discovery contracts.

16           Without specific swaps data we have no  
17 ability to claim that we are applying enforceable  
18 limits without understanding the full size of the  
19 market, and this is something the Commission not  
20 ought to be held accountable for. While the  
21 proposal meets the mandates of the Dodd- Frank  
22 Act, the proposal still suffers from significant

1       flaws in its complexity and the likelihood of  
2       achieving an end state of controlling excessive  
3       speculation remains in question.

4               I'm incredibly pleased that we have  
5       eliminated the proposed crowding out provision  
6       altogether and provided for generous netting  
7       provisions while we provided for broad bona fide  
8       hedge exemptions that extend to the counterparty  
9       of a swap, where the counterparty is hedging at a  
10      cash market risk. These are all good things and  
11      demonstrate a commitment to listening to the  
12      comments we've received from participants. The  
13      proposed limits, as set forth, will have the  
14      greatest impact on large concentration positions  
15      in each class, but I question whether they will  
16      have at all an impact on the price? And I think  
17      the activities in 2007, 2008, and global food  
18      markets should remind us that these position  
19      limits will not prevent price spikes.

20              In conclusion, I would like to thank the  
21      teams -- Sarah, Riva, Phyllis, John -- for all  
22      their hard work. The teams have done

1 extraordinary work, they've been very responsive.  
2 And I also like the position limits teams of Bruce  
3 and Steve Sherrod.

4 I have the greatest aspirations for the  
5 Commission's ability to complete these rulemakings  
6 in a manner that strikes an appropriate balance  
7 between the congressional intent and the needs of  
8 the market. And whether they be the end user,  
9 swap dealer, or speculator, it is important to  
10 keep things simple, cut away the layers, and then  
11 provide a clear vision of the futures and  
12 derivatives market.

13 Thomas Jefferson said, "History in  
14 general only informs us of what bad government  
15 is." In 10 years, I'd hate to look back on this  
16 year of rulemaking and find out that we have  
17 confirmed Jefferson's worst fears. So we're going  
18 to continue to hash at these rulemakings and try  
19 to make them better along the way and I appreciate  
20 everybody's support in working to find compromise  
21 where we can.

22 CHAIRMAN GENSLER: Thank you,

1 Commissioner O'Malia. I appreciate all of the  
2 commissioners' comments and support throughout  
3 these eight rulemaking meetings, but particularly  
4 in this last week. I think it's been a very  
5 constructive dialogue and that what we're  
6 considering today is better for it.

7 With that, I think, since this is our  
8 last public meeting this year, the first thing I  
9 think I'm going to consider is just -- with regard  
10 to two open meetings for January, we expect to  
11 have meetings on the 13th and 20th, again starting  
12 at 9:30 each of those days. To that end, the  
13 chair will entertain a motion to publish in the  
14 Federal Register notice consistent with the  
15 government and Sunshine Act announcement upon open  
16 meetings to consider if Dodd- Frank proposed  
17 rulemakings on those dates and times. Do I hear a  
18 motion?

19 COMMISSIONER SOMMERS: So moved.

20 COMMISSIONER CHILTON: Second.

21 CHAIRMAN GENSLER: All those in favor?

22 GROUP: Aye.

1                   CHAIRMAN GENSLER: Any opposed? The  
2                   ayes appear to have it. The ayes have it. We'll  
3                   have meetings on the 13th and the 20th of January.

4                   I also note that Commissioner Dunn, who  
5                   is joining us by videoconference from our Chicago  
6                   office, may be called away before the meeting  
7                   concludes. He has requested that he be permitted  
8                   to vote by limited proxy for all votes taken in  
9                   this meeting, a procedure we have utilized in  
10                  previous meetings.

11                  I suspect he'll be here in time because  
12                  we might get through in time, but just in case, to  
13                  that end, I request unanimous consent to permit  
14                  limited proxy voting for all votes subsequently  
15                  taken at this meeting without objection? So  
16                  ordered.

17                  The staff will now present. After each  
18                  of these the floor will be open for question. And  
19                  following discussion, the Commission will take the  
20                  vote as we have with Dave Stawick calling the  
21                  roll. To that end I ask unanimous consent that  
22                  all final votes for publishing proposed rules and



1 final rules to implement Dodd-Frank conducted in  
2 this public meeting of the Commission be recorded  
3 votes and that the results of those votes be  
4 included in the relevant Federal Register releases  
5 without objection? So ordered.

6 I now turn to Sarah Josephson, and  
7 Ananda Radhakrishnan, and John Lawton, who will be  
8 with us today, our third round of business conduct  
9 standards related to confirmations, portfolio  
10 reconciliation, and portfolio compression.

11 Sarah, I guess, take it away.

12 MS. JOSEPHSON: Thank you. Good morning  
13 and once again I'd like to thank my -- the  
14 incredibly talented and very dedicated team on  
15 Internal Business Conduct Standards for all of the  
16 work that they have done on this third round of  
17 rulemakings.

18 Today staff is recommending for the  
19 Commission's consideration a notice of proposed  
20 rulemaking on swap confirmation, portfolio  
21 reconciliation, and portfolio compression. These  
22 rules would be promulgated pursuant to Section

1 4(s)(i) of the CEA, which provides for timely and  
2 accurate confirmation, processing, netting,  
3 documentation, and evaluation of all swaps.

4 Confirmation, reconciliation, and  
5 compression have been recognized as important  
6 post-trade processing mechanisms for reducing risk  
7 and improving operational efficiency. These rules  
8 are especially important for swaps that will be  
9 executed bilaterally. Staff anticipates that swap  
10 dealers and major swap participants would be able  
11 to comply with each of the proposed rules by  
12 executing a swap on a swap execution facility or a  
13 designated contract market, or by clearing the  
14 swap through a derivatives clearing organization.

15 The objective of proposed Confirmation  
16 Rule 23.50-1 is that parties have full written  
17 documentation of all terms of their agreement as  
18 soon as possible after execution and also upon any  
19 change of ownership during the life of the swap.  
20 Swap dealers and major swap participants entering  
21 into swap transactions with other swap dealers or  
22 major swap participants would be required to

1 obtain confirmation on the same calendar day as  
2 execution. Similarly, swap dealer and major swap  
3 participants entering into swaps with  
4 counterparties that are not swap dealers or major  
5 swap participants would be required to send an  
6 acknowledgement to their counterparties for each  
7 swap on the same calendar day as execution.

8           For the purposes of this rule, an  
9 acknowledgement can be thought of as one side of  
10 the confirmation. Then dealers and major swap  
11 participants would have policies and procedures in  
12 place to confirm the swap with financial entities  
13 on the same calendar day as execution and with all  
14 other counterparties not later than the next  
15 business day following execution.

16           The purpose of the Portfolio  
17 Reconciliation Rule is to identify and resolve  
18 disputes regarding the material terms and  
19 valuation between counterparties with regard to  
20 swaps that they hold in their portfolios.  
21 Accordingly, staff is recommending proposed Rule  
22 23.50-2, which would require swap dealer and major

1 swap participants to reconcile their portfolios  
2 with one another and provide counterparties who  
3 are not registered swap dealers or major swap  
4 participants with regular opportunities for  
5 portfolio reconciliation.

6 The frequency of the reconciliation  
7 requirement depends on the number of swaps in the  
8 portfolio. Staff is recommending this approach  
9 because it is consistent with current market  
10 practice. Swap dealers and major swap  
11 participants would be required to resolve any  
12 discrepancy in valuation, identify it as part of  
13 the reconciliation process within one business day  
14 for swaps with other swap dealers or major swap  
15 participants, and have policies and procedures in  
16 place for the resolution of discrepancies in the  
17 material terms and valuation of swaps with  
18 counterparties that are not registered as swap  
19 dealers or major swap participants in a timely  
20 fashion.

21 Portfolio Compression is a mechanism  
22 whereby substantially similar transactions among

1 two or more counterparties are terminated and  
2 replaced by a smaller number of transactions of  
3 decreased denotational value in an effort to reduce  
4 operational risk and inefficiency. Under proposed  
5 Rule 23.50-3, swap dealers and major swap  
6 participants would be required to participate in  
7 multilateral compression exercises that are  
8 offered by those DCOs or self-regulatory  
9 organizations of which the swap dealer or major  
10 swap participant is a member and as required by  
11 Commission regulation or order.

12 A swap dealer or major swap participant  
13 would be permitted to exclude swaps from a  
14 compression exercise if including the swap would  
15 significantly increase the risk exposure to that  
16 swap dealer or major swap participant.

17 Additionally, swap dealers and major  
18 swap participants would be required to bilaterally  
19 terminate all fully offsetting swaps between them  
20 and to engage in annual bilateral portfolio  
21 exercises with counterparties that are also swap  
22 dealers or major swap participants, to the extent

1       that they hadn't participated in multilateral  
2       compression exercises previously.

3                 Finally, swap dealers and major swap  
4       participants would be required to maintain written  
5       policies and procedures for periodically  
6       terminating all fully offsetting swaps, and  
7       periodically engaging in compression exercises  
8       with those counterparties who are not registered  
9       as swap dealers or major swap participants.

10                Lastly, I would note that staff has  
11       endeavored to make these rules consistent with  
12       previously proposed rules on swap data reporting  
13       and for rules that the Commission may propose on  
14       SEFs and DCOs.

15                I'll be happy to take any questions.

16                CHAIRMAN GENSLER: Sarah, thank you so  
17       much. The chair will now entertain a motion to  
18       accept the staff recommendation to issue proposed  
19       rulemakings on confirmation, reconciliation, and  
20       compression.

21                COMMISSIONER SOMMERS: So moved.

22                COMMISSIONER CHILTON: Second.

1                   CHAIRMAN GENSLER: I'd like to open the  
2 floor to allow to ask questions with regard to  
3 this. I want to say, I support the proposed  
4 rulemaking and I'll have a short statement that  
5 will go on the record, but I think that these are  
6 critical pieces. I know that the public may not  
7 be as aware of these things, but the back office  
8 of Wall Street, the back office of the banking  
9 system will be better that these transactions are  
10 confirmed on the same day between those financial  
11 entities. It gives an extra day for trades with  
12 the non-financial entities, am I right?

13                   But if it's between a bank and a bank or  
14 a bank and an insurance company, to confirm that  
15 trade, that people aren't disputing that they even  
16 entered into the trade. And I think it also helps  
17 that they'll need to reconcile because many of  
18 these transactions stay out for years, up to 30  
19 years. And as we know from the financial crisis  
20 in 2008, sometimes there were disputes on  
21 valuation. We don't specifically say how to  
22 resolve those valuation disputes, is that correct?

1 But we say the parties must actually have a policy  
2 and must have a way to -- between them --  
3 reconcile their differences in a timely way. So I  
4 think these are very critical.

5 I think one of the primary goals of the  
6 Dodd- Frank Act is to establish comprehensive  
7 regulation of the swap dealers and ensure that we  
8 lower the risk, and this is a critical rule to  
9 help do that.

10 Commissioner Dunn?

11 COMMISSIONER DUNN: Thank you, Mr.  
12 Chairman. I support this and I'm looking forward  
13 to hearing the public comments on this, especially  
14 from the industry, on how this can be implemented.

15 I did have one question, Sarah. We are  
16 requiring them to maintain written policies and  
17 procedures for periodically determining the fully  
18 offsetting swaps and periodically engaging in  
19 compression exercises under the portfolio  
20 compression requirements. How are we going to  
21 enforce that and do you think that there may be a  
22 safe harbor of what those written policies and



1 procedures might look like?

2 MS. JOSEPHSON: The policies and  
3 procedures approach for swaps for entities that  
4 are not registered as swap dealers or major swap  
5 participants was specifically designed to retain a  
6 degree of flexibility in the rule, and so that was  
7 the approach we were trying to take. I imagine in  
8 an ongoing oversight of swap dealers and major  
9 swap participants, we'd review the policies and  
10 procedures. And also, we can monitor -- there's a  
11 recordkeeping requirement. No independent  
12 reporting requirement, but a recordkeeping  
13 requirement, so we can monitor the compression  
14 exercises that they enter into. Also, the  
15 portfolio reconciliation exercises, both ones that  
16 might be led by an independent vendor, third  
17 party, or conducted on a bilateral basis. So  
18 we'll be looking at that.

19 And there are also questions in the  
20 preamble about how this would relate to, for  
21 instance, clearing. If you clear, there's  
22 actually in the portfolio reconciliation a

1 specific carve out because clearinghouses, by  
2 their nature, do -- they arrive at settlement  
3 prices every day, and so that issue about  
4 valuation is mitigated to a large extent by the  
5 clearing process.

6 So -- and then there's specific  
7 questions about how this will relate to executions  
8 on SEFs or in DCMs as well, so.

9 COMMISSIONER DUNN: Thank you.

10 CHAIRMAN GENSLER: If I could, before  
11 turning to Commissioner Sommers, is it not also  
12 the case that if a swap dealer is a bank, the bank  
13 examiners could be looking for this? And so the  
14 Dodd-Frank Act gives the bank regulators the  
15 ability to look for compliance on all of these  
16 matters as well.

17 MS. JOSEPHSON: Yes, that is absolutely  
18 correct. And, in fact, a lot of this rule, as  
19 people will note in the preamble, builds on the  
20 work that has been done by the -- what is called  
21 the OTC Derivatives Supervisors Group, an  
22 initiative led by the New York Federal Reserve

1 Bank. And they have been using their efforts in  
2 moral suasion to get the industry to comply with  
3 this type of -- these very good practices, and now  
4 they'll have rules that they'll be able to rely  
5 upon as well.

6 CHAIRMAN GENSLER: Thank you.  
7 Commissioner Sommers?

8 COMMISSIONER SOMMERS: Thank you, Mr.  
9 Chairman. Just to sort of build upon that  
10 particular group, you talk about it a lot in the  
11 preamble that since 2005 this group has been  
12 meeting on a voluntary sort of basis to talk about  
13 these important issues. And I was wondering if  
14 you could go over for us, in both -- I guess, in  
15 all three areas of confirmation, reconciliation,  
16 and compression, why we've decided to go further  
17 than what the OTC Derivatives Supervisory Group  
18 has gone and what the differences are?

19 MS. JOSEPHSON: Right. So, as part of  
20 the collaboration and consultation with fellow  
21 U.S. regulators, we have been working very closely  
22 with both the Board of Governors and the Federal

1 Reserve Banks, particularly the New York Fed, to  
2 get their feedback on the proposals, the term  
3 sheets, and indeed the actual rule text.

4           And so I think that to take each one in  
5 turn, on confirmations the way that the OTC  
6 Derivatives Supervisors Group process has worked  
7 is that the group of 14 dealers, in addition to  
8 industry groups and some buy side involvement,  
9 have made commitments -- a series of commitment  
10 letters, starting back in 2005. Initially, the  
11 focus was on credit derivatives, CDS, because of  
12 the tremendous backlogs in confirmation, as  
13 everyone knows. And then the commitments have  
14 expanded to different asset classes and also  
15 involved both portfolio reconciliation. The  
16 initiatives to begin clearing more OTC derivatives  
17 also stems from that group.

18           So in terms of confirmations, the  
19 dealers -- and these commitment letters are, I  
20 believe, publicly available on the website from  
21 the Federal Reserve. They have committed to  
22 confirming in a very timely basis -- I think

1 sometimes it's within the same T plus zero basis  
2 that we have for credit derivatives, interest  
3 rates, and also commodities. And so I think that  
4 our commitment in that way is very close.

5 I do note in the preamble that there are  
6 some transactions that will take longer and this  
7 is why we're soliciting public comment. And  
8 there's a series of questions in the confirmation  
9 rule that get at this issue, allowing for  
10 structured products to make sure that we're  
11 flexible enough and so that's where we look  
12 forward to industry comments on that front.

13 With portfolio reconciliation they have  
14 -- and this is in the commitment letters --  
15 they've committed to reconcile those trades that  
16 are collateralized and, as I explained, we are  
17 expanding that to all trades. And then the same  
18 sort of frequency requirements for portfolio  
19 reconciliation, we've pushed a little bit on that,  
20 so they reconcile at a 500 swap portfolio level.  
21 We say 300 for those dealer-to-dealer trades and  
22 then it's a slightly higher threshold for trades

1 with non-registrants.

2           And on compression, there's been a  
3 commitment to do this. The key example in the  
4 compression context is 2008, when we saw the  
5 outstanding notionals in CDS, in a series of a  
6 number of months be reduced from, I think, \$66  
7 trillion to \$30 trillion. And that was just  
8 reducing economically redundant trades. So, to  
9 make this -- to tie this in to the extent that  
10 clearinghouses do this, because there are  
11 clearinghouses that will perhaps be offering  
12 compression exercises and the DCO team that will  
13 be presenting has a analogous compression rule --  
14 and we've worked together to develop those. So  
15 that, I think, a summary of how we've tried to  
16 build on that industry effort and enhance in some  
17 ways, but then ask questions to maintain a  
18 flexibility.

19           COMMISSIONER SOMMERS: You ask the  
20 questions with regard to the appropriateness of  
21 what we have proposed here today, so in case the  
22 comments back say we would not be able to meet

1       those targets within the implementation date,  
2       would we be able to pull those back and still go  
3       final with a rule?

4                   MS. JOSEPHSON: Right. One of the  
5       things that has been in all of the rules is a  
6       staggered implementation concept. So to the  
7       extent that we would need to stagger based on  
8       asset class or particular operational issues, yes,  
9       we'd very much welcome comments on substantiating  
10      the need for that. And then we could reflect that  
11      in a final rule.

12                   COMMISSIONER SOMMERS: Great, thank you.

13                   CHAIRMAN GENSLER: Thank you,  
14      Commissioner Sommers.

15                   Commissioner Chilton?

16                   COMMISSIONER CHILTON: Thank you, Mr.  
17      Chairman. Thanks, Ms. Josephson. You and your  
18      team have done a great job on this one. I don't  
19      sense that there's anything controversial.  
20      Perhaps during the comment period we'll hear  
21      something, but I think you've done a great job and  
22      I support it. Thank you.

1                   CHAIRMAN GENSLER: Thank you,  
2 Commissioner Chilton.

3                   Commissioner O'Malia?

4                   COMMISSIONER O'MALIA: I just have one  
5 question. Sarah. You've -- what are you, fourth  
6 time up here? Congratulations. Frequent flyer  
7 award.

8                   We talk a lot about how badly we need  
9 appropriations to meet all these mandates that  
10 we're sending out and requiring to comply with.  
11 What are we asking in all of your rulemakings?  
12 What are the costs that we're imposing on the  
13 industry in all these rulemakings you've put  
14 forward so far?

15                  MS. JOSEPHSON: Right. So we have tried  
16 -- and I'd like to thank Jody Partridge for doing  
17 really the hard work of the PRA and the putting  
  
18 together of what we think is a very accurate, or  
19 an attempt to be accurate, in a lot of these rules  
20 and how much it would cost.

21                  Now, for these particular rules, in a  
22 lot of ways the entities that are engaged in swaps



1 have to do this already, that they -- as the  
2 chairman mentioned, for their regular back office  
3 bookkeeping. It's just a matter of how quickly  
4 they need to do it. The other thing I would note  
5 is, especially on portfolio reconciliation and  
6 portfolio compression, there are a number of  
7 third-party vendors, service providers that offer  
8 these services and, as we note in the preamble,  
9 some of them charge based on results.

10 So we've tried to reflect as best as  
11 possible the costs, but, again, we look for  
12 industry feedback if we've gotten that wrong.

13 COMMISSIONER O'MALIA: Do you think  
14 there's a chance with a mandate the prices go up?

15 MS. JOSEPHSON: It could be, but it  
16 could also be that with the scale, prices could  
17 come down.

18 MR. RADHAKRISHNAN: And we're not  
19 forcing them to use third-party vendors.

20 MS. JOSEPHSON: They can also do it  
21 bilaterally.

22 MR. RADHAKRISHNAN: I must add, you

1 know, the idea of two supposedly sophisticated  
2 institutions not knowing what kind of deal they  
3 have is ludicrous. To me, in a way, I question --

4 COMMISSIONER O'MALIA: The question  
5 wasn't do you have sympathy for swap dealers? I  
6 get that that probably isn't going to be the first  
7 --

8 MR. RADHAKRISHNAN: Because I --

9 COMMISSIONER O'MALIA: Don't break out  
10 the tissues. (Laughter) I get that, but I was  
11 just asking how much this is going to cost --

12 MR. RADHAKRISHNAN: Oh, no, no, no.

13 COMMISSIONER O'MALIA: -- cumulative?

14 MR. RADHAKRISHNAN: It will cost  
15 something. I think, you know, we have done the  
16 cost-benefit analysis, but this is something  
17 they've got to do. You know, if an exchange or a  
18 DCO did not do this, we'd kick them out of  
19 business. So, to me, you know, it's -- and the  
20 other point is -- and I'm not on a soapbox, but  
21 commitments are one thing, but commitments without  
22 the force of law, in my humble opinion -- and

1 maybe it's the policeman in me -- I'm meaning  
2 this, again. So, you know, I think it's essential  
3 that there be a regulation that we can tell  
4 somebody you got to do this.

5 So this shouldn't be a surprise to  
6 people. You know, the New York Fed has been, you  
7 know, on them since 2005, except that that doesn't  
8 mean that, you know, that the caning element of it  
9 (inaudible).

10 (Laughter)

11 COMMISSIONER O'MALIA: It's the  
12 holidays. How about some sympathy?

13 CHAIRMAN GENSLER: You know, the public  
14 has gotten to know many of our staff and I imagine  
15 that they're getting the same affection that we  
16 have for Ananda and his passion. (Laughter)

17 Before calling the vote, I do think that  
18 each of these three pieces, in and of itself, is  
19 very significant to lower risk, that dealers  
20 confirm their trades with financial institutions  
21 on the same day. Big. They're doing it mostly  
22 now, but, as Ananda points out, it's just a

1 commitment and now it will be a rule.

2 Even as you said to Commissioner Sommers  
3 -- excellent question -- about portfolio  
4 compression, not something a lot of people know  
5 about. But after 2008, the credit default swap  
6 marketplace went from \$60-some trillion to \$28  
7 trillion. And you might say, well, that was just  
8 bookkeeping, but that lowers risk because it's a  
9 lot fewer disputes, paperwork, uncertainty, if one  
10 of the parties fails. So each of these are very  
11 big.

12 And I thank you for working so closely,  
13 by the way, with the New York Federal Reserve and  
14 the Federal Reserve and the FDIC and the OCC,  
15 because I know you've done that and shared all  
16 this with them.

17 So, with that, Mr. Stawick, do you want  
18 to call the roll?

19 MR. STAWICK: Commissioner O'Malia?

20 COMMISSIONER O'MALIA: Aye.

21 MR. STAWICK: Commissioner O'Malia, aye.  
22 Commissioner Chilton?

1 COMMISSIONER CHILTON: Aye.

2 MR. STAWICK: Commissioner Chilton, aye.

3 Commissioner Sommers?

4 COMMISSIONER SOMMERS: Aye.

5 MR. STAWICK: Commissioner Sommers, aye.

6 Commissioner Dunn?

7 COMMISSIONER DUNN: Aye.

8 MR. STAWICK: Commissioner Dunn, aye.

9 Mr. Chairman?

10 CHAIRMAN GENSLER: Aye.

11 MR. STAWICK: Mr. Chairman, aye. Mr.

12 Chairman, on this question, the yeas are five, the

13 nays are zero.

14 CHAIRMAN GENSLER: Thank you, Mr.

15 Stawick. The staff recommendation has been

16 accepted by the 5-0 vote you announced, and we

17 will send it to the Federal Register. Thank you

18 very much.

19 CHAIRMAN GENSLER: Bob Wasserman from

20 the Division of Clearing and Intermediate

21 Oversight, and the public might also know has also

22 been our team lead on bankruptcy and segregation

1 issues. Ann, it's good to see you in. Anne  
2 Polaski, also from the Division who's been working  
3 on key parts of this role. And Phyllis, the team  
4 lead and John Lawton and Ananda. Why don't you  
5 take it away. But I think we'll have much to hear  
6 from. Thank you.

7 MS. DEITZ: Thank you. Good morning,  
8 Mr. Chairman and commissioners.

9 I am pleased to recommend that the  
10 commission approve for publication in the federal  
11 register proposed regulations that would revise  
12 procedures for Derivatives Clearing Organization  
13 registration, and implement six core principals  
14 for DCOs, including systemically important DCOs.

15 I would like to take this opportunity,  
16 as others have, to thank the members of the DCO  
17 SDCO rulemaking teams for their many  
18 contributions. And I would particularly like to  
19 thank the Clearing Policy DCO Review, and Risk  
20 Surveillance staff in Chicago for their enormous  
21 contributions to this particular rulemaking.

22 Following a brief overview of our

1 proposal for DCO registration applications, my  
2 colleagues will present proposed rules  
3 implementing the following core principals.  
4 Participant and product eligibility, which John  
5 Lawton will discuss. Risk management, settlement  
6 procedures, treatment of funds, and default rules  
7 and procedures, which Anne Polaski, who is our  
8 lead attorney on this matter, will discuss. And  
9 then Bob Wasserman will close with system  
10 safeguards.

11 Turning to application procedures. In  
12 reviewing an application for DCO registration, the  
13 staff and, in turn, the commission, has to  
14 evaluate the applicant's ability to comply with  
15 the DCO core principles. The commission has  
16 issued general guidance regarding compliance, but  
17 staff -- and, no doubt, many applicants as well --  
18 have found the guidance to be too general to be  
19 very helpful.

20 We are, therefore, recommending that the  
21 commission propose a mandatory use of an  
22 application form that would be comprised of a

1 cover sheet and a series of detailed exhibits that  
2 would provide a comprehensive record upon which  
3 the commission could base its decision.

4 The staff believes that use of the new  
5 form DCO will make the registration process more  
6 transparent, will clarify for prospective  
7 applicants the registration standards, and will  
8 allow us to process applications in a consistent  
9 manner.

10 Thank you.

11 MR. LAWTON: Okay, good morning. I will  
12 proceed with the proposals with regard to  
13 participant and product eligibility.

14 Core Principle C, as amended by  
15 Dodd-Frank, requires each DCO to establish  
16 appropriate participant and product eligibility  
17 standards. With regard to membership, DCOs must  
18 require sufficient financial resources and  
19 operational capacity to meet the obligations  
20 arising from participation. Core Principle C  
21 further requires as such participation and  
22 membership requirements be objective, be publicly



1 disclosed, and permit fair and open access.

2 With respect to product eligibility,  
3 Core Principle C requires that each DCO establish  
4 appropriate standards for determining the  
5 eligibility of contracts submitted for clearing.  
6 The staff is proposing regulation 39.12 pursuant  
7 to Core Principle C.

8 I'll turn first to participant  
9 eligibility. Proposed 39.12 is designed to ensure  
10 that participation requirements do not  
11 unreasonably restrict any entity from becoming a  
12 clearing member, while at the same time  
13 eliminating risk to the DCO and its other clearing  
14 members.

15 Proposed 39.12(a) would require a DCO to  
16 establish participation requirements that permit  
17 fair and open access. To achieve fair and open  
18 access the proposal would prohibit a DCO from  
19 adopting a particular restrictive participation  
20 requirement if it could adopt a less- restrictive  
21 requirement that would not materially increase  
22 risk to the DCO or to its clearing members.

1                   The proposal would prohibit  
2 participation requirements that have the effect of  
3 excluding or eliminating clearing membership of  
4 certain types of market participants, unless the  
5 DCO can demonstrate that the restriction is  
6 necessary to address financial risk or  
7 deficiencies in a participant's operational  
8 capabilities that might prevent them from  
9 fulfilling their obligations as clearing members.  
10 It would prohibit a DCO from requiring clearing  
11 members maintain a swap portfolio of a particular  
12 size or that they meet any transaction volume  
13 threshold.

14                   The proposal would further require that  
15 clearing members have access to sufficient  
16 financial resources to meet obligations arising  
17 from participation in the DCO. It would require  
18 DCOs to establish capital requirements that are  
19 based on objective, transparent, and  
20 commonly-accepted standards that appropriately  
21 match capital to risk. It would require capital  
22 requirements to be scaleable so that they would be

1 proportional to the risk posed by individual  
2 clearing members. Thus, for clearing members risk  
3 exposure were to increase the DCO could increase  
4 the clearing members' corresponding capital  
5 requirement.

6 The proposal would specify that a DCO is  
7 not permitted to set a minimum capital requirement  
8 of more than \$50 million.

9 With regard to operational requirements,  
10 the proposal would require a DCO to establish  
11 participation requirements that ensure that  
12 clearing members have adequate operational  
13 capacity to meet obligations arising from  
14 participation. This would include, at a minimum,  
15 the ability to process expected volumes and values  
16 of transactions within required timeframes,  
17 including at peak times, and on peak days. The  
18 ability to fulfill collateral payment and delivery  
19 obligations, and the ability to participate in  
20 default management activities as required by the  
21 rules of the DCO.

22 Strong participation requirements will

1 not limit risk if they're not satisfied on an  
2 ongoing basis. Core Principle C requires that  
3 each DCO establish and implement procedures to  
4 verify on an ongoing basis the compliance of each  
5 participation and membership requirement of the  
6 DCO. The proposal would codify this requirement.

7 A DCO cannot effectively monitor  
8 clearing members if it's not adequately informed  
9 about their financial status. The proposal would  
10 address this point. Specifically, it would  
11 require DCOs to in turn to require their clearing  
12 members to file periodic financial reports with  
13 the DCO that contain any financial information  
14 that the DCO determines is necessary to assess  
15 whether the requirements are being met.

16 Turning now to product eligibility.  
17 Proposed 39.12(b) would require a DCO to establish  
18 appropriate requirements for determining the  
19 eligibility of contracts submitted for clearing,  
20 taking into account its ability to manage the  
21 risks associated with such contracts. The factors  
22 to be considered in determining product

1 eligibility would include but not be limited to  
2 trading volume, liquidity, availability of  
3 reliable prices, the ability of the DCO to measure  
4 risk for purposes of setting margin requirements,  
5 and the operational capacity of the DCO and its  
6 clearing members to address any unique risk  
7 characteristics of a product.

8 Section 2(h)(1)(B) of the act requires a  
9 DCO to adopt rules providing that all swaps with  
10 the same terms and conditions submitted to the DCO  
11 for clearing are economically equivalent within  
12 the DCO and may be offset with each other within  
13 the DCO. It further provides for  
14 non-discriminatory clearing of all swaps executed  
15 bilaterally or on our subject to the rules of an  
16 unaffiliated trading facility. Proposed rule  
17 39.12(b) would codify these requirement's in the  
18 commission's regulations.

19 Proposed 39.12(b)3 would also require a  
20 DCO to select contract unit sizes that maximize  
21 liquidity, open access, and risk management.  
22 Appropriate contract unit size can promote

1 liquidity, it can facilitate open access, and it  
2 can aid risk management in the event of a default,  
3 by permitting a DCO to have more potential  
4 counterparties for liquidation purposes.

5 Finally, the proposal would require each  
6 DCO that clears swaps to have rules stating that  
7 upon acceptance of a swap by the DCO for clearing  
8 by a clearing member on behalf of a customer, all  
9 the terms of the swap as carried in the customer  
10 account on the books of the clearing member must  
11 conform to the terms of the cleared swap  
12 established under the DCO's rule. The purpose of  
13 this provision is to encourage standardization of  
14 swaps and to avoid any problems that might arise  
15 based on a difference between the terms of the  
16 swap as carried at the DCO level and as carried at  
17 the clearing member level.

18 Thank you.

19 MS. POLASKI: Good morning, Mr. Chairman  
20 and commissioners.

21 The proposed regulation implementing  
22 Core Principle D, risk management, would address

1 three general categories of risk management  
2 requirements. General requirements, requirements  
3 addressing measurement of credit exposure and  
4 margin, and requirements relating to other risk  
5 control mechanisms.

6 The general requirements would require a  
7 DCO to have a comprehensive written risk  
8 management framework subject to internal audit and  
9 a chief risk officer. The proposed regulation  
10 contains a number of specific requirements with  
11 respect to the measurement of credit exposure and  
12 margin. For example, a DCO typically includes in  
13 its margin calculations an estimate of the time  
14 within which it would be able to liquidate a  
15 defaulting clearing member's positions. The  
16 proposal would require a DCO to use an estimated  
17 liquidation time that is a minimum of five  
18 business days for cleared swaps that are not  
19 executed on a designated contract market, and a  
20 minimum of one business day for all other products  
21 that it clears.

22 Margin coverage would have to meet a

1 confidence level of at least 99 percent based on  
2 data from an appropriate historic time period with  
3 respect to the following: Each product that is  
4 margined on a product basis, each spread within or  
5 between products for which there is a defined  
6 spread margin rate, each account held by a  
7 clearing member at the DCO by house origin and  
8 customer origin, and each swap portfolio by  
9 beneficial owner.

10 A DCO would be required to determine  
11 whether its margin coverage was adequate for each  
12 product on a daily basis. In addition, a DCO  
13 would be required to conduct periodic back tests  
14 to determine the extent of actual margin coverage  
15 over a period of time. The proposal would require  
16 daily back tests for products that are  
17 experiencing significant market volatility.  
18 Monthly back tests would be required for all  
19 products, for each clearing member's house and  
20 customer account, and for each swap portfolio by  
21 beneficial owner.

22 With respect to customer accounts only,



1 DCOs would be required to collect margin on a  
2 gross basis. Thus, a DCO would not be permitted  
3 to net positions of different customers against  
4 one another when collecting margin for a clearing  
5 member's customer account.

6 With respect to other risk control  
7 mechanisms, the proposal would require a DCO to  
8 impose risk limits on each clearing member's house  
9 and customer account to limit its risk exposure  
10 relative to the clearing member's financial  
11 resources, the DCO's financial resources, or both.

12 A DCO could only permit a clearing  
13 member to exceed such a risk limit if it posted  
14 additional margin. A DCO would be required to  
15 obtain from its clearing members copies of all  
16 large trader reports that clearing members filed  
17 with the commission, and review those reports on a  
18 daily basis, including reviewing each large  
19 trader's positions reported by any of the DCO's  
20 clearing members.

21 The proposal would require a DCO to  
22 conduct daily stress tests with respect to certain

1 large traders, and weekly stress tests with  
2 respect to all clearing member accounts by house  
3 and customer origins, and all swap portfolios by  
  
4 beneficial owner to compare the impact of  
5 potential price moves to the financial resources  
6 of the large traders and clearing members.

7 A DCO would also be required to offer  
8 multilateral portfolio compression exercises on a  
9 regular basis for its clearing members that clear  
10 swaps to the extent that such exercises are  
11 appropriate for those swaps that it clears.

12 The proposed regulation implement in  
13 Core Principle E, settlement procedures, would  
14 require a DCO to affect a settlement with each  
15 clearing member at least once each business day.  
16 And, to have the authority and operational  
17 capacity to affect a settlement with each clearing  
18 member on an intraday basis, either routinely when  
19 thresholds specified by the DCO were breached, or  
20 in times of extreme market volatility.

21 DCOs would be subject to three  
22 requirements in order to limit their exposure to

1 settlement bank risks. First, a DCO would be  
2 required to have documented criteria for  
3 acceptable settlement banks for the DCO and its  
4 clearing members addressing capitalization, credit  
5 worthiness, access to liquidity, operational  
6 reliability, and regulation or supervision of such  
7 banks. Second, a DCO would be required to monitor  
8 the approved settlement banks on an ongoing basis  
9 to ensure that they continue to meet the  
10 documented criteria. Finally, a DCO would be  
11 required to monitor the range and concentration of  
12 its exposures to the settlement banks in the event  
13 that the settlement bank with the largest share of  
14 settlement activity were to fail.

15           The proposed regulation implementing  
16 Core Principle F, treatment of funds, would  
17 require a DCO to comply with any applicable  
18 customer segregation requirements. The proposed  
19 regulation would also establish the procedures  
20 that must be followed and the information that  
21 must be submitted to the commission by a DCO  
22 seeking approval to either commingle futures

1       possessions in a swaps account governed by section  
2       4d(f) of the CEA, or to commingle swaps in a  
3       futures account governed by section 4d(a) of the  
4       CEA.

5               The proposed regulation would require a  
6       DCO to limit the assets it accepts as initial  
7       margin to those that have minimal credit market  
8       and liquidity risks without specifying which  
9       particular assets are acceptable. However, it  
10       would specifically prohibit a DCO from accepting  
11       letters of credit as margin.

12               The proposed regulation would require  
13       the valuation of assets posted as margin on a  
14       daily basis, the application of appropriate  
15       haircuts, and appropriate concentration limits as  
16       necessary to ensure liquidity.

17               Any investment of customer margin funds  
18       would have to comply with the regulation 1.25  
19       requirements, whether the customers are futures  
20       customers or swaps customers.

21               The proposed regulation implementing  
22       Core Principle G, default rules and procedures,

1 would require a DCO to maintain a current written  
2 default management plan and to conduct and  
3 document a test of the plan at least once a year.  
4 The proposal would require that in the event of a  
5 clearing member default, a DCO must have the  
6 authority to promptly transfer, liquidate, or  
7 hedge the customer or proprietary positions of the  
8 defaulting clearing member. In addition, a DCO  
9 would be permitted to auction or allocate those  
10 positions to other clearing members.

11           However, if a DCO's rules permit it to  
12 require other clearing members to accept an  
13 allocation of a defaulting clearing member's  
14 positions, the allocation would have to be  
15 proportional to the size of the accepting clearing  
16 member's positions at the DCO. The proposed  
17 regulation would also require a DCO to review a  
18 clearing member's continuing eligibility for  
19 membership if it filed a bankruptcy petition and  
20 to take appropriate action with respect to its  
21 positions.

22           Thank you.

1                   MR. WASSERMAN: Thank you. I'm going to  
2 deal with Core Principle I and I am going to  
3 briefly discuss three issues. System safeguards,  
4 business continuity standards for all DCOs, and  
5 business continuity standards for systemically  
6 important DCOs.

7                   In terms of system safeguards,  
8 regulation 39.1(a) implements Core Principle I's  
9 requirement that each DCO have a program of risk  
10 analysis and oversight with respect to operations  
11 and automated systems. Specifically, these  
12 systems must have adequate scaleable capacity and  
13 the program needs to address issues such as  
14 information security, business continuity and  
15 disaster recovery -- which I'm going to talk a  
16 little bit more about later -- capacity and  
17 performance planning, systems operations, systems  
18 development and quality assurance, and physical  
19 security and environmental controls.

20                   Key issue is that the DCO is required to  
21 follow generally accepted standards and industry  
22 best practices. So in other words, we're not

1 being prescriptive in terms of the exact  
2 standards. Rather, they need to follow what is  
3 essentially industry best practice.

4           In terms of business continuity and  
5 disaster recovery for all DCOs. The business  
6 continuity and disaster recovery plan needs to  
7 address physical, technological, and personnel  
8 resources. In other words, you can't just simply  
9 have wonderful physical and resources in computers  
10 and not address your people. The recovery time  
11 objective for all DCOs would be not later than the  
12 next business day. In addressing the resources  
13 for this, you may meet this through your own  
14 resources, including, for instance, cross-training  
15 of people. Or, the regulation explicitly notes  
16 that you may meet these requirements through  
17 written outsourcing arrangements.

18           The regulation requires periodic  
19 objective testing and review of the automated  
20 systems, and of the business continuity and  
21 disaster recovery plan. And you have to use  
22 testing protocols that ensure that the DCO's

1 business continuity resources are sufficient to  
2 meet the recovery time objective.

3 Testing must be conducted by qualified,  
4 independent professionals, and reports setting  
5 forth the protocols for these tests need to be  
6 communicated to and reviewed by senior management,  
7 as well as, of course, the results of the tests.

8 The regulation calls for a more  
9 searching review of tests with fewer no  
10 exceptions, on the theory that if you have a test  
11 that you do too well on, perhaps it wasn't a  
12 searching enough test. And the tests also must  
13 show that you work with your members and your  
14 service providers. Tests must also be coordinated  
15 with clearing members, and providers of essential  
16 services, such as telecom, water, power, and the  
17 like.

18 Specifically with respect to  
  
19 systemically important DCOs. The commission had  
20 proposed some rules back in May under which we  
21 were going to designate which of the DCOs, among  
22 other things, were critical. With respect



1 specifically to DCOs, since Dodd-Frank has  
2 essentially established through the FSOC  
3 designation criteria and a designation process for  
4 which DCOs are systemically important, rather than  
5 duplicate that process we will follow those  
6 designations. And so those are the DCOs who are  
7 subject to these higher standards.

8           The higher standards come in two areas.  
9 First off, what is required is a recovery time  
10 objective of two hours following a disruption,  
11 including a wide-scale disruption. In order to  
12 meet that there is a requirement of geographic  
13 dispersal of resources. In other words, you need  
14 to have among your backup resources  
15 infrastructure, physical, and technological  
16 resources that are geographically diverse from the  
17 resources that you might rely on to meet your  
18 normal needs. And with respect to personnel, you  
19 need to be having separate personnel -- that is,  
20 personnel outside of the normal commuting area of  
21 a primary location so that in the event that such  
22 personnel are temporarily or permanently

1       unavailable, essentially you have your backup  
2       resources.

3               The implementation date for this, since  
4       this is a higher standard, would give a minimum of  
5       a year. Or, July 30, 2012.

6               Thank you.

7               CHAIRMAN GENSLER: That it?

8               MS. DEITZ: That concludes our  
9       presentation.

10              CHAIRMAN GENSLER: No more.

11              MS. DEITZ: I think -- anyone else here?  
12       (Laughter) We have a cast of thousands today.

13              CHAIRMAN GENSLER: No, no. I'm kidding  
14       around a little bit.

15              Let me entertain a motion with regard to  
16       the Risk Management Requirements for Derivatives  
17       Clearing Organizations.

18              COMMISSIONER SOMMERS: So moved.

19              COMMISSIONER CHILTON: Second.

20              CHAIRMAN GENSLER: I'd like to open the  
21       floor now to allow commissioners to ask questions.  
22       Let me say, I was kidding around a little bit.

1 But this is a really critical set of roles. I  
2 support the proposed rulemaking and I'll have a  
3 further statement. But the proposal establishes  
4 robust risk management standards. And I think  
5 it's particularly important as more swaps are  
6 moved into central clearing, and as Congress  
7 mandated that swaps be there.

8 We've had clearinghouses since the  
9 1890s. They've really worked well in the futures  
10 markets, through two world wars, the Great  
11 Depression, and, yes, the crisis in 2008. But  
12 Congress has now mandated that swaps also be  
13 there.

14 Voluntarily, there have been in a lot of  
15 markets. But this is now going to be a mandate.  
16 So, these proposed rules are very important.

17 As I understand it, it's a question that  
18 these meet or at least are consistent with  
19 international standards as we know it. I know  
20 that's a moving target, but is that a yes?

21 MR. RADHAKRISHNAN: Yes.

22 CHAIRMAN GENSLER: Yeah, all right. I

1 think that's very important that they meet, or at  
2 least are consistent with international standards.  
3 That risk and derivatives know no geographic  
4 boundary. There are going to be swaps that are  
5 booked into clearinghouses we regulate, that might  
6 emanate out of Europe or Asia, and vice versa.  
7 And it's very important that the clearinghouses we  
8 regulate are accepted in Europe and Asia. And is  
9 it your thought, Ananda and Phyllis, that they  
10 would be, as you know it, what Europe and Asia is  
11 doing?

12 MR. RADHAKRISHNAN: Yes.

13 CHAIRMAN GENSLER: I think that also  
14 this rule, importantly, establishes some margin  
15 methodologies. But as I understand, it still  
16 leaves the setting of margin to the  
17 clearinghouses. I just want to confirm that.

18 MR. RADHAKRISHNAN: That's right.

19 CHAIRMAN GENSLER: And so the margining  
20 methodologies, critically, one is gross margining?  
21 Is that -- remember --

22 MR. RADHAKRISHNAN: That's the

1 collection of margin. It has to be on a gross  
2 basis.

3 CHAIRMAN GENSLER: So it has to be on a  
4 gross basis. And then also this methodology that  
5 if it's something not traded on a designated  
6 contract market, there's more days to liquidate  
7 the position.

8 MR. RADHAKRISHNAN: Five business day  
9 holding period.

10 And so, the gross margining -- just to  
11 clarify it. It's with respect to customer  
12 accounts.

13 CHAIRMAN GENSLER: Which gives greater  
14 risk protection at the clearinghouse, but also  
15 gives greater protection to the customer money,  
16 does it not?

17 MR. RADHAKRISHNAN: That's what we  
18 believe, yes.

19 CHAIRMAN GENSLER: And then it has, of  
20 course, what John Lawton talked about and I just  
21 want to ask quickly about is, participant  
22 eligibility. And I don't know, John, if you read

1 the New York Times story this past Sunday?

2 MR. LAWTON: I did see that, yes.

3 CHAIRMAN GENSLER: You did? All right.

4 Other people saw it, too, I gather.

5 My sense -- what you described is far --  
6 sort of, in many ways consistent with the futures  
7 model. But, do you have an estimate of the 125 or  
8 so futures commission merchants, how many might be  
9 able to meet the standards you talked about?

10 MR. LAWTON: Yeah, we looked at the  
11 list. There's 126 FCMS, 63 of them have capital,  
12 currently, of above the \$50 million number that we  
13 set. There's -- most of the ones that are below  
14 are not currently clearing members anyway. There  
15 are a few clearing members that are below the --  
16 current clearing members that are existing DCOs  
17 that are below that \$50 million number. They tend  
18 to be more specialized in some of the agricultural  
19 products.

20 CHAIRMAN GENSLER: And my sense is, this  
21 goes to the heart -- I mean, we were working on  
22 this rule for months now. But this goes to the

1 heart of the issues that the New York Times raised  
2 about that in swaps clearing today, they're rather  
3 inclusive. They have -- I'll call it an exclusive  
4 group of members which is far more exclusive than  
5 in the futures clearing model. Is that correct?

6 MR. LAWTON: Right. I mean, some of the  
7 clearing organizations have -- for example, a  
8 billion dollar capital requirement, which would  
9 exclude most FCMs.

10 CHAIRMAN GENSLER: And as I understand  
11 it, they also exclude people that aren't currently  
12 swap dealers, even if they are a futures  
13 commission merchant?

14 MR. LAWTON: That's correct.

15 CHAIRMAN GENSLER: And yet Congress said  
16 that they have to have a core principle for fair  
17 and open access. Is that -- I understand?

18 MR. LAWTON: Right.

19 CHAIRMAN GENSLER: Yeah. So here we  
20 have a rule and it's, I think, is a very important  
21 feature of this rule. Is that we're saying that  
22 the clearinghouses, to protect themselves in risk,

1 can scale somebody's participation with the amount  
2 of resources that member has but can't exclude  
3 them. But, can scale them. Is that right?

4 MR. LAWTON: Right. So we've seen in  
5 the past there have been clearinghouses that had  
6 capital-based position limits. So that if your  
7 capital is \$50 million you can only take on a  
8 certain amount of risk. If your capital is \$100  
9 million you can take on twice that amount of risk,  
10 and so forth. And it would generally be tied to  
11 the margin requirements, and they would also  
12 typically have some sort of provision for  
13 flexibility. If someone bumped up against their  
14 limit, they could potentially either get a capital  
15 infusion or pay an additional margin charge for  
16 the increment of position above their limit.

17 CHAIRMAN GENSLER: But we still allow  
18 the clearinghouse discretion to sort of set that  
19 scalability in how they look at it.

20 MR. LAWTON: That's right.

21 CHAIRMAN GENSLER: So, I think it's very  
22 important -- I think this will lower risk to the



1 American public. I think it will allow, as  
2 Congress said, fair and open access to these  
3 clearinghouses, as we really have in the futures  
4 world right now. We just don't yet have it in the  
5 swaps world, in my opinion. And some of the swaps  
6 clearinghouses do better than others. But, I  
7 won't get into naming names.

8 And then Bob Wasserman, I just have a  
9 question over on the recovery time. Did you say  
10 that the two hour recovery time is just for  
11 systemically important clearinghouses or for all  
12 clearinghouses?

13 MR. WASSERMAN: No, that would be just  
14 fro SDCOs. The systemically important ones.

15 CHAIRMAN GENSLER: I see. So of course  
16 it would wait until the financial stability  
17 oversight council moves through their process and  
18 designates, you know, some number of systemically  
19 important clearinghouses.

20 MR. WASSERMAN: Yes. And then through  
21 implementation there would be a minimum of one  
22 year and in any event, not before July 30, 2012

1       that the systemically important DCOs would be  
2       subject to those standards.

3               CHAIRMAN GENSLER:   And how does that  
4       compare this two hours to international standards?  
5       Or if there is such a thing.  I see Jackie Mesa  
6       here, (inaudible) international --

7               MR. WASSERMAN:   Two hours is the --  
8       seems to be the evolving international standard.

9               CHAIRMAN GENSLER:   All right.  Jackie,  
10       do you -- is that?

11              MS. MESA:   That's right.  Two hours is  
12       the --

13              CHAIRMAN GENSLER:   All right.  So, thank  
14       you.  Commissioner Dunn?  If you -- from Chicago?

15              COMMISSIONER DUNN:   Thank you, Mr.  
16       Chairman.  And I think this is one of the more  
17       important rules that we are going to be taking up  
18       during this period.

19              When I was -- during my tenure as acting  
20       chairman I laid out that risk management was one  
21       of the tenants that I thought we had to address.  
22       And this rule goes along way to do that, and I

1 appreciate the work of the staff in putting this  
2 proposed rule together.

3 I have to ask the question that I  
4 usually ask Ananda, and that is, do we have the  
5 resources to implement this?

6 MR. RADHAKRISHNAN: Today, no. I hope  
7 we get the money, but if you ask me if I can, you  
8 know -- if DCIO can effectively oversee all of the  
9 DCOs we have right now and the activity that we  
10 anticipate -- well, let me say it this way. If I  
11 took people away from other things and  
12 concentrated on DCOs, then perhaps I could do it.  
13 But then something has got to give. So, I guess  
14 the answer is, not necessarily.

15 It's all a matter of priority. So, I  
16 hope Congress does the right thing.

17 COMMISSIONER DUNN: I'm sure we're going  
18 to get a lot of comments about added cost of this  
19 particular regulation. And has the staff given  
20 any thought to what added cost might be and  
21 whether it's reasonable?

22 MR. RADHAKRISHNAN: A lot of it is, you

1 know, codification of current industry practices,  
2 which we have been -- the division has been trying  
3 to get people to do through our DCO reviews. So,  
4 I mean, there might be some added costs. But we  
5 think the benefits in terms of safety and  
6 soundness outweighs the costs. And, you know,  
7 this commission is aware. All it takes is a lack  
8 of confidence in one DCO, and there's going to be  
9 a spillover effect because people will stop  
10 trading on that market if there's no confidence in  
11 the DCO. So, you know, we think it essential that  
12 the safety and soundness of DCOs, you know, remain  
13 at a high level at all times.

14 And we believe the -- if the commission  
15 votes on, you know, this proposal and makes it  
16 final, we believe that this will go a long way  
17 towards achieving that goal.

18 COMMISSIONER DUNN: I noted that  
19 Commissioner O'Malia brought up the cost of  
20 implementation in the previous regulation that we  
21 were contemplating. When we write a regulation,  
22 there are always some boilerplate things that we

1 have to put in there saying if we meet the  
2 Regulatory Flexibility Act, to see if we meet the  
3 Paperwork Reduction Act. But, we are also  
4 required to do a cost-benefit analysis. And for  
5 folks that are looking at commenting on these  
6 regulations, please keep that in mind that those  
7 are in there, although they're boilerplate as  
8 required by law. It is something that we have to  
9 take into consideration as we implement these  
10 regulations.

11 Ms. Chairman, I am going to ask a  
12 question of you rather than the staff. And, that  
13 is on the SDCO. There are additional requirements  
14 for SDCO, but at this time there are no SDCOs and  
15 there won't be until the FSOC actually designates  
16 some. Do we have an idea of when we might get  
17 designation of SDCOs?

18 CHAIRMAN GENSLER: There is -- it's a  
19 very good question, Commissioner Dunn. The  
20 financial stability the oversight council put out  
21 an advance notice of proposed rulemaking so that  
22 they could move forward on an actual rule on the

1 designation criteria. I believe that that process  
2 is moving expeditiously, but it's most likely to  
3 try to complete a rule sometime in the spring to  
4 early summer of 2011.

5 I can't speak for the whole council, I  
6 am just one member. But, I've recommended to  
7 Secretary Geithner and the whole council in public  
8 and in private meetings that we'd like to have  
9 that designation process completed so that next  
10 summer that whichever financial market utilities  
11 in our jurisdiction would be designated the  
12 Securities and Exchange Commission has a similar  
13 interest. There are, you know, a number that they  
14 regulate. There are a number that we -- we have  
15 14 clearinghouses that we regulate. We are aware  
16 -- Ananda, I think we are aware of six more that  
17 might be seeking application?

18 MR. RADHAKRISHNAN: Right now we have  
19 three applications which are all on the commission  
20 website for comment. We might get 2 more -- 19,  
21 20.

22 CHAIRMAN GENSLER: So, we'll have 19 or

1       20. Again, others -- everybody is free to apply.  
2       But in terms of which of those 19 or 20 -- and  
3       they have to really, truly be systemic and so  
4       forth -- it's our hope that the Financial  
5       Stability Oversight Council could do that and do  
6       the designations so that by next summer those  
7       institutions that are designated by that council  
8       know it.

9                   COMMISSIONER DUNN: Thank you, Mr.  
10       Chairman. I appreciate your taking the time to  
11       answer that concern.

12                   I applaud you for -- the staff for  
13       having the mandatory application form. I think  
14       that goes a long way in telling folks where --  
15       what we expect. And, it -- I'm sure we're going  
16       to see applications covering the whole spectrum.  
17       And again, it brings me back to our ability to  
18       implement this without additional staff.

19                   Once again, I think this is one of the  
20       most important things that we're going to be  
21       taking up in this whole series of rulemaking. And  
22       I look forward to hearing from the public on this

1 as to whether we've -- we're getting it right or  
2 we're not getting it right. Whether it's going to  
3 be an excessive cost, whether people will still  
4 use the market.

5 But, again, this is one of the more  
6 important regulations, in my opinion.

7 CHAIRMAN GENSLER: Thank you,  
8 Commissioner Dunn. Commissioner Sommers?

9 COMMISSIONER SOMMERS: Thank you, Mr.  
10 Chairman. I'm going to start just with a comment  
11 with regard to some of the provisions in this  
12 proposal to say that I support many of the  
13 provisions that are in this proposal with regard  
14 to open access. Because I think they're very  
15 reasonable. And just to go through a couple of  
16 them.

17 The prohibitions for DCOs prohibit DCOs  
18 from requiring clearing members to be swap  
19 dealers, from requiring them from having a swap  
20 portfolio of any size. Prohibit them from  
21 requiring that they meet any sort of transaction  
22 volume threshold. I think that's all very



1 reasonable. You know, sufficient financial  
2 resources and operational capacity.

3           But then we get down to setting a  
4 minimum capital requirement, which is just not the  
5 way we usually do business here at the CFTC. So  
6 we picked a number of \$50 million, and I guess I  
7 look forward to comment from industry  
8 participants, and especially DCOs or those who may  
9 know that they're going to be SDCOs on the  
10 appropriateness of that number and whether we got  
11 that right.

12           My questions, with regard to this  
13 proposal, are on the business continuity and  
14 disaster recovery. I do have some concerns about  
15 the recovery objective -- recovery time objective.  
16 And, one of the footnotes that's in the proposal  
17 talks about the white paper that other financial  
18 regulators put out -- I think it was in 2003. So  
19 it perhaps is a little stale at this point. But,  
20 the language in the white paper says that the  
21 clearing organization should develop the capacity  
22 to recover and resume clearing and settlement

1 activities within the business day on which the  
2 disruption occurs with the overall goal of  
3 achieving recovery and resumption within two  
4 hours.

5 Do we know if other financial regulators  
6 in the U.S. are going to change their view on this  
7 with the language saying it's -- that the  
8 objective is two hours, but it could be within the  
9 same business day. Because our rule says it has  
10 to be within two hours. So, we've gone a little  
11 bit further.

12 MR. WASSERMAN: I think we've gone a  
13 little bit further than the white paper. I think  
14 it's fair to say that a number of the other  
15 financial regulators have, indeed, been working  
16 perhaps in less formal means. But, perhaps no  
17 less effective to get folks towards that two hour  
18 recovery time objective.

19 COMMISSIONER SOMMERS: Okay. And, my  
20 other question is real specific. But if you could  
21 explain the difference when we work on these  
22 issues -- the difference between hot and warm

1 backups, and whether or not you are required to  
2 have a hot backup in order to meet a two hour  
3 recovery time?

4 MR. WASSERMAN: The difference is  
5 whether you have machines that are operating --  
6 that is to say, they have the data, the machine is  
7 actually operating, but it's not operating, say,  
8 in parallel. And so, for instance, one mode that  
9 you might have which is more in the nature of the  
10 hot is where you have machines operating in  
11 parallel and doing the same thing.

12 Obviously if you have machines operating  
13 in parallel that gives you the ability to  
14 failover. That is to say, the moment or within  
15 milliseconds of something happening, essentially  
16 you go from one system which may then have --  
17 become inoperative to another system which is  
18 continually operating. And, thus, can take over  
19 the load.

20 I think it's fair to say that for a two  
21 hour recovery time objective it works a lot easier  
22 if, indeed, you have a hot backup. And in answer

1 to the next question, that is more expensive than  
2 warm.

3 COMMISSIONER SOMMERS: Is it standard  
4 industry practice to have hot backup?

5 MR. WASSERMAN: I think in some cases,  
6 yes. And in some cases, no.

7 COMMISSIONER SOMMERS: Thank you, Bob.

8 CHAIRMAN GENSLER: Thank you,  
9 Commissioner Sommers. Commissioner Chilton?

10 COMMISSIONER CHILTON: I don't have any  
11 questions. Thank you all for your work.

12 CHAIRMAN GENSLER: Before -- I'm going  
13 to turn to Commissioner O'Malia. But one thing  
14 that I know that we've worked jointly together on  
15 and I thank Ananda and the team for incorporating  
16 some things. But I won't associate -- because I  
17 -- you had raised in earlier meetings is,  
18 portfolio margining. And I know that this rule  
19 does take up some things on portfolio margining  
20 between swaps and futures and futures and swaps.  
21 But I want to thank Commissioner O'Malia and the  
22 team for trying to sort this through and associate

1       myself with this.

2                   COMMISSIONER O'MALIA:  I think it --  
3       maybe Ananda you can address what the challenge we  
4       have here and what the rule actually provides for  
5       with regard to the portfolio margining of swaps  
6       and futures?

7                   MR. RADHAKRISHNAN:  So, with respect to  
8       an application or somebody who wants to margin  
9       together futures and swaps in the swaps account.  
10      Then, the proposal provides for a mechanism for a  
11      DCO to submit a rule to us, to the commission and  
12      for the commission to approve it.  And then once  
13      the commission approves it, then they can do it.

14                  The other way around?  Where somebody  
15      wants to portfolio margin swaps and futures in the  
16      futures account what we are saying is, the current  
17      process under section 4d will continue to apply,  
18      and people can petition the commission for a 4d,  
19      as others have in the past.  And, you know, we  
20      will look at it under that process.

21                  COMMISSIONER O'MALIA:  Can you highlight  
22      kind of the standards that we're going to be

1 looking for in order to facilitate that and  
2 maintain the high standards of clearing? And how  
3 this might affect Core Principle 9 related to the  
4 clear port contracts?

5 MR. RADHAKRISHNAN: Let me look for it.  
6 But it's liquidity -- what do you see --

7 MS. DEITZ: Let's see.

8 MR. RADHAKRISHNAN: Liquidity, how  
9 you're going to margin the products. You know,  
10 the time horizons that you want to do for  
11 margining, who's going to -- okay. Risk  
12 characteristics, other swaps excluded bilaterally  
13 or excluded on the DCM. Because -- this is just  
14 my opinion. If a swap is on a DCM and meets all  
15 the requirements that the commission imposes on  
16 DCM trading, then in my humble opinion there's not  
17 that much difference between a swap and a futures  
18 contract because it will have the same kind of  
19 liquidity.

20 And then, you know, the liquidity of the  
21 markets. If you want to co-mingle futures and  
22 swaps, it's not just liquidity of the swaps

1 market, it's also the liquidity of the futures  
2 market. Because sometimes what people do -- say,  
3 if there is a failure and somebody has to manage a  
4 portfolio, reducing the risk of a portfolio -- it  
5 doesn't just involve getting out of positions. It  
6 could be taking positions in risk offsetting  
7 markets so that you reduce the risk in that way.  
8 So, we look at that as well. And, prices.

9 MR. LAWTON: I would add one additional  
10 point. Is that what we're talking about is in the  
11 customer account because of the segregation  
12 requirements. That there's actually -- that they  
13 also would be able to do portfolio margining in  
14 the house account without any sort of commission  
15 order.

16 MR. RADHAKRISHNAN: Right. All of this  
17 applies to customer position. So, right now -- in  
18 current law if somebody wants their portfolio  
19 margin swaps and futures in a "futures account"  
20 for the prop origin, they can do so.

21 COMMISSIONER O'MALIA: That's if they're  
22 traded on a DCM, though, right?

1 MR. RADHAKRISHNAN: No, it doesn't make  
2 a difference.

3 COMMISSIONER O'MALIA: It doesn't make a  
4 difference? Okay.

5 MR. RADHAKRISHNAN: It doesn't make a  
6 difference. Because there's no customer  
7 protection implications.

8 COMMISSIONER O'MALIA: John, you  
9 mentioned there's a billion dollar minimum in this  
10 open access debate. You referenced and you put it  
11 out that there's a billion dollar minimum for  
12 clearing access. That is not a figure we set,  
13 correct?

14 MR. LAWTON: Right. That's a figure set  
15 by one of the clearinghouses, yes.

16 COMMISSIONER O'MALIA: Who is their  
17 regulator?

18 MR. RADHAKRISHNAN: It's us.

19 COMMISSIONER O'MALIA: The billion  
20 dollar figure we set?

21 MR. RADHAKRISHNAN: Yes -- no, no, no.

22 COMMISSIONER O'MALIA: We approved?



1                   MR. RADHAKRISHNAN: Well, under current  
2 law --

3                   MR. LAWTON: Certified it --

4                   MR. RADHAKRISHNAN: They certified it.

5                   COMMISSIONER O'MALIA: Okay. In regard  
6 of the fair and open access provision, it requires  
7 that clearing members shall have access to  
8 sufficient financial resources to meet the  
9 obligations arising from participation in a DCO in  
10 "an extreme but plausible market condition". You  
11 want to put some flesh on the bone on that one?  
12 What are extreme and can you give -- is it a  
13 different standard that we've seen? Is it a  
14 similar standard we've seen in clearing? Or is  
15 this brand new?

16                   MR. LAWTON: That's the standard that  
17 we've used for financial resources at the DCO  
18 level when we say that they must be able to meet  
19 the default of their largest clearing member in  
20 extreme but plausible market conditions. So,  
21 we're sort of carrying that same standard down to  
22 the firm level. I think very broadly stated, you

1 would say that they're going to set margin  
2 requirements to cover 99 percent of market moves.  
3 So, extreme but plausible market conditions are  
4 market conditions in that 1 percent. So a market  
5 move that's beyond the 99 percent coverage that  
6 your margin would normally cover.

7 COMMISSIONER O'MALIA: All right. So  
8 this is not a new term. People should be very  
9 familiar with it.

10 MR. LAWTON: That's right.

11 MR. RADHAKRISHNAN: And that's how  
12 people size their -- you know, even prior to the  
13 commission proposing this rule. When we did our  
14 DCO reviews that's how DCOs sized their -- you  
15 know, their default fund. That's the -- you know,  
16 the conditions that they use.

17 MS. DEITZ: Yeah. I would just also add  
18 that that is a term used by the Commodity Exchange  
19 Act in talking about financial resources and the  
20 minimum amount of financial resources. Coverage  
21 of the largest exposure in extreme but plausible  
22 market conditions.

1                   COMMISSIONER O'MALIA: Thank you. Anne,  
2 Bob, you want to add to this? No. We'll keep  
3 moving.

4                   MR. WASSERMAN: Yeah. Actually  
5 (Laughter) --

6                   COMMISSIONER O'MALIA: Anne, you're  
7 going to have to come up with something.

8                   MR. WASSERMAN: No, that's in the  
9 existing CPSS IOSCO standards.

10                  MS. POLASKI: I agree. (Laughter)

11                  COMMISSIONER O'MALIA: There should be  
12 no comments on this one, then. The issue  
13 regarding product eligibility. The rule amends  
14 39.15b for DCOs to select contract sizes that  
15 maximize liquidity, open access in risk  
16 management. The rule says to "the extent  
17 appropriate, a DCO shall select contract units for  
18 clearing purposes that are smaller than the  
19 contract units in which the trades submitted for  
20 clearing were executed." Can you walk me through  
21 that process? And, then I have another follow up  
22 on it.

1                   MR. LAWTON: Yeah. I think the notion  
2                   is that you may have hedgers who bilaterally  
3                   negotiate a swap with a dealer that meets their  
4                   needs and then they agree to submit that for  
5                   clearing. And you could say that they did  
6                   something for \$100 and perhaps the DCO thought  
7                   that they could set \$10 million increments. So  
8                   then they'd have 10 contracts rather than 1 once  
9                   it was submitted -- clearing them. It would be  
10                  transparent to them, they'd have exactly the same  
11                  risk. It's just that it would be sized  
12                  differently, which may help them going forward if  
13                  they wanted to adjust their position they could  
14                  take on or off a fraction of the position. It  
15                  might also facilitate liquidity once these things  
16                  got moved to a trading facility. And, we think it  
17                  might also help a DCO in a default situation, if  
18                  they had somebody who had a large position who  
19                  defaulted and they needed to liquidate. If they  
20                  had sized it in smaller increments they could  
21                  parcel it out among more clearing members,  
22                  according to this scalability concept.

1                   COMMISSIONER O'MALIA: The one -- I  
2                   raised it with you earlier in our discussions.  
3                   But in breaking these things up, we have the  
4                   requirement for unique swap identifiers. And I  
5                   just want to make sure that from a continuity  
6                   standpoint that whatever we do to break these  
7                   things up to optimize the liquidity or whatever  
8                   we're going for here that we don't lose -- we  
9                   don't confuse ourselves and lose track of where  
10                  these things are. And, how we're going to track  
11                  them.

12                  MR. LAWTON: Yeah, we will coordinate  
13                  with the other teams on that point.

14                  CHAIRMAN GENSLER: I think Commissioner  
15                  O'Malia raised a good point at the end. And to  
16                  marry the risk reduction -- which I think the  
17                  staff recommended this some number of weeks ago in  
18                  my office. And I said, what an excellent point  
19                  that was that a clearinghouse has to have the  
20                  right to take a billion dollar trade. And if they  
21                  need to sell it in million dollar increments or  
22                  \$10 million increments -- if the billion dollar

1       counterparty defaults, they have to be able to  
2       liquidate it and do it in any way they can to  
3       lower risk. But I think Commissioner O'Malia also  
4       raised another point, just to make sure that these  
5       unique IDs line up and aren't lost and everything.

6               Mr. Stawick, do you want to call the  
7       role?

8               MR. STAWICK: Commissioner O'Malia?

9               COMMISSIONER O'MALIA: Aye.

10              MR. STAWICK: Commissioner O'Malia, aye.  
11       Commissioner Chilton?

12              COMMISSIONER CHILTON: Aye.

13              MR. STAWICK: Commissioner Chilton, aye.  
14       Commissioner Sommers?

15              COMMISSIONER SOMMERS: Aye.

16              MR. STAWICK: Commissioner Sommers, aye.  
17       Commissioner Dunn?

18              COMMISSIONER DUNN: Aye.

19              MR. STAWICK: Commissioner Dunn, aye.

20       Mr. Chairman?

21              CHAIRMAN GENSLER: Aye.

22              MR. STAWICK: Mr. Chairman, aye. Mr.

1 Chairman, on this question, the ayes are 5, the  
2 nays are 0.

3 CHAIRMAN GENSLER: Thank you, Mr.  
4 Stawick. The ayes having it, the staff  
5 recommendation on this clearinghouse rules are  
6 accepted and will be sent to the federal register.  
7 I thank you all. I know this is an awful lot and  
8 I know the public has a lot to digest. Those were  
9 excellent presentations.

10 We are now moving on to Riva? Mauricio?

11 MS. ADRIANCE: Sorry, we thought we had  
12 somebody else joining us.

13 CHAIRMAN GENSLER: That's all right.  
14 So, the next on agenda is the Commission  
15 consideration and the notice of proposed  
16 rulemaking implementing Core Principles and other  
17 requirements for swap execution facilities. Riva  
18 Spears Adriance -- I do this every time --  
19 Mauricio Melara, Rick Shilts, and David Van  
20 Wagner, all from the Division of Market Oversight  
21 will present today. Rick and David will get to  
22 stay in the chair when we go on to position limits

1 as Rick is the head of the Division of Market  
2 Oversight and David's the chief counsel of that  
3 division. Riva and Mauricio have just done  
4 excellent work. I think of our nearly 500 public  
5 meetings, there must be 40 or 50 of them that have  
6 been on this topic that you've had. You had a  
7 roundtable, you've been working so actively with  
8 each of the commissioner officers, so I turn it  
9 over to you for your presentation.

10 MS. ADRIANCE: Thank you. Good morning,  
11 Mr. Chairman and Commissioners. Today staff is  
12 recommending for publication of a rulemaking  
13 entitled, "Core Principles and Other Requirements  
14 for Swap Execution Facilities."

15 I want to thank all the members of this  
16 team, and this was a large team, and we had a lot  
17 to do, and particularly my deputy, Mauricio  
18 Melara. I also want to thank the team leaders and  
19 members of other rulemaking teams within the  
20 Commission as well as our sister agencies, the  
21 commissioners and their staff, and members of the  
22 public with whom we've interacted over the last



1 six months in formulating this rulemaking.

2 The Wall Street Reform and Consumer  
3 Protection Act, the Dodd-Frank Act, amended the  
4 Commodity Exchange Act to establish a new  
5 framework for execution and trading of swaps and  
6 security-based swaps. First the Dodd-Frank Act  
7 added a new definition under CEA Section 1(a)(50)  
8 for a new type of registered entity called a swap  
9 execution facility, also referred to as a SEF.  
10 Second, the Dodd-Frank Act amended the CEA to  
11 require that swaps subject to the clearing mandate  
12 be executed on a SEF or designated contract market  
13 if such swaps had been made available to trade.

14 Third, the Dodd-Frank Act added a new  
15 CEA section, Section 5(h), which establishes  
16 registration provisions for SEFs, including  
17 compliance with 15 core principles and sets forth  
18 Congress's goal of encouraging the trading of  
19 swaps on SEFs and the promotion of pre-trade price  
20 transparency.

21 The regulations, guidance, and  
22 acceptable practices proposed today implement the

1 new framework for the execution of trading of  
2 swaps on SEFs. Staff consulted extensively with  
3 market participants and other regulators by  
4 hosting and participating in numerous meetings as  
5 mentioned in a public roundtable. In addition,  
6 staff considered the numerous memoranda and  
7 letters submitted by the members of the industry  
8 to the team's rulemaking website.

9 I want to discuss the interpretation of  
10 the statutory definition for SEFs. This is  
11 obviously something that has raised a lot of  
12 concern, questions, interest. Certain terms  
13 within the SEF definition such as trading facility  
14 or designated contract markets are defined  
15 elsewhere in the CEA while other terms such as the  
16 definitions multiple participant to multiple  
17 participant requirement, require a more robust  
18 analysis, including consideration of the current  
19 methods of executing and trading swaps and the  
20 other CEA provisions specifically related to SEFs  
21 and, of course, the purpose of the CEA generally.

22 First, I want to stress that the SEF

1 trading requirement and, therefore, the SEF  
2 definition would apply to swap transactions that  
3 are subject to the clearing and execution  
4 requirements under the act, under Section 2(h),  
5 and this is that are made available for trading  
6 and that are not block trades. Under the proposed  
7 rulemaking we are calling these swap transactions  
8 required transactions under the sense they are  
9 required to be traded on a SEF or on a DCM. In  
10 other words, they're required transactions.

11 When determining what types of trading  
12 systems qualify, the proposal takes into account  
13 the SEF definition, the SEF core principles, and  
14 the goals provided in the act of Section 733 of  
15 the act --

16 CHAIRMAN GENSLER: Riva, I don't know  
17 whether it's your cell phone being close to that,  
18 I don't know if that would change something.

19 MS. ADRIANCE: We'll try. We'll see if  
20 that helps. All right. It's quieter. Sorry  
21 about that.

22 Okay, so the proposal takes into account

1 the SEF definition, the SEF core principles, and  
2 the goals provided in Section 733 of the  
3 Dodd-Frank Act which is to promote the trading of  
4 swaps on a regulated trading system or platform  
5 for swap transactions and pre-trade price  
6 transparency. To meet the SEF definition,  
7 multiple parties must have the ability to execute  
8 or trade swaps by accepting bids and offers made  
9 by multiple participants. In addition, Core  
10 Principle 2, SEF Core Principle 2, requires SEF to  
11 provide market participants with impartial access  
12 to the market. Therefore, the proposal offered  
13 here today interprets the SEF registration  
14 requirements to necessitate that the trading  
15 system or platform provide market participants  
16 with the ability to make bids or offers to other  
17 market participants or to accept bids or offers  
18 made by other market participants -- other  
19 multiple, I should have said -- to make bids or  
20 offers to other multiple participants and to  
21 accept bids or offers made by other multiple  
22 participants.

1           It promotes pre-trade price transparency  
2           and to ensure that the trading of swaps on the  
3           trading system or platform is in accordance with  
4           the core principles, the registration  
5           requirements, and the Commission's regulations,  
6           and to provide all market participants with  
7           impartial access to the SEF's market.

8           Under the proposal, required  
9           transactions could be traded on a Request for  
10          Quote system or order books. Irrespective of what  
11          specific trading methodology a SEF chose to use,  
12          all SEFs would be required to provide a basic  
13          functionality that gives all market participants  
14          the ability to choose whether to post firm or  
15          indicative quotes to all other parties  
16          participating in the SEF.

17          I mentioned earlier order books and  
18          Request for Quotes systems or platforms, and we've  
19          defined order books and we've defined it broadly  
20          to include, in addition to trading facilities or  
21          electronic trading facilities which are currently  
22          defined in our act, we also include trading

1 systems or platforms in which all market  
2 participants in the trading system or platform can  
3 enter multiple bids and offers, observe multiple  
4 bids and offers entered by other market  
5 participants, and choose to interact on such bids  
6 and offers. And I just want to mention that this  
7 is not a (inaudible) order book. When we define  
8 "order book" we're meaning something that's  
9 broader.

10 We also define Request for Quote systems  
11 and we include on that trading systems or  
12 platforms on which a market participant must  
13 transmit a Request for Quote to buy and sell --  
14 buy or sell a specific instrument to no less than  
15 five market participants in the trading system or  
16 platform to which all such market participants may  
17 respond, and where any bids or offers resting on  
18 the trading system or platform pertaining to the  
19 same instrument must be taken into account and  
20 communicated to the requestor along with the  
21 responsive quotes. Or, two, trading system or  
22 platforms in which multiple market participants

1 can both view real-time electronic streaming  
2 quotes, both firm or indicative, from multiple  
3 potential counterparties on a centralized  
4 electronic screen and have the option to complete  
5 a transaction by either accepting a firm streaming  
6 quote or transmitting a Request for Quote to no  
7 less than five market participants based on the  
8 indicative streaming quote, taking into account  
9 any resting bids or offers that have been  
10 communicated to them -- to that requestor along  
11 with any responsive quote.

12           The proposal provides that the  
13 Commission may determine that other trading  
14 systems or platforms are order books or Request  
15 for Quote systems. So, as we go forward we may  
16 find that as the marketplace changes and  
17 technology develops, that there are other possible  
18 order books or Request for Quote systems.

19           Just to emphasize, because all SEFs will  
20 be required to have a functionality for leaving  
21 and executing against resting orders market  
22 participants on SEFs that user Request for Quote

1 model would not be limited to having to utilize  
2 the Request for Quote mechanism to trade. In  
3 addition to this Request for Quote mechanism, they  
4 would have a basic functionality provide the  
5 ability to access to all other market  
6 participants. They could also provide a multiple  
7 to multiple Request for Quote trading system --  
8 I'm sorry, I'm reading this too fast here -- in  
9 addition to this basic functionality providing the  
10 ability to access all other market participants, a  
11 SEF could also provide a multiple-to-multiple  
12 Request for Quote trading system for those market  
13 participants that do not wish to display their  
14 bids, offers, or requests, to all other market  
15 participants. So, there's a difference there  
  
16 between the two.

17 A SEF's chosen approach or approaches  
18 would be described in its registration application  
19 to be evaluated by the Commission during the  
20 application process for compliance with the  
21 definition of a SEF, the registration  
22 requirements, and the core principles. As noted,



1 the Dodd- Frank Act also establishes registration  
2 and core principle compliance requirements as part  
3 of the framework for swap trading on the SEFs.

4           Regarding registration requirements,  
5 staff is proposing that applicants submit relevant  
6 information in an application form requiring  
7 certain information and specified documents.  
8 Also, in order to safeguard against significant  
9 disruption in the activities of swap markets and  
10 swap participants, staff proposes that the  
11 Commission provide conditioned grandfather relief  
12 to swap venues operating prior to the effective  
13 date of the final regulations. The proposed  
14 grandfather relief would allow an applicant who  
15 submitted a complete application and satisfied  
16 other conditions, to operate for a limited period  
17 of time while staff reviews his application for  
18 registration.

19           The proposal also includes a sunset  
20 provision such that the temporary grandfather  
21 relief would end 365 days from the effective date  
22 of the final rules.

1           Now, to mention regarding the 15 core  
2 principles that the Dodd-Frank Act imposes on SEFs  
3 to govern, they govern their general obligations,  
4 including trading and product requirements,  
5 compliance obligations, operational capabilities,  
6 surveillance operations obligations, financial  
7 information, and resource requirements. Staff  
8 proposes a combination of guidance, acceptable  
9 practices, and regulations to implement these core  
10 principles.

11           The proposed regulations implement the  
12 new statutory mandates in an attempt to balance  
13 the twin goals of greater on-exchange trading and  
14 transparency while taking into account current  
15 practices in the derivatives industry.

16           I'd like to highlight some key aspects  
17 of the proposal concerning compliance of the core  
18 principles just to give you some examples.

19           Under the Dodd-Frank Act, Core Principle  
20 2, which is compliance with rules, requires a SEF  
21 to establish, monitor, and enforce rules relating  
22 to various compliance functions, including a

1 requirement to provide impartial access, terms and  
2 conditions of the swaps to be traded on this  
3 trading platform or system, rules prohibiting  
4 abusive trading practices. Staff proposes  
5 regulations that, for example, it requires SEFs to  
6 maintain sufficient compliance staff and resources  
  
7 to carry out its obligations under the Core  
8 Principles. It doesn't get into a lot of all the  
9 granular details. There's a number of issues left  
10 to the SEF, but SEFs may choose to contract with a  
11 third party for the provision of regulatory  
12 services to assist and comply with the core  
13 principles, but the SEF ultimately remains  
14 responsible for compliance as required in the  
15 Dodd-Frank Act.

16 To comply with Core Principle 4, which  
17 is monitoring trading, a proposed regulation  
18 requires SEFs to have the ability to conduct  
19 real-time trade monitoring and comprehensive trade  
20 reconstruction. And just to point out that one  
21 thing we've done is to include the statutory  
22 language in our regulations so that it is there in

1 one place for market participants.

2 To meet Core Principle 13, to go on,  
3 staff proposes regulations relating to the types  
4 of financial resources available to SEFs to  
5 satisfy the financial requirements, valuation and  
6 calculation requirements that a SEF must make  
7 using its own methodology and financial resources  
8 reporting requirements.

9 Finally, Core Principle 15, designation  
10 of chief compliance officer, establishes the  
11 position, title, and function of compliance  
12 offices for each SEF. Consistent with the  
13 detailed requirements set out by the Congress  
14 under the Dodd-Frank Act, the proposed regulations  
15 require that SEFs designate a chief compliance  
16 officer who reports to the SEF's board or to a  
17 senior officer. The chief compliance officers  
18 must also generate and submit accurate annual  
19 reports describing a SEF's performance regarding  
20 compliance with the CEA.

21 Staff looks forward to hearing from the  
22 public on all aspects of the proposed rulemaking,

1 in particular with respect to the specific  
2 questions posed in the notice of proposed  
3 rulemaking and I'd be happy to answer any  
4 questions at this time.

5 CHAIRMAN GENSLER: Thank you so much,  
6 Riva. And the chair will entertain a motion to  
7 accept staff recommendation on core principles for  
8 SEFs.

9 COMMISSIONER SOMMERS: So moved.

10 COMMISSIONER CHILTON: Second.

11 CHAIRMAN GENSLER: With that I'd like to  
12 open the floor to allow commissioners to ask  
13 questions. I support this proposed rulemaking,  
14 and I want to say a few words on it. I'll have a  
15 statement to put in the record, but I think it  
16 fulfills Congress's mandate to have rules with  
17 regard to SEFs that promote transparency through  
18 the trading of swaps on these things called swap  
19 execution facilities. I know that term is just  
20 made up here in Washington, but it's taken on some  
21 meaning and the meaning that Congress gave to it  
22 is that there would be transparency and also that

1       there would be flexibility, that market  
2       participants have a flexibility as to how they  
3       transact, but they benefit from that transparency  
4       and market competition.

5               I think that this proposal does that. I  
6       think it will afford market participants' ability  
7       to make firm bids or offers if they choose to, but  
8       nothing will require them, and I just want to make  
9       sure, Riva, there's no market maker requirement in  
10      here, right?

11              MS. ADRIANCE: No, this proposal tries  
12      to provide market participants with the choice.  
13      It focuses on -- through the SEFs giving market  
14      participants the choice of how they transact.

15              CHAIRMAN GENSLER: Right. And the  
16      statute does say that market participants have to  
17      have the ability to execute or trade with other  
18      market participants and I don't personally see how  
19      you could afford that unless you have the ability  
20      to make a firm bid or offer or an executable bid  
21      or offer to others, if you choose to, but not  
22      required to.

1 MS. ADRIANCE: That's right, that's how  
2 the proposal --

3 CHAIRMAN GENSLER: Okay, but if a market  
4 participant wants to do a Request for Quote, leave  
5 an indicative quote, in the old days I would call  
6 that advertise their interest, but not to have an  
7 executable quote, SEFs can and, in fact, through  
8 this process are pretty well encouraged to do that  
9 as well to provide that facility, is that correct?

10 MS. ADRIANCE: Yes. It's the SEF's --  
11 we expect and we've talked with a lot of entities  
12 that believe that they will come in with  
13 applications as a SEF and we expect that a number  
14 of entities will continue to do both. A number  
15 will do both of the firm quotes, some will do the  
16 more Request for Quotes. We know that there are  
17 going to be -- there's going to be a number of  
18 different models, is what we're expecting to see.

19 CHAIRMAN GENSLER: Right, but these  
20 methods will provide hedgers and investors, Main  
21 Street businesses, both the flexibility to execute  
22 and trade by a number of methods, also the

1 benefits of transparency and market competition.  
2 I think this competition is consistent with  
3 Congress' mandate and definition of a "swap  
4 execution facility" where all market participants  
5 can communicate with all other market participants  
6 if they choose to. If not, they can go the more  
7 narrow approach and get those benefits.

8 It also allows for block trades, the  
9 larger trades, just like in the futures market, to  
10 be done with less pre-trade transparency. They  
11 will, because of the real-time reporting, be still  
12 reported. Is that right?

13 MS. ADRIANCE: Yes, and I wanted to  
14 mention, I didn't mention in my remarks, but we're  
15 differentiating with block trades regarding  
16 pre-trade transparency. Block trades, like we've  
17 done in the futures industry, block trades are not  
18 required to have the pre-trade price transparency  
19 that we would expect generally for the trading of  
20 swaps on SEFs.

21 CHAIRMAN GENSLER: Now, another  
22 important feature is that Congress said that there



1 is a mandate to bring transactions to swap  
2 execution facilities if they're both cleared and  
3 made available for trading. Is that correct?

4 MS. ADRIANCE: Yes, there is a mandate  
5 and we've determined that there's -- well, there's  
6 been questions as to whether this determination of  
7 as a swap made available for trading, whether this  
8 differs from listing and we, in our proposal,  
9 provide that this is not the same thing as listing  
10 a swap. It is a determination that must be made  
11 and that we would expect SEFs to make a  
12 determination as when they look over annually as  
13 to whether the swaps they have listed have been  
14 made available for trading.

15 CHAIRMAN GENSLER: So, it may be all the  
16 contracts they list, but they have to make a  
17 public determination and show that -- and we get  
18 to review that in some way, is that correct?

19 MS. ADRIANCE: Yes, they would provide  
20 that to us and we would review that to determine  
21 if this is a reasonable determination.

22 CHAIRMAN GENSLER: And then another key

1 part that Congress did, and I think it was in one  
2 of the core principles, was to promote impartial  
3 access. I gather you read the New York Times  
4 piece as well?

5 MS. ADRIANCE: Of course.

6 CHAIRMAN GENSLER: It was not mandatory.  
7 I think it was David Van Wagner that e-mailed it  
8 to me on Sunday morning. But I think that  
9 Congress addressed, just as in the clearinghouse  
10 rules, that there be fair and open access in a  
11 core principle. Congress, also, here addressed  
12 themselves to it, that swap execution facilities  
13 have to have impartial access. Is that correct?

14 MS. ADRIANCE: Yes, and that's one of  
15 the goals that we were trying to include in this  
16 rulemaking was to, in a sense, provide practical  
17 ways for market participants to have impartial  
18 access and we require the SEF, and there's a core  
19 principle that includes that in the core principle  
20 that the SEF must provide impartial access.

21 CHAIRMAN GENSLER: And am I right that  
22 any market participant that we call an ECP, an

1 eligible commercial -- contract -- I have to  
2 remember the Cs here -- what is it?

3 MS. ADRIANCE: (inaudible)

4 CHAIRMAN GENSLER: Eligible contract  
5 participant. But that means not the retail  
6 public, but the large institutions, any would have  
7 access as long as they have the financial  
8 resources and they have -- is it correct to say if  
9 they're transacting through a futures Commission  
10 merchant and has a clearing arrangement, is that  
11 what it needs?

12 MS. ADRIANCE: Yeah, you know, we  
13 basically refer to that -- if someone that has an  
14 appropriate clearing arrangement and that has --  
15 that certainly does not have a disciplinary  
16 history that might raise concerns for the SEF, it  
17 should be made -- given impartial access on a fair  
18 basis.

19 CHAIRMAN GENSLER: So, if a transaction  
20 is made available for trading and the SEF has to  
21 determine those things once a year and it's not a  
22 block trade, you say it's a required transaction,

1       it has greater pre-trade transparency, and all  
2       market participants who don't have a bad  
3       disciplinary history and have appropriate clearing  
4       arrangements, can participate if they choose to.  
5       Is that in the essence of this rule?

6               MS. ADRIANCE: I think that covers it.

7               CHAIRMAN GENSLER: Well, again, I  
8       support it. I congratulate the team -- I thank my  
9       fellow commissioners. I think this is a very  
10      strong rule. I think it's better for the extra  
11      week that we gave it to ripen within the agency.

12              Commissioner Dunn?

13              COMMISSIONER DUNN: Thank you, Mr.  
14      Chairman. You never cease to amaze me. Your  
15      technical knowledge of having the BlackBerry moved  
16      away from the microphone to improve the quality of  
17      sound, you just must know everything.

18              CHAIRMAN GENSLER: No, but thank you.

19      (Laughter)

20              COMMISSIONER DUNN: But I do want to  
21      talk a little about the procedure of how we got  
22      here on this regulation and I'm very, very quick

1 to note that my knowledge of the swap industry is  
2 extremely limited and for me, the communications  
3 we get on this and all these proposed regs, is  
4 going to help me determine where we are on a final  
5 regulation.

6 I was a bit amused last week as I got  
7 calls from reporters and even saw speculations  
8 that the regulation was pulled because there  
9 weren't enough votes to report out this proposed  
10 regulation. I think anybody that thinks that you  
11 can't count to three, severely underestimates your  
12 mathematical powers, but the fact is, you didn't  
13 want to stop at three, and that has been where we  
14 have been all along in this rulemaking process.

15 We've tried to get consensus, and at the  
16 11th hour one commissioner said I think I've got a  
17 better idea, and rather than disregard that, you  
18 put this off for a week. And we incorporated some  
19 of that better idea into this proposed regulation.

20 I wish we had the luxury of time to be  
21 able to do that always. We don't. We're mandated  
22 by Congress to get these rules out. I think we do

1 have a better product because of that additional  
2 week. A lot of the questions that I had initially  
3 on it have been addressed and answered during that  
4 time period. I'm still looking forward to hear  
5 what the public has to say on this.

6 I note that yesterday when you were in  
7 the House Agricultural Committee you were promised  
8 frequent and robust oversight of these regulations  
9 and how they are being implemented. I have said  
10 all along that one of the things that we  
11 absolutely have to do as we get this -- these  
12 batches of regulations out, is to take stock of  
13 what they've done. What has been the efficacy of  
14 these regulations as we've put them out? This one  
15 and the next regulation that we're going to take  
16 up certainly fall within those categories and Mr.  
17 Chairman, I think that it is imperative that on  
18 these regulations that at some point in time -- 12  
19 months or 18 months down -- we stop and take  
20 stock, did we do what we intended to do? Were  
21 there unintended consequences as a result of these  
22 regulations?

1                   We're not going to get it right 100  
2                   percent of the time, but we have to do the best we  
3                   can with the knowledge and the laws and the  
4                   resources that Congress has given us. I thank you  
5                   for taking the time to try to make this regulation  
6                   better.

7                   CHAIRMAN GENSLER: Thank you, Mike, for  
8                   all of your efforts and work on this in all of  
9                   these rules, and thank you for those kind remarks  
10                  about technology and my math skills as well.

11                  Commissioner Sommers.

12                  COMMISSIONER SOMMERS: Thank you, Mr.  
13                  Chairman. I want to say a particular thanks to  
14                  this team because you've been put under the fire  
15                  for two weeks in a row which is, I'm sure, very  
16                  stressful for you and time-intensive, the hours  
17                  that you've put in to making this rule, you know,  
18                  putting this package together for us today. So,  
19                  thank you for all of your work.

20                  I just have one general question with  
21                  regard to working with the SEC and making these  
22                  kind of rules consistent and whether we know where

1 the SEC is on rules for SEF and what kind of  
2 systems they anticipate allowing.

3 MS. ADRIANCE: We, of course, cannot  
4 speak for the SEC and we don't know where they're  
5 going to end up. Their process, while we were  
6 supposed to -- we had originally been scheduled to  
7 be considered around the same time, currently  
8 they're scheduling, we believe, in January. They  
9 don't -- from what I understand, I don't think  
10 they have a date yet. So, they're still in the  
11 process of working out a lot of their details, so  
12 all we can do now is to -- what we've done in the  
13 process, really, has been to talk a lot, has been  
14 to share with each other, has been to compare.  
15 We've tried as much as we could do to be  
16 consistent. They have an industry that has a  
17 different history with different requirements than  
18 ours and so we have found that there have been --  
19 while we've, in many ways, worked out a lot of  
20 things that we believe from what we're hearing  
21 will be very consistent with what they're doing,  
22 we don't know what they're going to finally come



1 out with. And we certainly -- we have discovered  
2 some things that their history has been different  
3 from ours and, therefore, they may come out  
4 differently from how ours do.

5 And certainly I don't know what they'll  
6 do in their proposal, but just one example would  
7 be in the block trade rulemaking, in the way the  
8 block trades are handled in the securities  
9 industry and on exchanges is different from the  
10 way it's handled in futures exchanges. So we came  
11 from a very different background in that sense of  
12 in the futures industry where block trades do not  
13 have pre-trade transparency and they have a  
14 different background on securities exchanges. So  
15 I don't know what their final rulemaking will do,  
16 but we certainly know that they are dealing with  
17 some different issues than some of the issues  
18 we've dealt with.

19 COMMISSIONER SOMMERS: I'm specifically  
20 more concerned about them allowing any type of  
21 system and not being as restrictive as we are  
22 being on the definition of a SEF. So, do you

1 anticipate that there will be specific challenges  
2 if we end up being where we are in a final rule  
3 and they end up allowing many different types of  
4 systems to register as SEFs? I mean, how do we  
5 deal with that when the industry then will have  
6 two different standards?

7 MS. ADRIANCE: Well, certainly we don't  
8 -- as I said, we don't know what they're going to  
9 propose, but from what we understand, we are, I  
10 don't think, that different from what they are  
11 thinking of proposing over there. We don't know,  
12 but certainly that's part of -- I mean, even if we  
13 propose something exactly the same, during the  
14 comment period we would both be getting comments  
15 and both need to individually ascertain how to  
16 deal with those comments. What I can say is that,  
17 you know, certainly there is -- there's certainly  
18 different asset classes, but we do know that there  
19 will probably be some entities that will want to  
20 operate in both worlds. And so we would hope that  
21 commenters will give us feedback on that, when  
22 they look at theirs and they look at ours. I

1 mean, there is -- my understanding is, is that  
2 there will be an overlap of comment periods, so  
3 they will be able to look at theirs and ours  
4 during a -- whatever it will be, a month or more,  
5 that they'll be able to look at both and compare  
6 and tell us if they think there's some reason that  
7 there's problems.

8 MR. SHILTS: I just wanted to add that  
9 we did send over the latest version and if the  
10 Commission chooses today to go ahead with this,  
11 then there -- we'll continue to have a dialogue  
12 and could explain the rationale of how we came up  
13 with this and help inform them as they go finalize  
14 their process.

15 CHAIRMAN GENSLER: Thank you,  
16 Commissioner Sommers.

17 Commissioner Chilton?

18 COMMISSIONER CHILTON: Thanks, Mr.  
19 Chairman, and echo my colleagues' appreciation for  
20 what you've done in this, I think it's moved in a  
21 good direction.

22 I did want to ask, before I started,

1 Riva, you said when you were explaining, you said  
2 -- you kept talking about trading system or  
3 platform. You know, quoting from the act, the  
4 goal of this section is to promote the trading of  
5 swaps on SEFs, on swaps execution facilities, and  
6 pre-trade transparency, but you sort of  
7 repeatedly used, in that specific regard, but  
8 repeatedly used trading system or platform, and  
9 I'm thinking I'm missing something.

10 MS. ADRIANCE: The -- actually referring  
11 to the language in the SEF definition in the  
12 Dodd-Frank Act, which -- have to look at it, make  
13 sure I don't garble it like I've garbled a few  
14 other things today -- and it says in here that the  
15 swap execution facility means a trading system or  
16 platform in which -- and then it goes on to the  
17 multiple-to-multiple -- multiple  
18 participant-to-multiple participant. So, because  
19 they're talking about a trading system or  
20 platform, we've tried to use those words as well.

21 COMMISSIONER CHILTON: All right. When  
22 we talk specifically about that rule of

1 construction, it's specifically a SEF, right?

2 Page 345-E?

3 MS. ADRIANCE: Yeah.

4 COMMISSIONER CHILTON: Okay. Thank you.

5 You know, Congress intended for their systems in  
6 which multiple participants have the ability to  
7 execute or trade swaps by accepting bids and  
8 offers made by multiple participants in the  
9 facility or system. That expansive language --  
10 that is expansive language and we need to ensure  
11 that we capture what Congress intended, so my --  
12 the current proposal does take into account any  
13 resting bids or offers integrated with any  
14 responsive quotes. So, my question is, would this  
15 requirement impose obligations on the existing RFQ  
16 systems as they're currently configured? Does  
17 that make any sense?

18 MS. ADRIANCE: The -- I know that  
19 there's a number of systems out right now who have  
20 RFQ, Request for Quote system -- mechanisms. And  
21 a number of those -- I mean, I cannot speak to all  
22 of them. We don't know that we've actually talked

1 to all of them, but we know that most of the  
2 entities we've talked to actually have multiple  
3 different kinds of systems. Some of them have not  
4 only just order books, which we've defined, but  
5 they actually go further and go all the way to  
6 central limit order books along with their Request  
7 for Quote systems. There is even those that will  
8 talk about Request for Quote systems have the  
9 ability to post firm quotes so that somebody can  
10 actually execute their executable, live -- the  
11 words I've heard of "executable," "live,"  
12 "actionable," these are -- so, it's not just a  
13 matter of having to send out a Request for Quote.  
14 A lot of these systems actually allow you to  
15 execute just by something you see coming at you  
16 and move directly into, without having to go back  
17 and forth, you can execute on that and have a  
18 trade.

19 So, we're expecting that from what the  
20 feedback we've gotten, that a number of the  
21 systems -- well, they're constantly innovating  
22 anyway, a number of the system that, you know, it

1       may be that most of the systems that already have  
2       what we're talking about, it would be hard until  
3       we get comments to really ascertain whether  
4       there's some that would actually have a problem.

5                COMMISSIONER CHILTON:  But some of them,  
6       you think, will have to change the way they're  
7       doing -- you can't know about everybody, of  
8       course, but --

9                MR. VAN WAGNER:  -- I mean, because,  
10       just to be clear, there's two types of RFQs which  
11       are specifically laid out in the regs, the  
12       proposed regs, as well as types of order books.  
13       But for each one of those provisions, there are  
14       catch-all phrases such that you could come to the  
15       Commission and use a variant of those RFQs or  
16       order books.

17               So, essentially what we've laid out is  
18       safe harbor provisions which can be fit into, but  
19       if you're outside -- if you're at deviance with  
20       that, you still might be able to come to us and  
21       have us approve it on a case-by- case.

22               COMMISSIONER CHILTON:  Okay, that's

1 helpful, Mr. Van Wagner. Thank you. And I do  
2 look forward to getting comments on this  
3 particular thing, but in general on the rule.  
4 And, again, I thank the Chair and thank all of  
5 you. I know this has been a tougher one, but  
6 thank you for your diligence and hard work.

7 CHAIRMAN GENSLER: Thank you,  
8 Commissioner Chilton.

9 Commission O'Malia?

10 COMMISSIONER O'MALIA: Thank you, Mr.  
11 Chairman. Thank you for your cooperation and the  
12 team's cooperation. We've come a long way since  
13 last week and I appreciate that. This is a much  
14 better definition, still some things to be worked  
15 out.

16 Commissioner Sommers mentioned  
17 coordination with the SEC. Could you discuss  
18 where we are internationally and what the  
19 international trading standard might be and how  
20 coordinated we are internationally?

21 MR. VAN WAGNER: There's an IOSCO  
22 working group, OTC derivatives working group,



1 right now, which was tasked with a number of  
2 things and one of them is to come up with a  
3 trading report which speaks to trading standards.  
4 I believe the date is July 1 is when the report  
5 has to be given up to IOSCO.

6 We've seen drafts of that report, which  
7 we actually -- I'm sorry, Commissioner Sommers is  
8 one of the co-chairs. We've seen drafts of that  
9 report and there's nothing in it that causes  
10 discomfort yet. I mean, I don't think there's an  
11 out trade between what's being proposed and what's  
12 in the draft of that trading report, but both of  
13 these things are moving targets. But at this  
14 point there's not inconsistency.

15 COMMISSIONER O'MALIA: Do you want --  
16 anything to add to that?

17 The questions -- I just have -- let me  
18 just run down a list of -- will an SEF or an RFQ,  
19 more specifically, be required to have a trade  
20 matching and executing algorithm?

21 MS. ADRIANCE: We're not expecting that  
22 you would have -- it's not required, if that's

1 your question.

2 COMMISSIONER O'MALIA: That is exactly  
3 my question.

4 MS. ADRIANCE: Yeah, there is -- it's  
5 not a requirement that we try to leave language  
6 that was broad enough that there could be multiple  
7 ways of providing this ability to offer to others  
8 a bid or an ask, but there is not just one way to  
9 do that.

10 COMMISSIONER O'MALIA: Okay, and I think  
11 you touched on this, but I want to -- it's on my  
12 list so I'm going to check it off anyway. A SEF  
13 or an RFQ, is it required to have a limit order  
14 book?

15 MS. ADRIANCE: Again, as I mentioned,  
16 that's what -- we tried to define "order book"  
17 more broadly --

18 COMMISSIONER O'MALIA: Right.

19 MS. ADRIANCE: -- because -- and I'm not  
20 -- when I say that, I don't know what people mean  
21 by "limit order book" --

22 COMMISSIONER O'MALIA: Let me rephrase

1 this. Let me just rephrase it. Are all SEFs  
2 required to have a limit order book?

3 MS. ADRIANCE: I would say no.  
4 Requiring -- we're saying that there needs to be  
5 this functionality for providing these --

6 COMMISSIONER O'MALIA: I would have  
7 stopped at no.

8 MS. ADRIANCE: I'll stop at no.

9 COMMISSIONER O'MALIA: Okay. Is a SEF  
10 required to have a trading facility functionality  
11 as that term is defined in Section 1(a)(51) of the  
12 Act?

13 MS. ADRIANCE: No. And we'll stop  
14 there.

15 MR. VAN WAGNER: No, and nor are they --  
16 nor do they have to be electronic trading  
17 facilities, if that's in your next question.

18 COMMISSIONER O'MALIA: Okay. Thank you.  
19 Does this proposal, an RFQ proposal -- or a SEF  
20 proposal -- require that a SEF give priority to a  
21 firm quote over the quotes that requestor receives  
22 whether he uses a firm or indicative -- let me

1 rephrase that. Is a SEF required to give priority  
2 to a firm quote over the quotes that a requestor  
3 receives when he uses the Request for Quote  
4 system?

5 MS. ADRIANCE: What we say is that the  
6 -- it must be able to take into account both the  
7 responses to the Request for Quote as well as to  
8 whatever is firm as in the system. I mean, we  
9 haven't defined that and that's something that we  
10 would certainly be interested, if there's  
11 comments, about that.

12 COMMISSIONER O'MALIA: But there's no  
13 priority, they couldn't execute before or fill  
14 partially? There's nothing in there that requires  
15 that?

16 MR. VAN WAGNER: Yeah, there's nothing  
17 in this, in Part 37. Full disclosure, there might  
18 be other provisions in other of our rulemaking  
19 team, such as best execution principles or what  
20 have you that might circumscribe the parties, but  
21 insofar as the SEFs go, there's no such  
22 requirement.

1                   COMMISSIONER O'MALIA: Thank you. Riva,  
2                   you mentioned the word a "firm streaming quote."  
3                   What is that? Is it any different than a firm --  
4                   or a streaming indicative quote?

5                   MS. ADRIANCE: From what I am hearing  
6                   and the explanations we have received, I believe  
7                   that there is a difference. From what we  
8                   understand there is some marketplaces that allow  
9                   you to do -- when I mentioned earlier about firm  
10                  quotes, what's coming out is something that you  
11                  can actually -- as the terms have been used,  
12                  "live," "actionable," you can click on it and you  
13                  can immediately go in -- when you click on it, you  
14                  have a trade. You have executed a trade. Whereas  
15                  indicative quotes are quotes that are -- they're  
16                  indications of where that person, that market  
17                  participant, is at that moment, and it's what's  
18                  required is if you are interested in that  
19                  indication, you click on it, if that's the way it  
20                  works in that system, you click on it and then you  
21                  will then have to, in a sense, send out a Request  
22                  for Quote. So, there's another stage. It's

1 basically telling the market participants where --  
2 that there is somebody who at that moment in time  
3 believes that they are at that price but there's  
4 nothing firm about it and you have to go through  
5 the Request for Quote process.

6 COMMISSIONER O'MALIA: All right. I may  
7 come back to that one. I'm concerned in the  
8 preamble of this proposal does not correctly  
9 interpret Core Principle 2 where it requires a SEF  
10 to provide market participants with impartial  
11 access, and I think the rule and the preamble seem  
12 disconnected somewhat. In the rule, as I  
13 understand it, it means that SEF need to use  
14 objective criteria to allow market participants to  
15 gain membership to the SEF or access to the SEF,  
16 which is what I think -- I think, Mr. Chairman,  
17 you've highlighted. In the preamble it seems to  
18 indicate that a SEF must provide market  
19 participants with the ability to execute on all  
20 bids and offers posted by any other market  
21 participant.

22 What's the market to think of this?

1                   CHAIRMAN GENSLER: Can I help? Can I --  
2           because I think -- I think the word "market  
3           participant" there must be that if somebody is a  
4           member of that SEF, right? I mean, is that not  
5           the case?

6                   MS. ADRIANCE: Yes. Yes, the market  
7           participant in that case means that somebody who  
8           has ability to access, to interact with that, with  
9           others, that they have ability providing impartial  
10          access to each other to reach each other.

11                  COMMISSIONER O'MALIA: So, is this the  
12          same impartial access standard or we're using it  
13          -- we're interpreting it two different ways  
14          depending on, you know, one to get access and then  
15          once you're in -- once you have access there's a  
16          different interpretation to it?

17                  MS. ADRIANCE: There is -- you're having  
18          impartial access to become a member, but also  
19          impartial access when you're on the facility that  
20          you not -- for instance, that the SEF doesn't  
21          provide different -- if there's bandwidth, that  
22          they provide -- and there's -- I mean, there are

1       certainly things that may -- this Commission may,  
2       in the future, consider how to handle things like  
3       bandwidth.  But certainly there has to be  
4       comparable treatment among the different  
5       participants, if they -- if you want greater  
6       bandwidth, but you're paying more and everybody  
7       has to pay more for greater bandwidth, that would  
8       certainly be part of impartial access.  And also  
9       just generally that you have the ability, like  
10      another market participant, to access other market  
11      participants.

12                 MR. SHILTS:  Yeah, I think impartial  
13      access goes to the ability to participate on the  
14      SEF and the ability to trade.  It doesn't go to  
15      the execution of a particular transaction which is  
16      governed by the -- you know, the ability to  
17      provide a way to issue bids and offers that  
18      execute the RFQs, but it doesn't require  
19      participation in that sense.

20                 COMMISSIONER O'MALIA:  Well, I think the  
21      preamble may be confusing then and I would -- you  
22      know, let the market know, you know, take a look



1 at that issue. That's an important question.  
2 Hopefully they'll respond to it and let's just put  
3 it on our list.

4 Let me ask another question here. "By  
5 means of interstate commerce," does that mean that  
6 voice systems are permitted to trade unless swaps  
7 subject to the (inaudible) clearing and execution  
8 requirement?

9 MS. ADRIANCE: The voice systems are --  
10 we've accounted for them in several ways, we  
11 expect them to operate in several ways. There is  
12 certainly -- if someone is carrying a block trade,  
13 we would expect that that's one of the methods  
14 they may choose to use --

15 COMMISSIONER O'MALIA: But block is off  
16 SEF?

17 MS. ADRIANCE: Well, block is executed  
18 off the SEF but then transmitted through the SEF.  
19 It's under the -- it has to be operated -- it has  
20 to be executed pursuant to the SEF's rules. But  
21 in terms of transactions that are to be -- those  
22 transactions that must be executed on the SEF,

1       there is certainly the voice, they would be just  
2       like you might have now. You may have a customer  
3       who calls up their clearing number or their -- you  
4       know, a dealer, a broker that they work with and  
5       say I'm interested in doing this. What we would  
6       envision is that the customer may decide they want  
7       to input it themselves into the system whenever  
8       the system is -- whatever they're using, RFQ or  
9       they're doing a firm quote or hitting on a firm  
10      quote or they may work with their voice broker to  
11      do this and has the voice broker, in a sense,  
12      acting as an agent.

13                We do have under Core Principle 2 under  
14      -- when we describe what is an audit -- you know,  
15      audit trail we need, what we think the SEF will  
16      need in order to be able to do its regulatory  
17      oversight obligations that just like we would have  
18      in say futures markets where there is a -- that we  
19      would want -- the SEF must have -- provide that  
20      it's -- in those cases where you have a customer  
21      calling up, say a voice broker, in that case to  
22      act as an agent, that the -- if the order or the

1 Request for Quote is actionable, is executable  
2 right away, immediately, then they should do so.  
3 If it is not, they should provide an electronic  
4 record so that if there is any need to go back and  
5 look at what happened, there would be that record.

6 COMMISSIONER O'MALIA: Thank you very  
7 much. The proposal requires a minimum 15-second  
8 pause between the entry of a matching customer to  
9 broker swap order or a customer to customer swap.  
10 Can you explain it and the rationale for it?

11 MS. ADRIANCE: Well, this is that  
12 situation -- in a sense, the situation I was just  
13 describing where you may get a -- if it's a voice  
14 broker that gets a call from a customer, maybe  
15 it's a customer -- they've got two different  
16 customers that have called in right around the  
17 same time and they've got two orders that almost  
18 could be executed against each other. And what  
19 it's saying is that when -- you know, if you're --  
20 when you're putting these into the system you  
21 basically -- in a sense you don't preload where  
22 you put it in so that there is the chance of their

1 interacting with anybody else's if there's a firm  
2 quote out there that there's, you know, you're  
3 trying to negate that chance. There's a pause  
4 there that you would put in place and that is  
5 similar to something we've seen in the -- that  
6 currently happens in the futures industry, it's a  
7 similar requirement and so there's this  
8 possibility that you would actually interact.

9           It's -- one thing we would like to do is  
10 we hope to encourage, for those participants that  
11 want to put a firm quote out there from a  
12 bid-and-ask, that there is reason to believe that  
13 they might be able to -- that parties may interact  
14 against them, but -- so, there is a pause there.

15           It also could be that somebody calls  
16 their swap dealer -- I mean, they're technically  
17 not acting as a swap dealer when they're on the  
18 SEF, but they call them and they want to do it on  
19 the SEF or they need to do it on the SEF and  
20 there's an interaction between -- the swap dealer  
21 was willing to take the other side, again, that  
22 there is, in a sense, you can't have -- there is

1       this process where the swap dealer would first put  
2       the customer order in and then there'd be this  
3       pause and then their order would go in. So they  
4       may or may not be on the other side depending on  
5       whether there is already a firm bidder asset. Is  
6       response competitive? I mean, this is only going  
7       to matter if there is no firm bidder assets there  
8       that's responsive, that's competitive, they would  
9       still get matched against each other.

10                   COMMISSIONER O'MALIA: Do you have --

11                   MR. VAN WAGNER: Could I just actually  
12       supplement? I mean, just -- it is a basic --  
13       there is a recognition that these markets are  
14       going to be thinly traded and there might well not  
15       be anything in the market and so it is a -- the  
16       15-second exposure to the market is a bit of a  
17       check in ensuring that the price is fair. And so  
18       if it's exposed, if the customer side is first  
19       exposed to the market, the market presumably would  
20       get to react. We thought 15 seconds was a  
21       reasonable amount of time, and then the entering  
22       broker presumably would be able to match it if

1 nothing else came in to intervene.

2 COMMISSIONER O'MALIA: My understanding,  
3 this is similar to the options market where they  
4 have a three- second --

5 MR. VAN WAGNER: And also similar --  
6 right. I'm not sure on all the timing, but -- and  
7 also in the futures market where there's been  
8 pre-execution communication between an  
9 intermediary and a customer and they want to  
10 submit orders together. There's just this check  
11 between the entry of the two orders.

12 MS. ADRIANCE: Just to add to that,  
13 usually in the futures industry what you have is 5  
14 seconds for futures and 15 seconds for options and  
15 -- which is where this --

16 COMMISSIONER O'MALIA: Well, I'm getting  
17 there's a strong bias towards the futures market  
18 here, so.

19 MS. ADRIANCE: It -- and it is not -- is  
20 basically that -- we don't view this as a bias.  
21 We view this as trying to look around that's been  
22 in the swaps industry, is there good practices we

1 can use as examples? Is there good practices in  
2 the futures industry we can use for examples? But  
3 we've always tried to look at -- we certainly took  
4 into account whether the futures industry example  
5 is appropriate for this model.

6 COMMISSIONER O'MALIA: Okay, in taking  
7 into account what's fair, what's right, do you  
8 have any concern whatsoever that large size, the  
9 transactions that are prevalent in the swaps  
10 market, might be undermined with this 15-second --

11 MR. VAN WAGNER: Well, large  
12 transactions, of course, if they're -- when -- if  
13 it's premised on large transactions --

14 COMMISSIONER O'MALIA: Well, you had  
15 mentioned the illiquid and --

16 MR. VAN WAGNER: If it's large enough,  
17 they can use the block mechanism where there is no  
18 exposure whatsoever.

19 COMMISSIONER O'MALIA: Well, my concern  
20 all along, SEFs are -- you know, there's a rule of  
21 construction we keep looking at and we've debated  
22 extensively, the pre-trade transparency

1 requirements, and the facilitating on-exchange  
2 trading. Now, they're not always working together  
3 in every aspect and I want to make sure that, you  
4 know, through electronic trading we're checking  
5 the box, we're getting pre-trade transparency to  
6 the absolute extent we can. We also have to work  
7 to make sure we get on- exchange, and using this  
8 block as an excuse isn't -- I'd prefer to put more  
9 on the exchange and just to say, well, I'm sorry,  
10 just put it in the block. That doesn't give us  
11 the transparency we need in either factor. It  
12 doesn't promote on-exchange and it doesn't promote  
13 pre-trade transparency, so, I don't want that to  
14 be a useful copout. I want to put as much as we  
15 can on the exchange. And, therefore, I believe we  
16 must have flexible venues for exchanges here and  
17 we've worked hard to get to a more flexible  
18 approach.

19           You know, you all have worked hard,  
20 words matter, we don't have a real good SEF  
21 definition. I'm not saying that this definition  
22 isn't good, but we don't have an example out there



1 of a good SEF and so we're making it up. And we  
2 need to make it up and, I believe cast, a wide net  
3 and then, you know, we can come back at it if  
4 we've missed it. But to do a broad catch now is,  
5 I think, the prudent thing to do and make sure we  
6 don't leave anybody out and avoid or deter  
7 pre-trade transparency and on-exchange trading.

8 CHAIRMAN GENSLER: Can I ask  
9 Commissioner O'Malia a question?

10 COMMISSIONER O'MALIA: I didn't sign up  
11 for that. Yeah, sure. of course.

12 CHAIRMAN GENSLER: No, no, we're  
13 deliberating --

14 COMMISSIONER O'MALIA: I'm sitting right  
15 here.

16 CHAIRMAN GENSLER: No, it's just you  
17 raised something that I think is a very  
18 interesting question about blocks. I tend to  
19 think that the block size is -- I mean, it's a  
20 proposed rule, we'll see where it is. They're not  
21 necessarily going to stay that high. I mean, I  
22 think they'll come down based on that formula, but

1       whatever those numbers are, are you -- you're  
2       highlighting that we've sort of given blocks maybe  
3       a total pass and there's maybe some transparency  
4       even on the blocks that might be appropriate?  
5       Might be appropriate.

6                COMMISSIONER O'MALIA: Well, we'll see  
7       when the block comments come back, but  
8       understanding what the block is and how those  
9       trade is very closely tied to what you can  
10      transact on a SEF and if people are comfortable  
11      that they can transact flexibly on a SEF and do  
12      their business, we will have far less necessity  
13      for block trades.

14               CHAIRMAN GENSLER: Right, right, I think  
15      you're right. I think that as people see if they  
16      can trade -- I mean, in the futures markets it's  
17      sort of you can trade a tick away or maybe a tick  
18      and a half away, you'd rather just take it down to  
19      the floor and get it done because the block's  
20      going to cost you, you know, whether it's three  
21      ticks or four ticks or something else. And so  
22      that's -- that will be if there's enough liquidity

1 in these swap execution facilities, I think people  
2 are just going to want to do it in the smaller  
3 sizes because they'll get better pricing.

4 If, on the other hand, it develops that  
5 they don't get better pricing, then they'll -- I  
6 think they'll rightly want to keep them in blocks.

7 COMMISSIONER O'MALIA: I think we'll  
8 move to smaller blocks, smaller size and better  
9 pricing as the market develops, but that's going  
10 to be --

11 CHAIRMAN GENSLER: I think we agree on  
12 that. I think we agree on that.

13 If there are no further questions, Mr.  
14 Stawick, do you want to call the roll?

15 MR. STAWICK: Commissioner O'Malia?

16 COMMISSIONER O'MALIA: Aye.

17 MR. STAWICK: Commissioner O'Malia, aye.  
18 Commissioner Chilton?

19 COMMISSIONER CHILTON: Aye.

20 MR. STAWICK: Commissioner Chilton, aye.  
21 Commissioner Sommers?

22 COMMISSIONER SOMMERS: No.

1                   MR. STAWICK: Commissioner Sommers, no.  
2 Commissioner Dunn?

3                   COMMISSIONER DUNN: Aye.

4                   MR. STAWICK: Commissioner Dunn, aye.  
5 Mr. Chairman?

6                   CHAIRMAN GENSLER: Aye.

7                   MR. STAWICK: Mr. Chairman, aye. Mr.  
8 Chairman, on this question, the ayes are four, the  
9 nays are one.

10                  CHAIRMAN GENSLER: With the vote being  
11 four to one, the staff recommendation on core  
12 principles on SEFs will be forwarded to the  
13 Federal Register. I thank you all for this  
14 excellent work.

15                  Rick and David, I gather you get to stay  
16 here -- or is it just Rick? Whomever. You are  
17 the chief counsel of the Division of Market  
18 Oversight.

19                  MR. VAN WAGNER: We're having so much  
20 fun.

21                  CHAIRMAN GENSLER: And then the rule  
22 team for position limits will be coming up. I

1       guess I can filibuster a little bit, but this team  
2       has done -- I mean, every one of the teams has  
3       done remarkable work, but this is something that  
4       we had three hearings on in 2009. We had a rule  
5       proposal in January of this year followed by yet  
6       another meeting in March of this year on the  
7       metals markets. Congress had numerous meetings  
8       and hearings in three years of time. They did  
9       significantly change and enhance our rule writing  
10      authority to be expanded to the swaps markets and  
11      with that I think the team is here so I'm going to  
12      hand it over. I've filibustered.

13                 Steve Sherrod, who is the head of our  
14      surveillance unit inside of the Division of Market  
15      Oversight; Bruce Fekrat, who is an attorney who  
16      has worked as the team lead and, in fact, was the  
17      attorney who led most of the writing on the rule.

18                 MR. FEKRAT: Good afternoon.

19                 CHAIRMAN GENSLER: Good afternoon. We  
20      want to be quick enough that we don't lose Mike  
21      Dunn.

22                 MR. FEKRAT: Okay. Commissioners, Mr.

1 Chairman, thank you for the opportunity to present  
2 this rule and the proposal to you. I'd also like  
3 to take a moment to thank and recognize the hard  
4 work of Ken Danger, Salman Banaei, Ali Hosseini,  
5 Tom Littlefield, Jim Outen, and Carlene Kim and  
6 Neal Kumar from OGC.

7           The proposed regulations would establish  
8 a process for setting position limits for certain  
9 derivatives executed pursuant to the rules of  
10 designated contract markets and, at the same time,  
11 for physical commodity swaps that are economically  
12 equivalent to the DCM contracts. The proposed  
13 regulations would establish initial position  
14 limits through a Commission order. The proposal  
15 also includes exemptions for bona fide hedging  
16 transactions and for positions that were  
17 established in good faith prior to the effective  
18 date of any final regulations that may be adopted  
19 pursuant to the rules.

20           Staff also recommends new account  
21 aggregation and visibility regulations, which are  
22 very similar to current reporting obligations for

1 large bona fide hedgers and new regulations  
2 establishing requirements and standards for  
3 position limits and accountability rules that are  
4 implemented by registered entities.

5           The Dodd-Frank Act amended Section 4(a)  
6 of the Commodity Exchange Act and authorized the  
7 Commission to extend position limits beyond  
8 futures and option contracts to swaps that are  
9 economically equivalent to DCM futures contracts  
10 with position limits. Most importantly, the act  
11 requires that the Commission apply position limits  
12 on an aggregate basis to economically equivalent  
13 derivatives across different trading facilities  
14 and manners of execution.

15           A primary mission of the CFTC is to  
16 foster open, efficient functioning of the  
17 commodity derivative markets. Congress has  
18 declared that sudden or unreasonable price  
19 fluctuations that can be attributed to excessive  
20 speculation create an undue and unnecessary burden  
21 on commerce and has directed that the Commission  
22 establish limits on the amounts of positions which

1       may be held as it finds necessary to diminish,  
2       prevent, or eliminate such burdens.

3               As the plain reading of the statute --  
4       statutory text indicates, the prevention of  
5       unreasonable changes in price attributable to  
6       large speculative positions, even without  
7       manipulative intent, is a congressionally endorsed  
8       regulatory objective. The Commission may impose  
9       position limits prophylactically based on its  
10      reasonable judgment that such limits are necessary  
11      for the purpose of diminishing, eliminating, or  
12      preventing the burdens associated with excessive  
13      speculation.

14             The proposal enumerates 28 core futures  
15      contracts that would be subject to the proposed  
16      position limit framework. The 28 commodities  
17      covered by the proposal include gold, silver,  
18      copper, crude oil, natural gas, soybeans, and  
19      wheat. The numerated contracts were selected  
20      either because they have high levels of open  
21      interest and significant notional value or because  
22      they otherwise may provide a reference price for a



1 significant number of cash market transactions.  
2 The covered contracts, which are called "reference  
3 contracts" in the proposal, are defined as  
4 derivatives that are directly or indirectly linked  
5 to the price of an enumerated contract or that are  
6 based on the price of the same commodity for  
7 delivery at the same locations as that of an  
8 enumerated contract or another delivery location  
9 with substantially the same supply and demand  
10 fundamentals.

11 Staff recommends establishing limits in  
12 two phases. In the first phase, staff recommends  
13 that the Commission establish spot-month position  
14 limits at the levels currently imposed by DCMs.  
15 The first phase would include related provisions,  
16 such as proposed regulations pertaining to bona  
17 fide hedging and account aggregation standards.

18 During the second phase staff recommends  
19 that the Commission establish and single-month and  
20 all-months- combined position limits and, at that  
21 time, to revise spot- month limits to base them on  
22 current estimates of deliverable supply. Phased

1 implementation or adoption of final regulations is  
2 possible because DCMs currently set spot-month  
3 position limits and base those position limits on  
4 their estimates of deliverable supply. These  
5 spot-month limits can, therefore, be implemented  
6 by the Commission relatively expeditiously.

7           For the second phase staff recommends  
8 that the Commission determine the numerical  
9 non-spot-month position limits for exempt and  
10 agriculture commodity derivatives by applying open  
11 interest formulas. Because the Commission will  
12 not be able to gather swap positional data for  
13 some time, staff recommends that the Commission  
14 determine the levels of such limits when the  
15 Commission receives data regarding the levels of  
16 open interest in the swap markets to which these  
17 limits will apply.

18           The proposed spot-month position limit  
19 formula seeks to minimize the potential for  
20 corners and squeezes by facilitating the orderly  
21 liquidation of positions as the market approaches  
22 the end of trading and also by restricting swap

1 positions which may be used to influence the price  
2 of reference contracts that are executed on DCMs.

3 In the second phase of implementation  
4 these spot-month limits, rather than being based  
5 on DCM position limits, would be based on 25  
6 percent of estimated deliverable supply as  
7 determined by the Commission, which could choose  
8 to adopt exchange-provided estimates or, for  
9 example, in the case of inconsistent estimates  
10 from exchanges could issue its own estimates. The  
11 proposed regulation would apply spot-month  
12 position limits separately for physical contracts  
13 and for cash-settled contracts, including  
14 cash-settled swaps. A trader may, therefore, have  
15 up to the spot-month position limit in both the  
16 physically delivered and cash-settled contracts.

17 With respect to cash-settled contracts,  
18 the proposed regulations also incorporate a  
19 conditional spot-month limit that permits traders  
20 with hedge -- without a hedge exemption to acquire  
21 position levels at 5 times the spot-month limit if  
22 such positions are exclusively in cash-settled

1 contracts and the trader doesn't hold a physical  
2 commodity position that is more than 25 percent of  
3 the estimated deliverable supply. In contrast to  
4 spot-month position limits, which are set as a  
5 function of deliverable supply, the class and  
6 aggregate single- and all-month limits as proposed  
7 would be tied to a specific percentage of overall  
8 open interests for a particular reference contract  
9 in the aggregate.

10 Under the proposed regulations there are  
11 two classes of contracts in connection with  
12 non-spot-month limits. One class is comprised of  
13 all futures contracts executed pursuant to the  
14 rules of the DCM. The second class is comprised  
15 of all swaps. Class and aggregate position limits  
16 based on a percentage of open interest help  
17 prevent any single speculative trader from  
18 acquiring excessive market power. Class limits  
19 ensure that market power is not concentrated in  
20 any one sub-market. The formula proposed ensures  
21 that no single speculator can constitute more than  
22 10 percent of a market as measured by open

1 interests, up to 25,000 contracts of open  
2 interests and 2.5 percent thereafter.

3 The new statutory of a bona fide hedge  
4 generally follows the existing definition in  
5 Commission Regulation 1.3(z) except the directive  
6 requires that all bona fide hedging transactions  
7 and positions to represent a substitute for a  
8 physical market transactions, and the directive  
9 provides an explicit exemption for a trader to  
10 reduce the risks of swap positions provided that  
11 the counterparty to the swap transaction would  
12 have qualified for a bona fide hedging transaction  
13 exemption or the risk-reducing positions offset a  
14 swap that itself qualifies as a bona fide hedging  
15 transaction. The proposed definition of "bona  
16 fide hedging" conforms to the statutory directive.

17 Staff recommends regulations that would  
18 set position visibility or reporting levels, also,  
19 and establish the requirements for all traders to  
20 report positions to us when the visibility levels  
21 are exceeded. The reporting regulations aim to  
22 make the derivatives and cash portfolios of the

1 largest traders in reference contracts visible to  
2 the Commission.

3 Staff also recommends proposed  
4 regulations for account aggregation standards.  
5 Thus, under such rules, the proposed rules would  
6 apply to position limits in reference contracts to  
7 all position and accounts in which any trader,  
8 directly or indirectly, has an ownership or equity  
9 interest of 10 percent or more by power of  
10 attorney or otherwise controls trading. Staff  
11 recommends a limited exemption from aggregation  
12 provisions for position in pools, the limited  
13 exemption for positions for future Commission  
14 merchants in certain discretionary accounts, and a  
15 limited exemption for entities to disaggregate the  
16 positions of an independently controlled and  
17 managed trader that is not a financial entity. In  
18 all three cases, the exemptions would require and  
19 become effective only upon the Commission's  
20 approval of an application under the proposed  
21 regulations.

22 I, along with my colleagues, would be

1 happy to answer any of your questions.

2 CHAIRMAN GENSLER: Bruce, thank you.

3 The chair will entertain a motion to accept the  
4 staff recommendation on position limits.

5 COMMISSIONER SOMMERS: So moved.

6 CHAIRMAN GENSLER: Do I hear a second?

7 COMMISSIONER O'MALIA: Second.

8 CHAIRMAN GENSLER: The chair will now  
9 allow -- open the floor for commissioner  
10 questions. I wanted to ask a number of questions.  
11 I do support the proposed rulemaking to establish  
12 position limits for physical commodities as the  
13 CFTC, I believe, has been directed by Congress to  
14 do. We do not as an agency regulate or set  
15 prices, but we have, since the 1930s, been asked  
16 to address ourselves to the burdens that may come  
17 from excessive speculation and to use this method,  
18 this means of limiting positions.

19 What we've done over the decades,  
20 initially in the agricultural markets and later  
21 with the help of the exchanges and the energy and  
22 oil -- energy and metals markets, is to address

1 ourselves to large positions or concentrations in  
2 those markets. And at the core of this was  
3 promoting market integrity, which the agency has  
4 historically done in a number of ways, but  
5 position limits has been part of that.

6 I think position limits have helped  
7 protect markets both in clear times and in stormy  
8 times. I'm just quoting from a Commission ruling  
9 in 1981. This might be preamble text, but, "The  
10 capacity of any contract market to absorb the  
11 establishment and liquidation of large speculative  
12 positions in an orderly manner is related to the  
13 relative size of such positions, i.e., the  
14 capacity of the market is not unlimited."

15 And I think, you know, those were  
16 written almost years by this Commission. They're  
17 relevant today.

18 This proposal today would implement new  
19 authorities under Dodd-Frank to prevent excessive  
20 speculation and manipulation in the markets. And,  
21 of course, Congress did expand the scope of this  
22 mandate to set limits also to include certain



1 swaps: Those that are economically equivalent and  
2 actually, later on, those swaps that perform a  
3 significant price discovery function or deemed to  
4 perform that.

5 This proposal reestablishes position  
6 limits in the agricultural -- I should say  
7 reestablishes position limits in the energy and  
8 metals markets. And I do have a question, Mr.  
9 Sherrod or Bruce, if you could just tell us a  
10 little of the history, or Rick. I know that in  
11 energy markets the exchanges set them through the  
12 summer of 2001, but I don't remember in metals  
13 what it was.

14 MR. SHERROD: That's correct. The  
15 Commission, through two different Federal Register  
16 notices in 1991 and '92, changed the framework.  
17 The Commission approved position accountability in  
18 lieu of the all-month limits for silver and gold  
19 in August of '92; for copper the next year in June  
20 of '93; sugar, number 11, in April 2001. We moved  
21 to a certification format with CFMA. And cocoa  
22 was certified in July 2001. Energy, as you

1 mentioned, were certified in the summer of 2001.  
2 And then finally, the Commission approved a rule  
3 for coffee C that substituted position  
4 accountability levels for position limits in the  
5 all-months and the single non-spot months.

6 CHAIRMAN GENSLER: I thank you. So, in  
7 essence, this proposal would -- that may be at  
8 different levels and different numbers, but  
9 reestablish position limits in a couple of  
10 agricultural markets, but in the energy and  
11 metals.

12 MR. SHILTS: And just -- let me just add  
13 a little bit.

14 CHAIRMAN GENSLER: Surely.

15 MR. SHILTS: Because in the '80s, the  
16 Commission required all markets to have limits,  
17 spot-month and back-month limits. And then in  
18 the '90s, they put out two, I guess, concept  
19 releases saying exchanges could adopt position  
20 accountability that first applied to the  
21 financials and, then as Steve said, it applied to  
22 metals and energy. And then the exchanges at

1 various times decided to implement that  
2 accountability regime.

3 CHAIRMAN GENSLER: Thank you, Rick.  
4 Also this proposal includes position limit regime  
5 for spot month and another regime for -- well, as  
6 Rick calls it, the back months, if I might. It  
7 would implement the spot-month limit, which are  
8 currently set in agriculture, energy, and metals  
9 currently. Is that right? I mean, there are  
10 spot- month limits in all of those products.  
11 Steve?

12 MR. SHERROD: That's correct.

13 CHAIRMAN GENSLER: Sooner, and then a  
14 single- month or all-months combined limit later.  
15 And I have a question to -- maybe this is a  
16 general counsel's question, but in terms of this  
17 phased implementation, Dan, does the Commission  
18 have the legal authority to adopt the approach  
19 that is in the proposed rule being recommended  
20 today?

21 MR. BERKOVITZ: Mr. Chairman, we believe  
22 the Commission does have ample legal authority to

1       adopt the position limits as proposed on a phased  
2       implementation schedule. Generally, as a matter  
3       of administrative law, the Administrative  
4       Procedure Act and case law interpreting that act  
5       and various statutes provides agencies with  
6       reasonable leeway in the manner and issuance,  
7       timing, and implementation of agencies' rules.  
8       This is particularly true in a case such as this  
9       where there's complex issues involved in the rule.

10               In addition, the Commodity Exchange Act  
11       itself permits the Commission to adopt position  
12       limits and phases such as proposing a formula now  
13       and opposing the actual numerical limits once we  
14       have more data. Section 4(a) of the act, which  
15       provides the Commission and directive to issue  
16       position limits, provides the Commission with  
17       discretion to determine the appropriate levels of  
18       such limits and how best to apply any such limits  
19       in order to achieve the statutory objectives of  
20       diminishing, eliminating, or preventing the  
21       burdens from excessive speculation.

22               For example, when the Commission first

1 proposed and adopted the open interest formula in  
2 the early 1990s, the application of the formula  
3 was phased in over a period of time. The  
4 Commission first proposed the 10.25 -- 10, 2-1/2  
5 formula that's in the proposal today for certain  
6 agricultural commodities in 1992. About one year  
7 later, in 1993, the Commission adopted the formula  
8 in an interim final rule. And I would also note  
9 that at that time that was really the first time  
10 we moved what might be called aggregate limits  
11 because we combined the futures and the options  
12 limits to a single limit. The Commission phased  
13 in the formula over a period of time. The first  
14 phase was aggregating futures and options, the  
15 second phase was going halfway to the formula  
16 levels, and then the third phase was adopting the  
17 full formula levels. So there's clear precedent  
18 for the Commission phasing in position limits over  
19 time, so we believe there's -- both under the  
20 Commodity Exchange Act and the Administration  
21 Procedure Act there would be authority to adopt a  
22 phase-in implementation as in the proposal.

1                   CHAIRMAN GENSLER:  And does the  
2                   Commission have the legal authority under the act  
3                   to do a role that would provide a formula, as this  
4                   rule does, a formula for determining the position  
5                   limits, but then that the numerical limits under  
6                   the formula would be established later date by an  
7                   order as I understand it?  So this would be  
8                   establishing a formula.  Could we, in essence, go  
9                   final on the formula, though that it would be, you  
10                  know -- the actual limits would be determined by  
  
11                 an order later?

12                  MR. BERKOVITZ:  Right, Mr. Chairman.  
13                 The Commission could, by rule, establish the  
14                 formula.  The formula would specify how the data  
15                 would be -- how the numerical limits would be  
16                 calculated based on the data, what we would do  
17                 with that data, so people would have notice and  
18                 opportunity for comment on the formula in the rule  
19                 under consideration.  And then when the data comes  
20                 in we just crank the data through the formula and  
21                 the limits could be established.

22                  CHAIRMAN GENSLER:  And though Congress

1 had 180 days on the exempt commodities and 270  
2 days on the agricultural commodities, does your  
3 answer still stand? I mean, it's in light of  
4 those things?

5 MR. BERKOVITZ: Right. The Commission  
6 has, again, the courts would find, a reasonable  
7 amount of discretion in terms of issuance of the  
8 rule. Even if it's past 180 days, our authority  
9 very clearly does not go away on day 181. The  
10 authority is there on day 181 and 182 and so on,  
11 so we have the authority past day 180 clearly.  
12 And we have a reasonable amount of time before a  
13 court would -- before there would be any  
14 (inaudible).

15 CHAIRMAN GENSLER: That's very helpful.  
16 Let me just ask I don't know who on the panel just  
17 so -- to actually implement the spot-month limits  
18 -- not the back- months, but the spot-month limits  
19 -- am I correct, the proposal's a proposal that we  
20 would be relying on the exchanges to do some  
21 calculations and then it would be reviewed and  
22 validated by the CFTC? Is that correct?

1                   MR. FEKRAT: That's correct. The DCM  
2 limits are premised on 25 percent of deliverable  
3 supply. And when they set these limits we either  
4 approve them or certify them, so we conduct a  
5 review and ensure that what they're doing and the  
6 limits that they're setting is consistent with the  
7 cash market and the deliverable supply for the  
8 particular futures contract.

9                   CHAIRMAN GENSLER: And I'd ask another  
10 question of Mr. Berkovitz and then I have some  
11 questions for you, Rick.

12                   Dan, is the Commission required to find  
13 that there has been excessive speculation or price  
14 distortions from speculation in order to issue  
15 position limits? In essence, is the Commission  
16 required to find that position limits are  
17 necessary to prevent excessive speculation or will  
18 prevent excessive speculation in order to adopt  
19 position limits? I guess that's two questions.  
20 Maybe I should split them.

21                   MR. BERKOVITZ: Mr. Chairman, in  
22 summary, we believe the Commission is not required



1 to make a specific finding that there has been  
2 excessive speculation or that there have been  
3 price distortions or that the limits will, in  
4 fact, prevent excessive speculation or those price  
5 distortions. As Bruce mentioned in his opening  
6 statement, position limits are a prophylactic  
7 measure. They're intended to prevent harm to the  
8 market, so obviously you don't need harm to have  
9 occurred. They're supposed to be preventative.

10 The Commodity Exchange Act directs the  
11 Commission to fix such limits that the Commission  
12 finds are necessary to diminish, eliminate, or  
13 prevent such burdens on interstate commerce that  
14 Congress has already found result from excessive  
15 speculation. And this finding need not be made  
16 through detailed economic analysis or economic  
17 studies, but rather the finding of what position  
18 limits are necessary may be based on the  
19 Commission's judgment and experience with position  
20 limits.

21 I think you've quoted and Bruce also  
22 mentioned the excerpt from the 1981 rulemaking,

1       when the Commission first required the exchanges  
2       to have position limits for all commodities where  
3       the Commission itself hadn't established position  
4       limits. And this issue was raised at the time the  
5       Commission proposed the rule that exchanges shall  
6       have position limits for all commodities that were  
7       not subject to the federal limits at the time,  
8       which would have been many of the non-agricultural  
9       commodities. Commenters raised this issue, saying  
10      you need to find that there has been excessive  
11      speculation and the Commission needs to find that  
12      these specific limits will prevent specific harms.

13                 And the Commission itself stated at the  
14      time, "As stated in the proposal, the prevention  
15      of large and/or abrupt price movements which are  
16      attributable to extraordinarily large speculative  
17      positions is a congressionally endorsed regulatory  
18      objective of the Commission. Further, it is the  
19      Commission's view that this objective is enhanced  
20      by speculative position limits since it appears  
21      that the capacity of any contract market to absorb  
22      the establishment and liquidity of large

1 speculative positions in an orderly manner is  
2 related to the relative size of such positions,  
3 i.e., the capacity of the market is not  
4 unlimited."

5           Again, the Commission also responded to  
6 the general objections regarding the effectiveness  
7 and the need for position limits that was raised  
8 in some of the comments. The Commission's  
9 response in 1981 was, "The Commission believes  
10 that the observations concerning the general  
11 desirability of limits are contrary to  
12 congressional findings in Section 3 and Section  
13 4(a) of the act and considerable years of federal  
14 and contract market regulatory experience."

15           A similar statement -- the Commission  
16 made a similar statement when it adopted the 10,  
17 2-1/2 formula in 1993: "Speculative position  
18 limits have been a tool for the regulation of the  
19 futures markets for over a half- century. During  
20 this time the Congress has consistently expressed  
21 confidence in the effectiveness of speculative  
22 position limits as a tool of preventing

1 unreasonable or unwarranted price fluctuations."

2           So those are the examples of the type of  
3 findings. They're not specific findings. We  
4 don't have to find that harm has occurred. These  
5 are preventive measures.

6           CHAIRMAN GENSLER: Thank you. That was  
7 very helpful.

8           Commissioner Chilton has shown  
9 extraordinary leadership on these issues and we  
10 together were asked to testify yesterday in front  
11 of the House Subcommittee and the Agricultural  
12 Committee. And one of the concerns raised  
13 yesterday, I think by both of us, is that these --  
14 we're in this challenging circumstance of putting  
15 a formula in place, but if it's a formula applied  
16 to data that comes later, it will be some time  
17 until these are in place.

18           So I have a question for Rick or maybe  
19 it's more a statement and then you'll react. But  
20 based on the proposal it'll be some time before  
21 position limits are in place. And in the interim,  
22 do we have the ability -- so in this interim

1 number of months -- do we have the ability to ask  
2 futures market participants for information about  
3 their futures and their swaps and cash positions  
4 if they exceed certain levels?

5 For instance, could we, during these  
6 number of months, have these various parties, you  
7 know, the market participants that have a  
8 significant position greater than the levels that  
9 are being suggested here, so if we were to do  
10 calculations greater than this 10 and 2-1/2  
11 percent formula, can we ask for additional  
12 information?

13 MR. SHILTS: Yes, Mr. Chairman. Under  
14 our Regulation 18.05 the Commission has brought  
15 authority to inquire about a futures market  
16 participant's future swaps or cash positions and  
17 asked them to submit information about their book  
18 of business through our special call authority.  
19 And, in fact, I think it was in 2009, the  
20 Commission clarified or modified Regulation 18.05  
21 to clarify our authority to get information about  
22 a trader's swaps positions.

1                   CHAIRMAN GENSLER:  If that's the case, I  
2                   think it would be helpful to do that, that until  
3                   position limits become fully implemented, and I  
4                   know it's some number of months away, but until  
5                   they're fully implemented I think that it would  
6                   give this Commission a better look into the market  
7                   and help us identify potential concerns.  But I'd  
8                   like, you know, your thoughts on that, too.

9                   MR. SHILTS:  I do think that that would  
10                  be helpful from a surveillance perspective.  We do  
11                  want to know more about traders when their  
12                  positions are large, particularly if a trader does  
13                  not have a bona fide exemption we'd want to know  
14                  the details of their position and what their  
15                  intentions are.  And also, having that information  
16                  would give us additional information into how the  
17                  positions proposed -- that may be proposed today  
18                  actually might impact traders if they are put into  
19                  effect finally.

20                  CHAIRMAN GENSLER:  I thank you, Rick,  
21                  for that.

22                  COMMISSIONER SOMMERS:  Can I ask a

1 couple questions to clarify?

2 CHAIRMAN GENSLER: Sure.

3 COMMISSIONER SOMMERS: Thank you for  
4 letting me interrupt.

5 CHAIRMAN GENSLER: Always.

6 COMMISSIONER SOMMERS: How is this  
7 different? We used our 18.05 authority to do the  
8 special call that we're currently collecting.

9 MR. SHILTS: Correct.

10 COMMISSIONER SOMMERS: So how would this  
11 be any different than what we're currently  
12 collecting under 18.05?

13 MR. SHILTS: I'm sorry, this would be  
14 addressed to, as I understand it, to traders that  
15 -- in the futures markets that have positions that  
16 would exceed the proposed levels that the staff is  
17 recommending now, the 10, 2-1/2 percent, whereas  
18 the other special call was really focused on swap  
19 dealers to get information, looking behind their  
20 (inaudible) to the positions of traders with  
21 respect to both their swaps book and those that  
22 might be, you know, index trading. I mean, it's a

1 different focus and it'd be a different universe.

2 COMMISSIONER SOMMERS: In current  
3 practice, if we have a large trader in our market  
4 that is above the position limit, the spot-month  
5 position limit that already exists for all of  
6 these markets, if we have somebody who's above  
7 that limit do we not already do that kind of due  
8 diligence, or the exchange, to know why that  
9 entity is above a position limit, what their cash  
10 market positions are, what their swaps positions  
11 are, I mean, isn't that already current practice?

12 MR. SHILTS: It's current practice at  
13 the exchanges. I mean, in most cases it's their  
14 obligation to enforce limits. Except for the few  
15 agricultural commodities, it's the exchanges that  
16 actually do enforce our have limits in place, and  
17 most of those just apply to the spot month. They  
18 have position accountability in the back months.  
19 And also, as part of our surveillance program, we,  
20 working with the exchange, would be looking into  
21 traders' positions. But we wouldn't necessarily,  
22 unless we thought there was some market situation,



1 be gathering information with respect to any  
2 specific level for -- looking at the back months  
3 right now. And I think this is a proposal to do  
4 that.

5 COMMISSIONER SOMMERS: This is for the  
6 back months as well.

7 MR. SHILTS: Yeah.

8 COMMISSIONER SOMMERS: Okay.

9 CHAIRMAN GENSLER: So just, Rick, to  
10 clarify, I mean, I think that it would be helpful  
11 during this pendency -- let's call it a transition  
12 period -- that we as a Commission, through our  
13 surveillance of markets, understand whom in the  
14 markets for these 28 contracts and energies,  
15 metals, and agricultural products, are beyond the  
16 10 and 2-1/2. They're not firm limits; they're  
17 just a proposal. But it would be helpful to  
18 understand whom amongst and know more about that  
19 with regard to their positions, their swap  
20 positions, and cash positions. And you're saying  
21 we do have that authority or ability, is that  
22 right?

1                   MR. SHILTS: We could -- I mean, it  
2                   could be done under a special call or it could be  
3                   done -- I mean, we regularly contact traders, so  
4                   if we could set a threshold level where we would  
5                   be -- for traders that exceed these -- you know,  
6                   the 10, 2-1/2 percent levels, we would contact  
7                   them. It could be done informally as we do now or  
8                   it could be done through a special call.

9                   CHAIRMAN GENSLER: And that's an  
10                  excellent point because a lot of -- the public  
11                  should know there's a lot of communications  
12                  between this agency and market participants that  
13                  don't need, you know, a special document or call.  
14                  But I'd like -- and I think I -- Dan, you tell me  
15                  if I have the authority to do this as just  
16                  directing the staff, but I'd like to ask the staff  
17                  or, more informally, direct the staff that during  
18                  this pendency, during this transition period until  
19                  any limits are implemented, that you'll -- we'll  
20                  review large trader positions on a designated  
21                  contract market or significant price discovery  
22                  markets. That's a technical term, I know, but for

1       these contracts that we're reviewing today, these  
2       28 contracts. And if a trader does appear to  
3       exceed the numbers -- the 10 and 2-1/2 level for  
4       the markets -- I'd ask staff to make appropriate  
5       inquiries, collect appropriate information,  
6       whether that be, as you say, in the informal way  
7       or if you need to through the special, and then  
8       monitor it and then report to us.

9                We have -- the public should know we  
10       have -- and I think it's going on for over 30  
11       years -- every Friday, a surveillance meeting, a  
12       surveillance and enforcement meeting. We publish  
13       that in the Federal Register, but it's a closed  
14       door meeting. But I'd like to direct staff to do  
15       that on these, particularly during this period, to  
16       keep us informed and just so that we can  
17       understand that during that period of time.

18               Dan?

19               MR. BERKOVITZ: You certainly have that  
20       authority, Mr. Chairman.

21               CHAIRMAN GENSLER: Thank you. Then as I  
22       say, Mr. Shilts, make it so.

1                   MR. SHILTS: Yes. Yes, we will do that  
2                   and report to the Commission on a monthly basis.

3                   CHAIRMAN GENSLER: Thank you.  
4                   Commissioner Dunn?

5                   COMMISSIONER DUNN: Thank you very much,  
6                   Mr. Chairman. I'd be remiss if I didn't recognize  
7                   my colleague Commissioner Chilton for all the hard  
8                   work that he's put into this. If the number of  
9                   e-mails and late- night phone calls that I've  
10                  received (inaudible) are any indication of how  
11                  much work he's put into this, it has been nothing  
12                  short of amazing.

13                  When we were discussing this back on  
14                  August 5 of 2009, I had said I was concerned that  
15                  we didn't have the authority to do  
16                  over-the-counter. We now have that authority.  
17                  But I was also concerned about what was happening  
18                  with foreign boards of trade.

19                  And if I could, Mr. Chairman, if Jackie  
20                  Mesa is there, if she could have a seat and answer  
21                  a couple questions for me.

22                  CHAIRMAN GENSLER: That would be

1       terrific. And for the public, Jackie is the head  
2       of our Office of International Affairs; done an  
3       excellent -- I mean, she travels the globe and I'm  
4       glad she's here because sometimes she's not.

5               MS. MESA: I'm here, Commissioner Dunn.

6               COMMISSIONER DUNN: Thank you. Thank  
7       you. It's my understanding that the EU is  
8       considering position limits. And can you describe  
9       the approach to position limits that they are  
10      taking?

11              MS. MESA: Sure. Just to be clear on  
12      the background, on December 8th, the European  
13      Commission published a public consultation  
14      document on revising their Markets in Financial  
15      Instruments Directive, or MiFID, which had been in  
16      place since 2007, but they have a section on the  
17      consultation regarding directive markets and  
18      over-the-counter markets and a specific section  
19      on position reporting and position limits. In  
20      this provision they propose harmonizing position  
21      limits across EU authorities. Currently it varies  
22      what the national authorities will do regarding

1 position management and position limits. The  
2 European Commission said that they wanted to  
3 harmonize its approach because of the increased  
4 growth of the derivative markets to diminish  
5 regulatory arbitrage and to have a level playing  
6 field. And they also cited that the European  
7 Parliament has specifically directed the European  
8 Commission to do this.

9           The way that they would do it is to have  
10 greater coordination and implementation of the  
11 position limits. They intend to set a number of  
12 factors that national authorities would consider,  
13 which would cause a trigger of position limits.  
14 And some kind of reporting to the European-wide  
15 authority, ESMA, when position limits are set or  
16 not set for particular reasons. So in this way  
17 the European Commission believes that they're  
18 going to harmonize a position limit regime across  
19 EU jurisdictions. They intend to make a proposal  
20 May 2011 on this, and then it still needs to be  
21 voted on by the European Council and the European  
22 Parliament.

1 COMMISSIONER DUNN: (inaudible)

2 MS. MESA: Sorry, I think we couldn't  
3 hear that question.

4 COMMISSIONER DUNN: And it would be  
5 implemented at what date after it was voted on?

6 MS. MESA: I'm not sure actually, but  
7 once it's proposed -- they still need to make a  
8 proposal in mid -- I'm sorry, May 2011, and then  
9 it'd be a number of months before the European  
10 Council and European Parliament would then vote on  
11 it, so perhaps four to six months.

12 COMMISSIONER DUNN: You have been in  
13 consultation with them all along?

14 MS. MESA: Yes, our -- the Commission  
15 has been in touch with them, and Commission staff.  
16 We've been having actually weekly phone calls with  
17 them on all the rules, but this limit has --  
18 position limit regime and what we're proposing has  
19 come up a number of times on the call and we've  
20 had very technical conversations about our regime  
21 and what they're thinking about as well.

22 COMMISSIONER DUNN: I've seen press

1 accounts that has indicated that the EU is backing  
2 away from hard limits. Is that accurate in your  
3 opinion?

4 MS. MESA: I don't think it is accurate.  
5 In fact, the consultation document specifically  
6 states that they're talking about hard limits.  
7 What you may see being reported is that they would  
8 still leave this to the discretion of the national  
9 authorities.

10 COMMISSIONER DUNN: So at some point in  
11 the future we should see something akin to what we  
12 are discussing here today?

13 MS. MESA: I'm hopeful. I'm hopeful.  
14 That's about all I can say.

15 COMMISSIONER DUNN: Thank you. I  
16 appreciate that. And it's difficult to make you  
17 the spokesperson for the entire EU, I apologize.

18 MS. MESA: I'm happy to help.

19 COMMISSIONER DUNN: I notice that what  
20 we're talking about on the spot proposed limits,  
21 that will be set at 25 percent of the deliverable  
22 supply for a given commodity. How is that



1 deliverable supply going to be ascertained?

2 MR. SHILTS: Yeah, the 25 percent rule,  
3 so to speak, is something that's been around, that  
4 the Commission has used and the exchanges for  
5 many, many years. And the estimate generally  
6 looks at the definition of the deliverable  
7 commodity that you're looking at, the locations  
8 that are specified, the quality, and any other  
9 parameters defining the deliverable product. And  
10 then looking at whatever information is available  
11 about available supplies of the product during a  
12 specific delivery month and then making any  
13 appropriate adjustments for -- as to what might  
14 actually be available or deliverable if some of  
15 that is committed to other uses or it may not be  
16 available for certain reasons, because it doesn't  
17 meet the quality specifications or whatever, then  
18 that would be deducted. So it's essentially  
19 looking at if you were a short trader and you  
20 wished to make delivery on the futures contract,  
21 how much of the commodity typically would be  
22 available to you to go out and acquire to make

1 delivery?

2 COMMISSIONER DUNN: Does the Commission  
3 go out and audit, actually take inventory of  
4 supply? I've gotten e-mails from folks that says  
5 that in some metals there may not be that supply  
6 there. How do we ascertain that's correct?

7 MR. SHILTS: Well, usually what we'll  
8 look at is actual data that's put out, whether it  
9 be by the Agriculture Department or Energy  
10 Information Administration. And for metals the  
11 deliverable stocks for both the precious metals  
12 and others, you can look at actual supplies in the  
13 warehouses: The number of vault receipts or  
14 warehouse receipts that are actually there. So  
15 that's -- you know, there's very specific numbers  
16 to focus on.

17 COMMISSIONER DUNN: My question is do we  
18 go out and determine if those are correct, the  
19 number of receipts that are there?

20 MR. SHILTS: No, we don't.

21 COMMISSIONER DUNN: And for things like  
22 crude oil, we don't look at what is maybe sitting

1 in a tanker out in the Gulf or it's in the  
2 pipeline?

3 MR. SHILTS: No. And in doing the  
4 assessments, what we'll look at is the actual data  
5 that might be available from reputable sources,  
6 but also we do have a lot of conversations with  
7 the exchange staff who develops these, but also  
8 independently validating the information by  
9 talking to people in the industry. You know,  
10 we've got a group that actually -- a product  
11 review group who has a number of contacts with  
12 people in all the specific industries and we'll  
13 discuss with them their understanding of how the  
14 market operates and as a way to validate both the  
15 numbers and the derivation of the estimates.

16 COMMISSIONER DUNN: How many swaps do we  
17 feel are going to perform a significant price  
18 discovery function?

19 MR. FEKRAT: This proposal addresses  
20 economically equivalent swaps. And the Section  
21 4(a) --

22 COMMISSIONER DUNN: Yes, I know this is

1 a future regulation that we're going to have on  
2 that, but I want to know an estimate of how many  
3 we think are out there.

4 MR. FEKRAT: We don't have an estimate.  
5 It could -- there are byproducts, there are  
6 chemical derivatives, swaps. There are many, many  
7 types of swaps that are connected to the swaps  
8 that are economically equivalent to the futures  
9 contracts that we have a proposal on. And we hope  
10 to gain a better understanding of what's out there  
11 through the visibility rules that we have proposed  
12 in this rulemaking. And those rules trigger  
13 reporting obligations on large traders when they  
14 hit a certain percentage of the position limits.

15 And more specifically, we enumerated  
16 limits so that we would get around 20 traders of  
17 the largest traders, we would get reports on them  
18 and we would also get reports on commodities that  
19 are substantially similar to the economically  
20 equivalent commodities. So we hope to have a  
21 better idea of what's out there with respect to  
22 significant price discovery function swaps.

1                   COMMISSIONER DUNN: I've seen estimates  
2                   that the swaps industry is roughly nine times that  
3                   of the futures industry. Do we think we'll see  
4                   nine times as many?

5                   MR. SHERROD: Commissioner, those  
6                   estimates include the financial swaps. Certainly  
7                   by notional value the largest portion of the  
8                   markets, as we understand it, are in financial,  
9                   particularly interest rate swaps. So we're  
10                  focusing on a specific set of 28 physical  
11                  delivery, physical commodity futures contracts and  
12                  the economically equivalent swaps. So we should  
13                  see by a notional amount a much smaller dollar  
14                  amount. Whether that ratio will hold of 9-to-1,  
15                  at this point we don't know.

16                  COMMISSIONER DUNN: What does the term  
17                  "as appropriate" in the Frank-Dodd Act mean to  
18                  you?

19                  MR. BERKOVITZ: We believe that the  
20                  Commission has the discretion to determine which  
21                  levels are appropriate.

22                  COMMISSIONER DUNN: I have no further

1 questions, Mr. Chairman.

2 COMMISSIONER SOMMERS: In the absence of  
3 the chairman, I guess it's my turn.

4 I have some questions specifically with  
5 regard to the enforceability of these levels and  
6 the new authority that the chairman just bestowed  
7 upon the Department of Market -- or Division of  
8 Market Oversight to receive what additional  
9 information, special call, 18.05 information on  
10 swaps or cash positions for people that we see in  
11 our markets. But is that really a comprehensive  
12 look in order to be able to enforce position  
13 limits or spot-month limits?

14 MR. SHILTS: No, and if you're talking  
15 about what the chairman just directed, no, this is  
16 really more to get some additional information  
17 during an interim period before limits are in  
18 place. It -- obviously to enforce limits we would  
19 have to have information about traders' positions  
20 in the swaps markets as well as the futures  
21 markets. And that's kind of the idea of this  
22 swaps trader reporting regime, and then ultimately

1 we'd have it through the swap data repositories.

2 COMMISSIONER CHILTON: If my colleague  
3 would yield just briefly. For example, if they  
4 weren't over that what I call position point  
5 level, if they were -- they could be big in the  
6 swaps world and we would never know, so there are  
7 obviously some flaws with this approach. I'd  
8 agree with you.

9 MR. FEKRAT: Commissioner, we -- a month  
10 and a half ago, the same group that's proposing or  
11 submitting this recommendation to you, we proposed  
12 a swap, physical swap, position reporting system.  
13 So when that becomes effective, and the comment  
14 period closed in December, when that becomes  
15 effective it's a -- when it becomes effective is a  
16 function of certain statutory analysis that must  
17 be done with respect to definitions and also  
18 resources, Commission resources and how quickly  
19 the industry can adjust to the requirements. But  
20 that's when we would get comprehensive position  
21 data and that could -- one of the dates that we  
22 projected was July.

1                   COMMISSIONER SOMMERS: Thank you. I'm  
2                   going to move on to something that I alluded to in  
3                   my opening statement with regard to other market  
4                   participants and other ways that we could treat  
5                   classes of traders because I think that there's no  
6                   doubt that we have the authority to do that. And  
7                   it's been my hope all along that we would do some  
8                   sort of analysis in how position limits would  
9                   affect market makers, ETFs, commodity index funds.  
10                  And we haven't done that up until now. And this  
11                  is a very complex issue and whether or not you  
12                  think limits are necessary, whether you think  
13                  they're appropriate, whether or not we have the  
14                  data, there's a number of different of issues with  
15                  imposing position limits. But I think that this  
16                  is a whole other set of issues that we really have  
17                  yet to analyze and I guess I would ask as we go  
18                  through this phase approach, do we have any  
19                  intention of looking at different classes of  
20                  traders and how hard position limits would affect  
21                  market makers or ETFs or commodity index funds?

22                  MR. SHERROD: Commissioner, as you know,



1 market makers generally try to keep a relatively  
2 flat book. So with respect to at least their  
3 market-making position the levels of the limits in  
4 all months and in individual months, using the  
5 formula that we're suggesting, would establish  
6 very high levels in which to address --

7 COMMISSIONER SOMMERS: I understand  
8 that, but it's my understand that limits apply  
9 intraday as well, not just end of day.

10 MR. SHERROD: That's correct. So at a  
11 level, for example, of 100,000 contracts or  
12 higher, that's substantially higher than the  
13 current positions of most traders in the markets  
14 that we've looked at. So as we recommended to you  
15 back earlier this year with the proposed levels  
16 for the energy commodities, a limited number of  
17 traders would be affected. And those traders that  
18 would be have the ability to manage their  
19 positions. They're large and sophisticated  
20 traders. And they also would have a new bona fide  
21 hedging definition that would allow them  
22 additional flexibility to go beyond the limits to

1 the extent their swap counterparties were bona  
2 fide hedgers themselves.

3 COMMISSIONER SOMMERS: I guess that  
4 confuses me a little bit. Because in the case of  
5 either market makers or ETFs or commodity index  
6 funds are they going to have commercial clients?

7 MR. SHERROD: Well, in terms of a market  
8 maker if you mean a swap dealer, for example?

9 COMMISSIONER SOMMERS: Yeah, I mean a  
10 swap dealer.

11 MR. SHERROD: You mean a futures  
12 contract market maker?

13 COMMISSIONER SOMMERS: Yes.

14 MR. SHERROD: So the market makers on  
15 the futures markets --

16 COMMISSIONER SOMMERS: Liquidity  
17 providers, whatever they call themselves.

18 MR. SHERROD: The liquidity providers,  
19 the levels that we're proposing for all months and  
20 individuals months are substantially higher than  
21 our understanding of what a market maker would  
22 ever have on an intraday basis, long or short,

1 during the day. The market makers that we've  
2 reviewed typically, as I mentioned, they provide  
3 liquidity intraday and they typically bring their  
4 position to a balance at the end of the day. And  
5 these levels are far beyond the needs for the  
6 market makers.

7 COMMISSIONER SOMMERS: Okay. So beyond  
8 whether or not these would or would not affect  
9 someone right now, do we have any intention of  
10 classifying traders differently and how the  
11 position limits may apply to them?

12 MR. SHERROD: Under the current proposal  
13 the only distinction made between the traders  
14 would be whether they qualify for a bona fide  
15 hedging exemption or not. There isn't a further  
16 distinction.

17 COMMISSIONER SOMMERS: It's a concern of  
18 mine and I guess I'm hopeful that as we move  
19 forward in this area that that's something that  
20 we'll look into. And I just have one  
21 clarification on the class limits that you  
22 described, if netting is allowed between classes.

1           MR. SHERROD: In the all-months limits,  
2           for example, there are the futures contracts as a  
3           class and the swaps as a class. To the extent a  
4           trader is on opposite sides in the markets, that  
5           would certainly reduce and they would be within  
6           their aggregate limit. The aggregate limit would  
7           add up the two positions of futures and swaps.  
8           And to the extent the trader was on the same side  
9           of the market they would have to comply with the  
10          aggregate limit. So the trader would have  
11          discretion if they would have been over the limit  
12          to decide which venue, whether in futures or in  
13          swaps, that they need to manage their position  
14          down to maintain themselves within the aggregate  
15          limit.

16                 COMMISSIONER SOMMERS: Is that a no?

17                 MR. SHERROD: I think that's a no.

18                 COMMISSIONER SOMMERS: Thank you.

19                 CHAIRMAN GENSLER: Thank you,  
20          Commissioner Sommers, for chairing the meeting for  
21          a few moments and asking questions.

22                         Commissioner Chilton?

1                   COMMISSIONER CHILTON:  Thanks, Mr.  
2           Chairman.  Thanks, everybody, for their hard work.  
3           I want to particularly commend a guy who I think  
4           is one of the better staffers at the CFTC and  
5           that's Steve Sherrod, who has been fighting a cold  
6           as many have this last week, but comes up with  
7           some really creative and good ideas, and you're a  
8           great public servant.

9                   Okay.  I appreciate that the chairman  
10          moved forward on this sort of concept of getting  
11          some -- more information when traders go over this  
12          level.  And I talked a little bit about this to  
13          Americans for Financial Responsibility on Tuesday,  
14          and we spoke about it more at the hearing on the  
15          Hill yesterday, this thing that I've called a  
16          position point proposal.  But we're not all the  
17          way where I think we need to be, but I'm not sure  
18          that it takes anything more than confirming a lot  
19          of what you all do already.  And it may take a  
20          direction by the staff or by the chairman, or it  
21          may take a direction by the commissioners.  So  
22          let's go through it, shall we?

1                   All right. So -- and let me ask Mr.  
2                   Sherrod, since I gave him such nice compliments,  
3                   maybe you'd give me positive answers here. Not  
4                   that Mr. Shilts isn't also great.

5                   So if a trader gets above this level,  
6                   what we call 10 and 2.5, 10 percent of the first  
7                   25,000 contracts have open interest and 2.5  
8                   percent of the contracts thereafter, which, by the  
9                   way, for folks listening, that was in our energy  
10                  proposal, it is in the proposal on position limits  
11                  that we're considering right now. We're in a  
12                  little cul-de-sac here talking about this proposal  
13                  that I have. It's just a little cul-de-sac. It's  
14                  not part of the rulemaking.

15                 So that level, Mr. Sherrod, would that  
16                 be an easy thing for the Division of Market  
17                 Oversight to sense, to know when a trader goes  
18                 above that level? I mean, Commissioner Sommers  
19                 talked about how we do some of this stuff already.

20                 MR. SHERROD: Well, as you're well  
21                 aware, the Commission's large trader reporting  
22                 system identifies traders at a very low level.

1                   COMMISSIONER CHILTON: Yes.

2                   MR. SHERROD: And as you heard from us  
3 in numerous surveillance briefings we identify for  
4 you the specific names of all the large traders in  
5 the markets when we have a particular market that  
6 we're focusing on, so that's relatively easy to  
7 do.

8                   COMMISSIONER CHILTON: Okay. Now, it's  
9 one thing to say we can identify it. Then what do  
10 we do? Mr. Shilts said that -- in your colloquy  
11 with the chairman, said that you were instructed  
12 to get additional information. You mentioned that  
13 there was something other than our 18.05. That's  
14 Section 18.05 authority, which is our special call  
15 authority to obtain other information, swaps  
16 information. And the reason we have that  
17 authority -- correct me if I'm wrong, Mr.  
18 Berkovitz -- is because those could impact the  
19 regulated exchange which we oversee. So that's  
20 the 18.05 authority.

21                   But they also said that we could go  
22 about obtaining this information in a more

1 informal fashion, and I accept that. But what I'd  
2 like to be clear on -- and perhaps maybe even the  
3 chairman can clarify -- is that once a trader goes  
4 over this level, the 10, 2.5 level, absent bona  
5 fide hedgers -- and these are folks that have an  
6 underlying interest in a physical commodity; we  
7 understand that they may be (inaudible) -- but  
8 absent that, that you will obtain this information  
9 either through a special call or through the  
10 informal basis. So you will get that information.  
11 And this may be exactly what the chairman was  
12 asking, I just want to -- or instructing.

13 CHAIRMAN GENSLER: I think it was.

14 COMMISSIONER CHILTON: Okay.

15 MR. SHILTS: Yes, that's my  
16 understanding.

17 COMMISSIONER CHILTON: Okay. That's all  
18 our understanding now, great. Okay.

19 Now, now they're over the level and  
20 they're over this position point level. And then  
21 the question is what do you do about it? You  
22 obtain all this information and then you make a



1 determination about the aggregate net position of  
2 those traders. So say they're the 10, 2.5.  
3 They've hit this position point level, but then  
4 when we look at their swaps and come to think  
5 they've got lots and lots of the same positions  
6 and they're way over, that's one possible  
7 scenario.

8           The other is we looked at their  
9 positions and their hedge and actually they're way  
10 under that level. In which case I would imagine  
11 you'd say, oh, no harm, no foul. Interesting,  
12 glad we looked at it, part of our market oversight  
13 we do. When they come up again maybe we'll flag  
14 it again, but no harm, no foul.

15           If they are in the other circumstance,  
16 net above that position point level -- and we have  
17 seen traders who are far above that sort of level.  
18 We've seen 20, 30 percent in net gas and crude.  
19 We've seen roughly 35 percent in silver. So we've  
20 seen large, large -- I mean, far above this 10,  
21 2.5 level. So if they are above this level, there  
22 are certain steps that the agency -- I'll try to

1 say this carefully -- that the agency may take if  
2 they deem it appropriate to get the trader down.  
3 We can jawbone them. We can take a vote to do  
4 something else. There are all sorts of things  
5 that the Commission can do, and one of them is  
6 working with the exchange, in order to get these  
7 traders down.

8 Look, this isn't mandatory position  
9 limits where it's, you know, the law of the land.  
10 This is a far cry from that. But we currently  
11 have -- we've used these things before, you've  
12 suggested that we use them. So we have the  
13 ability, if we deem it appropriate, to ask the  
14 trader to reduce below that position point level.  
15 Is that correct, Mr. Sherrod?

16 MR. SHERROD: I need to be very careful  
17 in how I answer. As you described as has been our  
18 practice, we work closely with the exchanges. We  
19 are familiar with the large traders. Our  
20 surveillance economists are in frequent discussion  
21 with the traders of the purposes of their large  
22 positions as are the regulatory staff at the

1 exchanges. So we know the large traders. We  
2 typically know the very largest traders, what  
3 their intentions are.

4 As you've also described, our concerns  
5 are less if we understand the larger traders in  
6 position accountability regimes are managing their  
7 commercial risk in either the cash or other  
8 derivative markets. The exchanges have the  
9 authority under position accountability. Once a  
10 trader has exceeded that level, the trader has  
11 given the exchange their automatic consent when so  
12 ordered by the exchange to either stand still and  
13 not increase further or to reduce. So one of the  
14 things that we would do with the information about  
15 a large trader that we had concern with and we do  
16 this now is talk to the exchange, and the exchange  
17 has an interest in keeping orderly markets. So  
18 the exchanges have exercised their authority in  
19 the past to ask traders to stand still.

20 COMMISSIONER CHILTON: Okay, I gotcha.  
21 Now, we work with the exchanges. They're  
22 self-regulatory organizations, and I'm not

1 suggesting they don't do a good job. They've got  
2 a different motive than we do. They've got profit  
3 also in their motive. There's nothing wrong with  
4 that. Profit's a good thing, the American way.  
5 That's not our job. We don't want to ruin  
6 businesses. We don't want to do anything that's  
7 harmful. We want to be careful, not act hasty,  
8 but ours is making sure these are efficient,  
9 effective markets to avoid fraud, abuse, and  
10 manipulation.

11 So, for example, when we had the metals  
12 hearing, Tom LaSala with CME touted these great  
13 accountability levels and how they had looked, I  
14 believe the number was at 29 different --  
15 abrogations is too strong a word, but times in  
16 which traders had gone above these accountability  
17 levels, which are (inaudible) voluntary and they  
18 serve as sort of triggers to look at. And what  
19 they said was: And in these 29 instances we asked  
20 the trader to either maintain or reduce their  
21 position. And boy, that sounded strong.  
22 Twenty-nine times they asked them to maintain or

1       reduce.

2                   And I asked the question, well, of those  
3       29 times how many times was it to reduce your  
4       position? I know, but, Mr. Sherrod, do you recall  
5       how many times of the 29 they asked them to reduce  
6       those positions? The answer is zero, never, not  
7       once.

8                   So these great accountability levels  
9       ain't so great. They may serve some important  
10      purpose, but they're hardly mandatory position  
11      limits and they're hardly position points that I'm  
12      talking about, that once you get that above a  
13      certain level, we seek the additional information,  
14      we figure out what the net aggregate is. There  
15      are things that we can do above and beyond the  
16      SRO, above and beyond the exchange.

17                  Now, those things -- and I know that Mr.  
18      Berkovitz and the other attorneys in the room  
19      start getting very nervous when I'm talking about  
20      these things. I am not committing to anything.  
21      All I'm saying is we have additional authorities  
22      that, if we chose -- if three of the five of us

1 chose -- we could institute an order to reduce  
2 that trader's position if we thought it was a  
3 problem in the market.

4 Mr. Berkovitz, I don't want to get you  
5 too down the road this rabbit hole, so I'm looking  
6 for a yes, Commissioner, there are additional  
7 authorities. And you don't have to explain them.  
8 But is it correct that we have additional  
9 authorities, that if the Commission acted we could  
10 use to order a trader to get below a certain  
11 position?

12 MR. BERKOVITZ: There are authorities in  
13 the act --

14 COMMISSIONER CHILTON: That we could  
15 use?

16 MR. BERKOVITZ: -- to enable the  
17 Commission to take action in specified  
18 circumstances to have a --

19 COMMISSIONER CHILTON: I'll accept yes.  
20 Okay. So, there we are. (Laughter)

21 We have this authority. We could do it.  
22 Those three could do it. Us three could do it.

1 Three of us could do it. It's our job, no profit  
2 motive. We're trying to do the right thing. We  
3 may agree or disagree. Okay.

4 So, this actually, this little colloquy  
5 thing -- and then we'll get back to the real rule  
6 -- is sort of an important deal. Because what it  
7 says is one of the goals that Mr. Berkovitz  
8 expressed in the law is to deal with excessive  
9 speculation. And the overall goal in the  
10 Commodity Exchange Act, as you talked about with  
11 regard to findings, is to prevent and deter fraud,  
12 abuse, and manipulation. So we have the ability  
13 to use the tools that we have now, using this  
14 position point proposal where we see a level which  
15 is the same level that would be in the proposal,  
16 and then -- and people could sort of get used to  
17 it -- maybe it's not going to be in the final  
18 proposal, maybe the number will change, but they  
19 could get used to this -- and that will add a  
20 heightened level of oversight. These people would  
21 be -- these traders that go over that level would  
22 be on our radar screen. We essentially flag them

1 and they'd be on, you know, sort of a watch list.  
2 I know that may be stronger than you all would  
3 like to say, but, in essence, Mr. Sherrod, is that  
4 correct?

5 MR. SHERROD: Well, I don't think I'd  
6 describe it as a watch list like a credit rating  
7 agency watch list.

8 COMMISSIONER CHILTON: Right.

9 MR. SHERROD: But it's something that we  
10 do.

11 COMMISSIONER CHILTON: Like TSA maybe.

12 MR. SHERROD: It's something that we do  
13 all the time. We watch the large traders and we  
14 shine a light on them and we let them know that  
15 we're here.

16 COMMISSIONER CHILTON: Okay. All right.  
17 Well, thank you very much and I'll stop. I do  
18 have other questions separately from this, but I

19 think that's helpful. I appreciate -- and I want  
20 to make sure, Mr. Chairman, I think you asked --  
21 and, again, I just want to make sure -- that  
22 monthly the staff will come to us as part of our



1 surveillance meeting and they will tell us about  
2 traders that go above this level. And if there is  
3 an action plan that we need to take or staff  
4 needed to take, you'll give us a recommendation on  
5 that. So this isn't just some little thing that  
6 you may or may not do if you get around to it.  
7 This is a proactive responsibility on your  
8 division, and I think that's what the chairman's  
9 (inaudible), to come to us and make sure we know  
10 what's happening. We're the people that have  
11 these things on our wall.

12 CHAIRMAN GENSLER: Could I, Commissioner  
13 Chilton?

14 COMMISSIONER CHILTON: Absolutely.

15 CHAIRMAN GENSLER: I have such respect  
16 for the staff. They have terrific -- and I don't  
17 know whether it's because they like me, they're  
18 afraid, or whatever, but they're always delivering  
19 when I ask them to do something. I mean, they're  
20 just -- I think mostly they're just pros.

21 COMMISSIONER CHILTON: Well, I was --

22 CHAIRMAN GENSLER: And so they're just

1       terrific. So, I mean --

2                       COMMISSIONER CHILTON: You know,  
3       Commissioner O'Malia, Mr. Chairman, said something  
4       that I take as a real honor a couple weeks ago.  
5       For better or worse, he said he was inspired by  
6       something I'd done. And I'm inspired, and he's  
7       not going to like this at all, I'm inspired by  
8       Ananda Radhakrishnan who said, you know,  
9       essentially, you know, he's a firm police officer,  
10      a detective, and better to have it down clearly  
11      what we're going to do. He'd rather have the  
12      rules. Remember Reagan? Trust but verify, so.

13                      CHAIRMAN GENSLER: No, I understand.  
14      But this is a terrific group of individuals. And  
15      what I think we have is we have a 30+ year history  
16      of having surveillance meetings on Fridays, all in  
17      the Federal Register. And what I've asked staff  
18      to do is to make sure that we stay apprised of  
19      these parties that might be over. I say "might be  
20      over" 10 and 2-1/2 because we haven't set  
21      numerical limits yet, so it's just formula, and,  
22      of course, to make any recommendations they would

1 make to us. And I think, as you were saying, that  
2 then we'd take up whatever -- if Mr. Sherrod in  
3 his normal surveillance matter or Mr. Shilts and  
4 his Division of Market Oversight matter has a  
5 recommendation we would take it up at that point  
6 in time. I mean -- but I don't --

7 COMMISSIONER CHILTON: But, Mr.  
8 Chairman, every month they're going to come to us  
9 and they're going to -- as part of a surveillance  
10 and say we want to report on this position point  
11 or whatever they want to call it. And they can  
12 say it's very short, there aren't any. But every

13 month they're going to come to us --

14 CHAIRMAN GENSLER: I think that's what I  
15 asked them to do 45 minutes ago. Rick, is that  
16 right?

17 MR. SHILTS: Yes. Again, that's my  
18 understanding.

19 CHAIRMAN GENSLER: I haven't -- you  
20 haven't let me down yet on anything, so.

21 COMMISSIONER CHILTON: Okay, good. I'm  
22 done for now. Now.

1                   CHAIRMAN GENSLER: Thank you.

2           Commissioner O'Malia?

3                   COMMISSIONER O'MALIA: Thank you. In  
4           the discussion of the special call that  
5           Commissioner Chilton's talking about do we get the  
6           same level of detail on the look-through to the  
7           dealer to understand whose position it actually  
8           is? Do we get the same level of fidelity as we  
9           get in the -- that's in the proposed rule through  
10          a special call?

11                   MR. SHERROD: I'm not sure I'm  
12          following, so.

13                   COMMISSIONER O'MALIA: To understand  
14          exactly who it is that we're tagging for these  
15          positions that Commissioner Chilton had discussed,  
16          are we -- when we do a special call or we go for  
17          the largest traders, assuming, you know, they're  
18          dealers, do we actually look through to find out  
19          who they're trading on behalf of similar to what  
20          we've provided for in the rule?

21                   MR. SHERROD: So under the -- I guess  
22          the quick answer would be we can do that. The

1 current Regulation 18.05 requires the reportable  
2 traders to keep books and records about their cash  
3 positions, about their OTC derivative positions.  
4 And in our special call on index investment data  
5 that Rick mentioned a little while ago, we asked a  
6 certain number of swap dealers to give us their --  
7 the identities of their large counterparties. So  
8 we can look through to the other side of the book.

9 The difficulty we have right now is  
10 those counterparties may not be reportable traders  
11 in futures and we would not have reach to them if  
12 they're not currently a reportable trader in  
13 futures. So they have a swap position opposite  
14 the swap dealer, the swap dealer's reportable, but  
15 we can't get to the person that's only in swaps  
16 through the current 18.05.

17 COMMISSIONER O'MALIA: That seems  
18 somewhat problematic.

19 CHAIRMAN GENSLER: Any other questions?  
20 I'm going to take a short 10-minute recess. I  
21 think I get to do that.

22 COMMISSIONER DUNN: Mr. Chairman?

1                   CHAIRMAN GENSLER: With unanimous  
2 consent?

3                   COMMISSIONER DUNN: Mr. Chairman?

4                   CHAIRMAN GENSLER: Yes.

5                   COMMISSIONER DUNN: Mr. Chairman?

6                   CHAIRMAN GENSLER: Yes.

7                   COMMISSIONER DUNN: I do have to leave  
8 for another appointment. I'll remind you that you  
9 have my proxy. Please use it wisely.

10                   (Recess)

11                   CHAIRMAN GENSLER: I don't know where  
12 Commissioner Chilton is. I'm going to give a  
13 minute or two to Commissioner Chilton. Is he --

14                   Hey, John, do you know where  
15 Commissioner Chilton is? We're going to come out  
16 of recess, but I'm going to give a few minutes for  
17 Commissioner Chilton to come back in.

18                   So as we're waiting for Commissioner  
19 Chilton, I'm going to ask on the first of the  
20 three rules that we've considered already for  
21 unanimous consent that they be technical  
22 amendments -- the technical fixes be allowed,

1       they're not really amendments, to those first  
2       three as we've done in our other Commission  
3       meetings so that they can be sent along to the  
4       Federal Register.

5               Not hearing any objections to that,  
6       those will be done with dispatch.

7               We don't have Commissioner Chilton back  
8       and we may have lost Commissioner Dunn, I don't  
9       know. And there's a lot of holiday parties people  
10      want to get to and the press wants to file their  
11      stories.

12               (Recess)

13              CHAIRMAN GENSLER: Once again, I want to  
14      thank staff for all of their efforts. As the  
15      public is seeing real-time, we are a Commission of  
16      five independent-minded and independently  
17      confirmed commissioners. And just as we did last  
18      week, I hope I can use the time wisely, but I am  
19      respectful that Commissioner Chilton has raised  
20      some very -- matters important to him and I just  
21      wanted to make sure that we stay abreast during  
22      the pendency, during this number of months until

1 the rule can be implemented in the position limit  
2 regime.

3 That -- I think it might be best if I  
4 ask for a motion to adjourn the meeting, allow  
5 people to get some -- did I do that as a UC?  
6 Maybe it's a UC? Is that what I was supposed to  
7 do, unanimous consent? So I'm going to ask for  
8 that unanimous consent. But for my friends in the  
9 press, just as I did last week, I think that this  
10 one might just need a little bit more time to  
11 ripen.

12 COMMISSIONER CHILTON: Mr. Chairman,  
13 just a procedural question. Do we need to -- had  
14 we gotten to the motion stage or no?

15 CHAIRMAN GENSLER: There is a motion and  
16 a second on the floor, so this is the pending  
17 business in front of the Commission.

18 COMMISSIONER CHILTON: Okay. Okay,  
19 thank you.

20 CHAIRMAN GENSLER: And as I understand  
21 from Mr. Stawick, this is -- did I say that  
22 correctly?



1 MR. STAWICK: Yes.

2 CHAIRMAN GENSLER: So I'm asking  
3 unanimous consent that we adjourn the meeting and  
4 wish everybody a happy holiday, maybe both in the  
5 unanimous consent.

6 Not hearing any objection, this meeting  
7 is adjourned.

8 (Whereupon, at 1:40 p.m., the  
9 PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Christine Allen, 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.

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Notary Public, in and for the District of Columbia

My Commission Expires: January 14, 2013