

UNITED STATES OF AMERICA  
COMMODITY FUTURES TRADING COMMISSION

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

Washington, D.C.

Wednesday, December 1, 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:

9 PHYLLIS DIETZ  
10 Division of Clearing and Intermediary  
Oversight11 ANANDA RADHAKRISHNAN  
12 Division of Clearing and Intermediary  
Oversight13 JONATHAN LAVE  
14 Division of Clearing and Intermediary  
Oversight15 JAKE PREISEROWICZ  
16 Division of Clearing and Intermediary  
Oversight17 NANCY MARKOWITZ  
18 Division of Market Oversight19 NADIA ZAKIR  
20 Division of Market Oversight21 SARAH JOSEPHSON  
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1       PARTICIPANTS (CONT'D):

2                   MARK FAJFAR  
3                   Office of General Counsel

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5                   Office of General Counsel

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

(9:30 a.m.)

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3 CHAIRMAN GENSLER: This meeting will  
4 come to order. This is a Public Meeting of the  
5 Commodity Futures Trading Commission to consider  
6 issuance of the following proposed rules under the  
7 Dodd-Frank Act. We have two rules related to  
8 clearinghouses, one related to legal and  
9 compliance matters and a second related to  
10 recordkeeping and reporting. Thirdly, we have  
11 rules and guidance related to designated contract  
12 markets. Fourthly, recordkeeping and reporting  
13 relating to swap dealers. And fifthly, the much  
14 talked about and anticipated joint proposal with  
15 the Securities and Exchange Commission with regard  
16 to entity definitions.

17 Before we hear from staff, I'd once  
18 again like to thank Commissioner Mike Dunn,  
19 Commissioner Jill Sommers, Commissioner Bart  
20 Chilton and Commissioner Scott O'Malia for all  
21 their thoughtful work to implement the Dodd-Frank  
22 Act. I probably owe them a debt of gratitude but

1 a bit of an apology for even scheduling the  
2 meeting right after Thanksgiving break because  
3 everybody has thoughtfully done their best to look  
4 through these documents but doing it through the  
5 Thanksgiving holidays and into this week was quite  
6 -- I also wanted to wish both Commissioner O'Malia  
7 and John Riley, our Director of Legislative  
8 Affairs, a happy birthday. I don't know what it  
9 means that John Riley and Scott O'Malia have the  
10 same birthday, but it's probably something cosmic  
11 or otherwise, and I think we're going to have some  
12 cupcakes a little later too. I didn't bake them.  
13 You can thank me for that too.

14 I'd like to welcome members of the  
15 public, market participants, members of today's  
16 meeting as well as those listening on the phone  
17 and the webcast. This is our sixth meeting to  
18 consider Dodd-Frank rulemakings. Before we turn  
19 to the staff for their recommendations I'd like to  
20 chat a little bit about the agenda going forward.  
21 We have two more meetings scheduled for December.  
22 I think they've been already Federal Register

1 noticed for December 9 and December 16. In  
2 addition, we now anticipate that we'll have at  
3 least two meetings in January and we'll sort  
4 through those dates. I think your offices know  
5 what we're trying to get to on the dates. And  
6 we'll of course as we have been doing announce the  
7 topics of each of those meetings as we get I think  
8 7 days in advance of each meeting.

9 In addition to the public meetings,  
10 these four rulemaking meetings that I've just  
11 mentioned, two in December and two in January, we  
12 have two more staff roundtables. One is tomorrow  
13 on disruptive trading practices and the other  
14 roundtable on capital margin is being coordinated  
15 with the Federal Reserve, the Securities and  
16 Exchange Commission, other regulators, bank  
17 regulators, and that one is scheduled for December  
18 10. I think it's important that regulators hear  
19 from the public. Commissioner O'Malia had raised  
20 this and as we reached out to other regulators  
21 everybody signed on very quickly on the issues of  
22 capital margin and I thought I'd raise, and this

1 is from me and not from the Commissioners, some  
2 questions that I certainly think it would be  
3 helpful to hear.

4 Under the Act, the prudential regulators  
5 and the Federal Reserve will be responsible for  
6 capital margin for bank swap dealers so that's not  
7 our remit here at the CFTC, but we along with the  
8 SEC will be responsible for nonbank swap dealers.  
9 These may be companies that aren't even parts of  
10 financial institutions.

11 One question to us is on capital. How  
12 should requirements in the context of nonbanks,  
13 the things that we have to take a look at,  
14 particularly if they're not a financial  
15 institution? Capital requirements have  
16 traditionally been set for banks and other  
17 financial institutions, but as a result of  
18 Dodd-Frank there may be a number of nonbank  
19 entities offering swaps to the public that would  
20 be subject to regulation. I still think there  
21 will be more banks than nonbanks, but we'll have  
22 some of them. And I think that we'll need to hear

1 from the public on how to account for the  
2 differences between bank swap dealers and nonbank  
3 swap dealers. For example, nonbanks generally  
4 have different assets than traditional financial  
5 institutions. Furthermore, the current regulatory  
6 capital standards for banks and other financial  
7 institutions are most likely not to directly to be  
8 applicable to nonbanks so that that's a pretty  
9 important topic and hopefully this roundtable will  
10 give us some help on that.

11 As it relates to margin, the Dodd-Frank  
12 Act says, and I'm going to quote, that margins  
13 should be set to "offset the greater risk to the  
14 swap dealer and the financial system from the use  
15 of swaps that are not cleared and that regulators  
16 should help ensure the safety and soundness of the  
17 swap dealer and set margin requirements that are  
18 appropriate for the risk associated with the  
19 noncleared swaps." They certainly are speaking  
20 about noncleared swaps, the bilateral swaps and  
21 about risk not only to the swap dealer but to the  
22 financial system.

1           There are two areas of questions that  
2       come to mind for me. First, what are the views of  
3       the public about appropriate margin requirements  
4       that might relate to both initial margin and  
5       variation margin, and I'm highlighting initial and  
6       variation, between financial entities, financial  
7       entities like swap dealers, major swap  
8       participants and other financial entity  
9       counterparties? Second, though I certainly can't  
10      speak for the Federal Reserve and I'm not speaking  
11      for the SEC or even my fellow Commissioners, my  
12      view is that uncleared swaps entered into between  
13      financial entities pose more risk to the financial  
14      system than those where one of the parties is a  
15      nonfinancial entity. As you know, this got quite  
16      a bit of debate doing the congressional process on  
17      Dodd-Frank. But interconnectedness between and  
18      among financial entities allows one entity's  
19      failure to cause uncertainty and possible runs on  
20      the funding of other financial entities, and  
21      that's because so many financial entities rely on  
22      short-term funding. It's just the very nature of

1 the financial system itself. So that risk, the  
2 interconnectedness, can spread and economic harm  
3 can go throughout the country. We know from the  
4 AIG debacle that interconnectedness of financial  
5 entities through their swap books raises the risk  
6 of bailouts. Transactions involving nonfinancial  
7 entities however do not present the same level of  
8 risk to the financial system and financial systems  
9 are the words Congress chose in the statute, that  
10 the nonfinancial entities' interconnectedness does  
11 not present the same risk to the financial system  
12 as those solely between financial entities. The  
13 risk of a crisis spreading throughout the  
14 financial system is greater than more  
15 interconnected financial companies are to each  
16 other. So I think that Congress also recognized  
17 the different levels of risk posed by transactions  
18 between financial entities and nonfinancial  
19 entities when they said in their clearing  
20 requirements that nonfinancial entity transactions  
21 are exempt from clearing if they choose to be  
22 exempt.

1                   Consistent with this I believe that  
2                   proposed rules on margin requirements should focus  
3                   only on transactions between financial entities  
4                   rather than those transactions involving  
5                   nonfinancials, but I'd be very interested from the  
6                   public on these views and their thoughts on these  
7                   topics of margin, so I took a little opportunity  
8                   here to talk about next week's roundtable. But  
9                   I'd like to thank staff for all of their work in  
10                  drafting what they're doing, their thoughtful  
11                  recommendations, and before we move forward I was  
12                  going to turn to fellow Commissioners.

13                  COMMISSIONER DUNN: Thank you, Mister  
14                  Chairman, and let me extend also to my colleague  
15                  Commissioner O'Malia a happy birthday and I'm  
16                  delighted that my term is up before my next  
17                  birthday because is this is the kind of presents  
18                  you're going to present, Mister Chairman, I don't  
19                  want to be here.

20                  CHAIRMAN GENSLER: But we want you to  
21                  stay, Mike.

22                  COMMISSIONER DUNN: I'd like to

1 associate myself with your remarks on the upcoming  
2 roundtable because I think the bottom line in what  
3 you're talking about here is the need for  
4 transparency in the financial service industry so  
5 that everyone understands where the risk is and  
6 how the interconnectivity sets them up to assume  
7 that risk. I applaud you on that and the upcoming  
8 meeting for the staff and the roundtables and  
9 getting them all together is great.

10 I want to thank everyone for joining us  
11 today on this important regulatory meeting  
12 regarding the implementation of the Dodd-Frank  
13 Act. Today we're going to talk about the core  
14 principles and other requirements for designated  
15 contract markets, general regulations for  
16 derivatives clearing organizations, information  
17 management requirements for derivatives clearing  
18 organizations, reporting, recordkeeping, daily  
19 trading records requirements for swap dealers and  
20 major swap participants and the definition of swap  
21 dealers, security based swap dealers, major swap  
22 participants and eligible contract participants.

1           I will support publishing these proposed  
2 rules in their current form, but I am concerned  
3 that the rules addressing DCM core principles as  
4 currently drafted may be too prescriptive. If  
5 this rule was before us today as the final rule, I  
6 would have reservations voting for its release  
7 based on my firm belief that the CFTC should  
8 remain a principle-based regulator and not a  
9 prescriptive regulator. However, after meeting  
10 with staff it is my understanding that many of the  
11 provisions in the proposed DCM core principles are  
12 actually already being followed by industry or  
13 have become best practices over time. In essence,  
14 my understanding is that this proposed rule simply  
15 codified what is already being done. It is my  
16 understanding that many in the industry desire the  
17 establishment of the safe harbor that will ensure  
18 that they are in fact meeting the intent of the  
19 core principles. However, I do not know this to  
20 be true and look to the public comments on this  
21 proposed rule to guide my decision- making process  
22 regarding the final rule.

1           Comments indicating that we are indeed  
2 merely codifying best practices already in use and  
3 that a safe harbor is needed for legal certainty  
4 will influence my vote on a final rule. The  
5 proposed rules also provide an extension of time  
6 for CFTC staff to review applications. Given the  
7 present staffing level, this may be warranted.  
8 However, it does not allow the agency to be  
9 responsive to industry developments as would be  
10 desirable to an efficient and effective regulator.  
11 I will be guided by the funding levels of the  
12 agency when making final decisions on these  
13 proposals.

14           I'm also very interested in reviewing  
15 the public's comments on our entities definitions.  
16 These definitions along with product definitions  
17 that will be discussed in a couple of weeks will  
18 finally let everyone know where they stand  
19 vis-à-vis the Dodd-Frank Act. Based on the  
20 interest on these definitions I have to date, I  
21 expect the proposed rules to receive a significant  
22 level of comment. I would like to remind everyone

1       that these are proposed definitions that with your  
2       help we can write final definitions that work for  
3       everyone. I would like to note, Mister Chairman,  
4       the difficulty in arriving at mutually acceptable  
5       definitions with other regulators and I would  
6       commend you for your personal involvement in  
7       moving this process forward.

8                 Mister Chairman, I put a great deal of  
9       faith in the process we follow under the  
10      Administrative Procedure Act. Recent reports that  
11      the agency is receiving forged comment letters are  
12      a cause for alarm. I have today asked the  
13      Inspector General to investigate these charges and  
14      have further asked the Office of the Secretariat  
15      to develop a procedure for verification of comment  
16      letters sent to this agency. Again, I would like  
17      to thank staff for all the hard work in getting us  
18      here today.

19                CHAIRMAN GENSLER: Let me thank  
20      Commissioner Dunn, and if I might say that we do  
21      look forward to receiving all comments from the  
22      public. Those are comments that are sent in and

1 are truly from the public. I will note as  
2 Commissioner Dunn said that the Commission  
3 recently became aware of some comment letters that  
4 were fraudulently submitted in response to a  
5 proposed rulemaking. We have removed the  
6 identified letters from the comment files and  
7 we've also referred the matter to the Department  
8 of Justice. We're working to ensure the integrity  
9 of the comment process which is so critical to  
10 moving forward and for the public's confidence in  
11 these matters. Commissioner Sommers?

12 COMMISSIONER SOMMERS: Thank you, Mister  
13 Chairman. I want to echo the Chairman and  
14 Commissioner Dunn's thanks to the staffs of all  
15 the teams. I know the hard work that you've put  
16 in on these proposed regulations, the long hours  
17 taking place at night and on weekends and over  
18 your Thanksgiving holiday, so that I want to let  
19 you know how much I appreciate your time and the  
20 efforts of all the teams that are presenting  
21 today.

22 In the end, I am not supporting all of

1 the proposed regulations we are regulations we are  
2 considering today. My vote against any of the  
3 proposals has everything to do with basic policy  
4 differences among the five Commissioners and  
5 nothing to do with the quality of work product  
6 before us. Each team has done an exemplary work  
7 and the quality of these documents is nothing  
8 short of excellent.

9 Today is the sixth Commission meeting to  
10 consider proposed regulations that the Commission  
11 has linked to Dodd-Frank. In each of our meetings  
12 we have all expressed great concern about  
13 Commission resources needed to perform our current  
14 responsibilities while keeping pace proposing  
15 these regulations and the pace that will be  
16 required next spring, summer and fall to attempt  
17 to finalize these regulations. Our concerns about  
18 those resources remain.

19 I would be remiss if I did not point out  
20 that a number of the regulations that we have  
21 already considered and a number of the regulations  
22 that we are considering today are not required by

1 Dodd-Frank. Commission staff has spent months and  
2 months drafting proposed regulations that are  
3 purely voluntary and all the while the Commission  
4 is expressing grave concerns about our level of  
5 resources. I suspect we will continue to spend  
6 months and months of our limited staff time  
7 proposing and attempting to finalize regulations  
8 that are not required by Dodd-Frank. This has  
9 been a mistake in my view and an unwise use of our  
10 limited resources.

11 Over the past few months I've been  
12 speaking publicly about a little-discussed  
13 provision of Dodd-Frank which gives the Commission  
14 the authority to abandon its successful  
15 principles-based regulatory approach in favor of a  
16 prescriptive rules-based approach. I have said  
17 that I think such a move would be a mistake.  
18 Today with these proposals before us, the  
19 Commission is in large part abandoning  
20 principles-based regulation. There does not  
21 appear to be a reason other than we can.  
22 Principles-based regulation has worked very well

1       in our industry and our industry has flourished  
2       because of it. Principles-based regulation did  
3       not cause or contribute to the financial crisis.  
4       Nonetheless, the Commission will be piling on  
5       regulations and restrictions in the wake of the  
6       crisis. This too in my opinion is a mistake.

7                Even though we may only be codifying  
8       today's best practices, markets evolve and  
9       innovate and when our markets and market  
10       structures transform because of the requirements  
11       of Dodd-Frank, I think codifying today's best  
12       practices seems a bit premature. I have voted  
13       against proposed regulations at prior meetings  
14       when I thought among other things that the  
15       proposed regulations were too broad or where I  
16       believe they amounted to the Commission  
17       overreaching. Some of my votes today will be for  
18       those same reasons.

19               I have concerns about a number of the  
20       proposals, but I want to talk a little bit about  
21       the definitions proposal. In addition to my  
22       overall concern that the definition of swap dealer

1 is too broad and will likely capture entities that  
2 do not functionally operate as dealers, I am  
3 struck by another provision of this proposed  
4 regulation that I think is bad policy and I would  
5 like to publicly address. The preamble to this  
6 regulation states that in connection with the  
7 registration requirement, market participants are  
8 in a position to assess their activities to  
9 determine whether they function in the manner  
10 described in the definitions. That seems  
11 reasonable. Dodd-Frank allows a person to be  
12 registered as a swap dealer or major swap  
13 participant for a single type or a single class or  
14 category of swap or activities and not be  
15 considered a swap dealer or major swap participant  
16 for all classes or categories of swaps or  
17 activities. That seems reasonable as well.

18           These proposed regulations however state  
19 that a person who is a swap dealer or major swap  
20 participant for any swap or activity shall be  
21 deemed a swap dealer or major swap participant for  
22 all swaps it enters into. This does not seem

1 reasonable particularly in light of the statement  
2 from the preamble and the provision in Dodd-Frank.  
3 The regulations do allow a swap dealer or major  
4 swap participant to apply for a limited  
5 designation as a swap dealer. However, while the  
6 Commission is considering the application to limit  
7 the designation of the swap dealer or major swap  
8 participant however long that might take, the swap  
9 dealer or MSP will essentially be held hostage and  
10 must comply with all of the regulatory  
11 requirements for all of the swaps including the  
12 capital and margin. I believe this approach is  
13 wrong. If we believe that market participants can  
14 assess their own activity to determine whether  
15 they are a swap dealer or an MSP, surely they can  
16 assess whether or not they are entitled to limited  
17 designation. Our regulations should allow swap  
18 dealers and major swap participants to initially  
19 register in a limited capacity and not require  
20 them to full register and then hope that the  
21 Commission allows them to escape the full  
22 designation. I fear the construct in the proposed

1 regulation will needlessly impose onerous  
2 requirements on market participants and I cannot  
3 support it. Again I want to say thank you to the  
4 teams today and I look forward to your  
5 presentations.

6 CHAIRMAN GENSLER: Thank you,  
7 Commissioner Sommers. Commissioner Chilton I  
8 think is with us by phone.

9 COMMISSIONER CHILTON: Yes, I'm here,  
10 Mister Chairman. Thank you. I'll try to be  
11 brief.

12 CHAIRMAN GENSLER: Commissioner Chilton,  
13 I don't know if you want to be closer to the  
14 phone. We're not hearing you well.

15 COMMISSIONER CHILTON: I started to say  
16 I was thinking last night as I was finishing the  
17 Thanksgiving soup and my mother used to make that  
18 and the meat would all fall off the bones and you  
19 had this great aroma and great taste and I thought  
20 we are doing exactly the opposite. We're putting  
21 meat on the bones of this new law and as everybody  
22 has said and continues to put in all these caveats

1 about what we do, we certainly don't want to end  
2 up with a turkey. I don't think we will because  
3 of the good work of the staff and because of the  
4 public input that we're getting.

5 I did want to make a comment briefly  
6 about two things, one that's not on the agenda  
7 today, and that's position limits. We were  
8 originally internally talking about doing this at  
9 this meeting and I've yet to see a proposal. I  
10 know staff is working very hard, but yet I still  
11 don't have any papers. This thing didn't fall out  
12 of the sky. We've had it for 4 months and we're  
13 supposed to be implementing it in mid-January so  
14 that I think it's time for us to do something.

15 Even at our December 9 meeting I think we should  
16 try to get it done. We should certainly hold the  
17 option when we publish in the Federal Register the  
18 issues that may come up, position limits, in case  
19 we have the opportunity to move forward on it. I  
20 know everybody is working hard, but this is one  
21 that Congress clearly wanted done earlier than  
22 other things. I know there are issues that my

1 colleagues have raised about how we do it, but  
2 there's a way to get it done.

3 The last little point was I was really  
4 heartened with all the work that people were doing  
5 over the weekend. I had questions including one  
6 on position limits that were answered on Saturday  
7 so that staff was working over the holiday weekend  
8 and this talk that we've seen in the media about a  
9 spending freeze, et cetera, I think for us that  
10 doesn't make any sense. The people who work at  
11 CFTC aren't in it for the money. They could be  
12 making more money some place else. They're in it  
13 to be public servants and the good work they've  
14 done even on a holiday weekend warms my heart more  
15 than any soup could ever. Thank you, Mister  
16 Chairman.

17 CHAIRMAN GENSLER: Thank you,  
18 Commissioner Chilton. Commissioner O'Malia?  
19 You're going to make a mention about soup and  
20 turkey too?

21 COMMISSIONER O'MALIA: Why do I have to  
22 follow him? I should on my birthday at least be

1 able to go first maybe. That would have been  
2 fair. I just can't compete with this. I'll just  
3 read the thing. Thank you for the kind wishes.  
4 Happy birthday to John as well.

5 Mister Chairman, I'd like to thank the  
6 teams who have worked so hard on the rules we will  
7 consider here today. Staff continues to seek  
8 input from the Commissioners and I appreciate that  
9 and they've worked diligently over the  
10 Thanksgiving holiday to improve these rulemakings.  
11 I should have thought of sending them soup but I  
12 didn't. I would like to commend the various teams  
13 that will be presenting here today, teams headed  
14 by Phyllis Dietz, Nancy Markowitz, Sarah Josephson  
15 and Mark Fajfar. I appreciate your unwavering  
16 commitment to respond to staff's comments,  
17 concerns and criticisms with thoughtful and  
18 professionalism.

19 This is our sixth in a series of  
20 proposed rulemakings under the Dodd-Frank Act and  
21 while the format has become routine, the content  
22 is anything but. I am concerned that these rules

1 will present a deluge of potential outcomes that  
2 we have not fully explored and that may have  
3 negative impacts on the markets we regulate. With  
4 regard to the swap dealer definition, while  
5 reasonable people will continue to debate who  
6 should ultimately fall under the regulatory  
7 category of swap dealer, for years after the final  
8 rules are promulgated, one thing we should all be  
9 able to agree on here today is that the rule  
10 should be clear as to who falls into the category  
11 and who does not. Unfortunately, the 145-page  
12 proposal does not provide the regulatory certainty  
13 that I believe many market participants are  
14 seeking, particularly commercial end users. In  
15 fact, I have concerns that many end users will be  
16 unintentionally swept into the dealer definition  
17 and will be subject to significantly higher costs  
18 to hedge their commercial risk. I commend staff  
19 for their attempts to characterize the activities  
20 of a dealer based on limited statutory direction.  
21 I would have preferred to see a more thorough  
22 discussion of a range of safe-harbor activities

1 that end users will clearly understand. They need  
2 to know whether or not their bilateral swap  
3 activities will cross the line and earn them the  
4 dreaded Scarlet Letter SD for swap dealer.

5 I strongly encourage the market to  
6 comment on this proposal establishing what I  
7 perceive to be a very limited de minimis standard  
8 for swap dealing conduct that will result in few  
9 exceptions. I hope that the public comments will  
10 focus on this proposal and will provide guidance  
11 as to the appropriate size of a de minimis  
12 exclusion and whether it should be adjusted by  
13 asset class. It is my hope that after reviewing  
14 the public comments that the final swap dealer  
15 rule can be significantly improved by providing  
16 greater specificity to the dealer definition and  
17 considerably narrowing the definition to focus  
18 only on those entities that perform a traditional  
19 swap dealer role. I know that the end users are  
20 anxiously awaiting the publication of this  
21 rulemaking. And Mister Chairman with regard to  
22 the capital and margin rulemaking, I'd like to

1       thank you for your willingness to delay this  
2       rulemaking which I recognize takes the Commission  
3       off its schedule in order to conduct an important  
4       hearing on this complex matter. I greatly  
5       appreciate that and your willingness to  
6       accommodate us.

7                   I believe at the end of the day the  
8       proposal will be better informed after receiving  
9       public input prior to publication. I was  
10      particularly pleased with the careful  
11      consideration that Sarah Josephson and her team  
12      gave to the technological advancements in recent  
13      years that have lowered the cost and increased the  
14      feasibility of capturing and retaining  
15      communications regardless of their original format  
16      in her rulemaking. Given that we have yet to  
17      define the facilities upon which many of the  
18      affected transactions will take place, it makes it  
19      especially difficult to define the records and  
20      associated costs of recordkeeping necessary to  
21      conduct comprehensive and accurate trade  
22      reconstructions as required by the Act. I do look

1 forward to receiving comments on this particular  
2 rulemaking.

3 With regard to the designated contract  
4 markets, the notice of proposed rulemaking  
5 codifies and interprets the core principles that  
6 applicant contract markets must comply with to  
7 become designated and they must continue to comply  
8 with on an ongoing basis was obviously quite an  
9 undertaking. I appreciate the team's hard work.  
10 I would like to thank the team for considering  
11 under Core Principle 4 different risk controls  
12 that DCM should employ to effectively manage  
13 market disruption. On November 19 after  
14 considerable discussion with Commissioner Chilton  
15 -- I know was supportive -- Commissioner Dunn and  
16 Sommers and the Chairman as well, I established a  
17 subcommittee of the Technology Advisory Committee  
18 chaired by Michael Gorham, the former Director of  
19 CFTC's Division of Market Oversight. I've asked  
20 Dr. Gorham and other subcommittee members to  
21 conduct a review and provide recommendations of  
22 applying pretrade functionality at the direct

1 access participant trading firms, clearinghouse  
2 and exchange levels. As a baseline, the  
3 subcommittee was advised to consider the FIA's  
4 work with regard to market access risk-management  
5 recommendations and risk control for trading  
6 firms. It is my expectation that the  
7 recommendations or regulatory guidance as the case  
8 may be will provide a roadmap for an application  
9 and implementation of best practices with regard  
10 to direct market access and pretrade functionality  
11 while appropriately steering the Commission in the  
12 right direction regarding identifying and  
13 mitigating disruptive trade practices.

14 I have serious concerns however with  
15 many of the other provisions in this proposal.  
16 The Commission's core principle regime has worked  
17 well, providing flexibility to adapt to  
18 innovations in our markets as both Commission  
19 Sommers and Dunn have referenced. This notice  
20 moves significantly away from our principles-based  
21 regime by adopting several regulatory requirements  
22 and interpreting core principles in highly

1 prescriptive ways instead of maintaining guidance  
2 as safe harbors in applicable practices. For  
3 example, the Dodd-Frank bill amended Core  
4 Principle 9 to include language that boards of  
5 trade must provide a mechanism for executing  
6 transactions in a way that protects the price  
7 discovery process of trading in centralized  
8 markets. At the same time, the core principle  
9 explicitly states that the boards of trade may  
10 authorize exchanges -- futures for swap trades.  
11 The statutory language of Dodd-Frank specifically  
12 permits the trading of swaps on DCMs as well as  
13 SEFs. Staff interpretation of Core Principle 9's  
14 language that the price discovery process must be  
15 protected, however, requires that 85 percent of  
16 the trading in a contract must be through a  
17 centralized market for the contract to continue to  
  
18 be listed on the DCM. The practical effect of  
19 that interpretation may very well be that few if  
20 any swaps will be executed on a DCM and the  
21 contracts known as EFSes will no longer be able to  
22 operate as futures and will be forced to trade

1 solely on SEFs. There are likely to be negative  
2 implications of this interpretation and because it  
3 is on its face contrary to the statutory language  
4 in the Dodd- Frank Act, I have great concerns  
5 about this proposal. Further, this proposal would  
6 likely create uncertainty for traders regarding  
7 the protections of the segregated funds with --  
8 will receive if they are required to execute  
9 contracts solely on SEFs instead of DCMs and  
10 whether or not they will be able to continue to  
11 avail themselves of certain Commission-approved  
12 market efficiencies like portfolio margining  
13 pursuant to a 4(d) order and they 're able to use  
14 when they're trading on swaps and futures on a  
15 DCM. There are other examples where this proposal  
16 creates regulatory requirements that exceed the  
17 articulated core principles in Dodd-Frank. More  
18 specifically, Core Principle 9 has also been  
19 interpreted by staff to support a regulatory  
20 requirement regarding block trades. I hope the  
21 public will not overlook this proposal and will  
22 provide comment on it.

1                   In closing let me thank my staff and the  
2 rulemaking teams for their hard work over the  
3 Thanksgiving holiday. I know everyone has made  
4 sacrifices by putting rulemakings ahead of their  
5 families on this holiday and I want everyone to  
6 know how important I think their work is and I  
7 appreciate their hard work on these rulemakings.  
8 Thank you.

9                   CHAIRMAN GENSLER: Thank you,  
10 Commissioner O'Malia, and I think all the  
11 Commissioners because we might have some  
12 differences but I think we're working  
13 extraordinarily well together. I think all the  
14 comments and the edits in these proposals are just  
15 proposals, but they're better for all of the  
16 comments from Commissioners' offices and their  
17 legal assistants. With that I was going to turn  
18 to Ananda Radhakrishnan, Jonathan Lave and Phyllis  
19 Dietz who are going to present both of the  
20 clearing rules. I can't recall if you're doing  
21 legal and compliance first. Phyllis Dietz is the  
22 team lead. Thank you, Phyllis.

1                   MS. DIETZ: Thank you, and good morning,  
2                   Mister Chairman and Commissioners. I am pleased  
3                   to recommend that the Commission approve for  
4                   publication in the Federal Register proposed  
5                   regulations that would implement certain core  
6                   principles for derivatives clearing organizations.  
7                   These regulations would establish standards for  
8                   compliance with DCO core principles relating to  
9                   overall compliance, rule enforcement, antitrust  
10                  considerations and legal risk.

11                  The proposed rules would also implement  
12                  the DCO chief compliance officer requirements  
13                  under the Dodd-Frank Act, revise procedures for  
14                  DCO applications, clarify procedures for the  
15                  transfer of a DCO registration and add  
16                  requirements for approval of DCO rules  
17                  establishing a portfolio margining program for  
18                  customer accounts carried by an FCM that is also a  
19                  securities broker dealer. Additionally, the  
20                  notice proposes amendments to the Commission's  
21                  regulations to update certain definitions and to  
22                  add other definitions for terms relating to DCOs

1 and clearing activities.

2 I'd like to take a moment to thank the  
3 DCO core principles rulemaking team for their many  
4 valuable contributions, and I would like to add a  
5 special thank you to members of other teams who  
6 worked closely with us in developing and  
7 harmonizing the proposed requirements for chief  
8 compliance officers. Jonathan Lave has been the  
9 lead attorney on this rulemaking and he will  
10 present an overview of the proposed rules. Thank  
11 you.

12 MR. LAVE: Thank you and good morning.  
13 I will begin by discussing the proposed  
14 definitions.

15 The proposed rules would amend the  
16 definitions of clearing member and clearing  
17 organization in Section 1.3 to make the  
18 definitions consistent with terminology currently  
19 used in the Commodity Exchange Act as amended by  
20 the Dodd- Frank Act. The proposed rules are also  
21 proposing to add to Section 1.3 definitions for  
22 the terms customer initial margin, initial margin,

1 spread margin, variation margin and margin call.  
2 In addition, the proposed rules would amend  
3 Section 39.1 to add definitions of back test,  
4 compliance policies and procedures, key personnel,  
5 stress test and systematically important  
6 derivative clearing organization. These changes  
7 would provide clarity and legal certainty.

8           The proposed rules would also set forth  
9 three procedural changes. First, the proposed  
10 rules would amend Section 39.3 to streamline the  
11 DCO application process by eliminating the 90-day  
12 expedited application review period. The  
13 Commodity Exchange Act does not set forth a time  
14 period for the Commission to review the DCO  
15 application. Currently the Commission allows for  
16 two tracks, a 180-day review period or a 90-day  
17 expedited review period. Over the past nearly 10  
18 years however the Commission has determined that a  
19 90-day period is not practicable. Accordingly,  
20 the proposed rules would eliminate the 90-day  
21 period and all applications would be reviewed on a  
22 180-day schedule. Of course the Commission could

1 render a decision in less than 180 days.

2           Second, the proposed rules would clarify  
3 the procedures to be followed by a DCO when  
4 requesting a transfer of its DCO registration due  
5 to a corporate change. The proposed rules set  
6 forth the information that must be included in  
7 such a request and require representation by the  
8 DCO that the DCO is in compliance with the  
9 Commodity Exchange Act and Commission regulations  
10 and a representation by the transferee that it  
11 will remain in compliance after the transfer.  
12 Currently there are no rules on this topic and the  
13 proposed rule would provide legal certainty.

14           Finally, Section 713 of the Dodd-Frank  
15 Act allows for portfolio margining of futures and  
16 securities. The Act imposes no deadline on this  
17 rulemaking. Under proposed Section 39.4, a DCO  
18 seeking approval to provide clearing and  
19 settlement services for portfolio margining in a  
20 futures account would have to submit its proposed  
21 portfolio margining rules for Commission approval  
22 under Section 40.5. This is a first step and the

1 Commission is actively consulting with the  
2 Securities and Exchange Commission regarding the  
3 additional rulemaking.

4 Turning to proposed regulations  
5 implementing statutory requirements for chief  
6 compliance officers, Section 725(b) of the  
7 Dodd-Frank Act requires each DCO to designate a  
8 chief compliance officer and further specifies the  
9 duties of the chief compliance officer. Among the  
10 chief compliance officer's duties are the  
11 preparation and submission of an annual compliance  
12 report to the Commission. Proposed Section 30.10  
13 codifies the statutory requirements for the chief  
14 compliance officers and adds additional  
15 requirements such as an annual meeting with the  
16 board of directors or the senior officer. The  
17 proposed rules also would require the person  
18 designated as chief compliance officer to meet  
19 minimum ethical requirements and would establish  
20 the procedure for filing the annual report.

21 Finally, the proposed regulations would  
22 implement certain DCO core principles. Section

1 25(c) of the Dodd- Frank Act amends Core Principle  
2 A, compliance, to require a DCO to comply with  
3 each core principle set forth in Section  
4 5(b)(C)(2) of the Commodity Exchange Act and any  
5 requirement that the Commission may impose by rule  
6 or regulation pursuant to Section 8(a)(5) of the  
7 Commodity Exchange Act. Proposed Section 39.10  
8 would implement Core Principle A.

9 Second, Section 725(c) of the Dodd-Frank  
10 Act also amends Core Principle H, rule  
11 enforcement, to require a derivatives-clearing  
12 organization to maintain adequate arrangements and  
13 resources for the effective monitoring and  
14 enforcement of compliance with its rules and for  
15 resolution of disputes. The Dodd-Frank Act also  
16 requires a DCO to have the authority and ability  
17 to discipline, limit, suspend or terminate the  
18 activities of a clearing member due to a violation  
19 of any DCO rule. Proposed Section 39.17 would  
20 codify these requirements.

21 Third, Section 725(c) of the Dodd-Frank  
22 Act amends Core Principle N, antitrust

1 considerations, and conforms the standard for DCOs  
2 to the standard applied to designated contract  
3 markets under Core Principle 19. Proposed Section  
4 39.23 would codify Core Principle N.

5 Finally, Section 25(c) establishes new  
6 Core Principle R, legal risk. This core principle  
7 is consistent with the legal risk standard  
8 recommended by the Committee on Payment and  
9 Settlement Systems of the Central Banks of the  
10 Group of 10 Countries and the Technical Committee  
11 of the International Organization of Securities  
12 Commissions. They concluded that if the legal  
13 framework of a clearing organization is  
14 underdeveloped, opaque or inconsistent, the  
15 resulting legal risk could undermine the clearing  
16 organization's ability to operate effectively and  
17 increase the likelihood that market participants  
18 may suffer a loss because the clearing  
19 organization's rules, procedures and contracts  
20 that support its activities, property rights and  
21 other interests are not supported by relevant laws  
22 and regulations. Proposed Section 39.27 would

1       implement Core Principle R and require a DCO to  
2       address certain identified legal risks. Thank you  
3       for the opportunity to describe this release.

4               CHAIRMAN GENSLER: Thank you for the  
5       staff presentation. Do I hear a motion on the  
6       staff recommendation on this rule?

7               COMMISSIONER DUNN: So moved.

8               COMMISSIONER SOMMERS: Second.

9               CHAIRMAN GENSLER: The motion being  
10       moved and seconded, now we'll go to questions. I  
11       want to say I support the proposed rule on legal  
12       and compliance and I'll put a little statement in  
13       the record for that, but I think that it is  
14       consistent with the requirements of Dodd-Frank but  
15       also importantly consistent with international  
16       standards. I do have a question on that I want to  
17       ask Jonathan, Phyllis and Ananda as to whether  
18       you've consulted with the folks in Europe and so  
19       forth with regard to this particular clearinghouse  
20       rule and how it lines up against what's called the  
21       CPSS-IOSCO standards. These are these  
22       international standards for clearinghouses.

1                   MR. RADHAKRISHNAN: The legislation of  
2 the Dodd- Frank Act is a mirror image of what's  
3 called the Recommendations for Central  
4 Counterparties issued in 2004. When staff  
5 provided technical advice to the committees in  
6 Congress, that's what we did. We took a look at  
7 the RCCPs and made sure that the language of the  
8 legislation was if not the same, very, very close.  
9 There is now an effort to modify it but the  
10 problem with that is all we have is drafts, number  
11 one. Number two, nobody has seen a proposal  
12 because there is no proposal yet so we're working  
13 with a moving target. What we have done is every  
14 time we come before the Commission we take a look  
15 at the latest draft and we make sure that what we  
16 are proposing conforms with the latest draft so  
17 that we are actively consulting with our  
18 colleagues both domestically and overseas.

19                   MR. LAVE: I would add that the legal  
20 risks that are identified in the proposed rules  
21 are the legal risks identified by CPSS-IOSCO.

22                   CHAIRMAN GENSLER: That's really my

1 question. So these are consistent with what the  
2 international standards are as we know them today?

3 MR. RADHAKRISHNAN: Yes, as we know them  
4 to be. Right. So that if you ask me what are the  
5 international standards, the international  
6 standards in existence today are the 2004  
7 recommendations.

8 CHAIRMAN GENSLER: Right, but Jonathan  
9 also said these are consistent with what we know  
10 of the draft proposal.

11 MR. RADHAKRISHNAN: The draft to be,  
12 yes.

13 CHAIRMAN GENSLER: That even if it's  
14 moving it's consistent?

15 MR. RADHAKRISHNAN: We've made every  
16 effort to make sure that every proposal that the  
17 division makes is consistent with the latest  
18 iteration or latest version of a draft.

19 CHAIRMAN GENSLER: My other question is  
20 the chief compliance officer provisions that you  
21 have here, as I understand it Dodd-Frank had  
22 mandated chief compliance officers for

1 clearinghouses, for swap dealers and I gather also  
2 maybe for swap execution facilities.

3 MR. RADHAKRISHNAN: For SEFs, yes.

4 CHAIRMAN GENSLER: So this is compliance  
5 with that?

6 MR. RADHAKRISHNAN: Yes.

7 CHAIRMAN GENSLER: Thank you.

8 Commissioner Dunn?

9 COMMISSIONER DUNN: Thank you, Mister  
10 Chairman. To follow-up on your first question  
11 because they do say on page 8 of my draft, I'm not  
12 sure which one they're working on in there, that  
13 Section 25(c) of Dodd-Frank establishes new Core  
14 Principle R, legal risk, which is consistent with  
15 the legal-risk standards recommended by the  
16 Committee on Payments and Settlements Systems,  
17 CPSS, and the Technical Committee on International  
18 Organizations of Security Commissions, ISOSCO.  
19 What other international regulators have embraced  
20 these two concepts?

21 MR. RADHAKRISHNAN: What we have been  
22 told is that all of the participants in the 2004

1 committee, the people who have participated in  
2 those committees, have embraced the 2004  
3 standards. The issue is some regulators don't  
4 have statutes. For example, the Federal Reserve  
5 doesn't have a statute that codifies this so that  
6 what they have done is they've issued a policy  
7 statement under which the Federal Reserve Board  
8 said they will comply with these standards, but  
9 there are other nations that have told us that  
10 they either have it in statute or this is what  
11 they do by regulation or by policy.

12 COMMISSIONER DUNN: Jonathan, you stated  
13 and it's also in the preamble that based on the  
14 experience in reviewing DCO applications over the  
15 past nearly 10 years the Commission is proposing  
16 to amend 39.3 to streamline the DCO application  
17 process by eliminating the 90-day rule. You're  
18 going to leave in the 180-day rule but you're  
19 going to streamline by eliminating the 90-day  
20 rule. That doesn't sound consistent to me.

21 MR. RADHAKRISHNAN: I think,  
22 Commissioner Dunn, what we are proposing to do is

1 the 90-day rule really doesn't work because as you  
2 know the Commission has a policy of seeking public  
3 comment on DCO applications and the Commission  
4 usually grants a 30-day comment period. What  
5 we've found is despite their best efforts, the  
6 first cut is never enough and as Jonathan pointed  
7 out, this was if I may use the terminology, and  
8 forgive me for using it, shooting ourselves in the  
9 foot because there is no statutory requirement as  
10 to when we need to do this. I understand that we  
11 can't delay, we can't -- 4 years, but we thought  
12 that 90 days was in our experience really  
13 insufficient because what we've been doing in the  
14 90 days is telling people how to do their jobs  
15 which we try not to do, but we want to make sure  
16 that the applications are as sound as possible so  
17 that that's why we thought that giving ourselves  
18 180 days or giving the Commission 180 days is  
19 relevant.

20 Also we don't get funding. We've got  
21 three DCO applications right now. It used to be  
22 their day job and now it's going to be their night

1       job looking at DCO applications. So we can't do  
2       anything about the applications we have before us,  
3       but we really think that in order for the staff  
4       and the Commission to make sure that we do a  
5       thorough analysis of the application that 180 days  
6       is warranted. But as Jonathan pointed out, it  
7       doesn't mean that we will take 180 days. If staff  
8       finishes the analysis in a shorter period of time  
9       we will certainly forward our recommendation to  
10      the Commission for the Commission's consideration  
11      but we also don't want to jam the Commission.

12               MS. DIETZ: I would also like to address  
13      specifically your comment and I certainly  
14      understand about streamlining, how is that you  
15      streamline but you're taking more time? What we  
16      have found with the 90-day expedited process is  
17      because it isn't really enough time to evaluate  
18      some of these very complex and novel proposals  
19      that we get, there is an awful lot of back and  
20      forth between staff and applicant and in the past  
21      on a number of occasions we have ended up having  
22      to stay our review. We either bump it to 180 days

1 and even at that we may stay the review. So our  
2 view has been if we can just all start out  
3 understanding we've got 180 days, here are the  
4 items we need to have to evaluate, here are the  
5 standards that we're going to be looking for, we  
6 can have a streamlined procedure, we don't feel  
7 tied to rushing around in 90 days and we're not  
8 saddled with the likelihood of the change in  
9 scheduling the stay. This gives us what we hope  
10 would be ample time and we can always make a  
11 recommendation and approve in less than 180 days.  
12 Along with this in the next rulemaking that we're  
13 going to do for DCO core principles, it is staff's  
14 hope that we can recommend adoption of an  
15 application form with instructions that will be  
16 more specific and will enable us to get uniform  
17 submissions, complete submissions, and that too we  
18 hope will contribute to streamlining the process  
19 so that we can do away with a lot of this back and  
20 forth that we've experienced in the past.

21 COMMISSIONER DUNN: I notice under the  
22 procedures for transfer of DCO registration we

1 used the term as soon as practical. Is the same  
2 concept applying here?

3 MS. DIETZ: Yes. We don't want to be in  
4 the position of holding up a corporate event  
5 because we need to give approval for the transfer  
6 of a registration so that the goal there is to get  
7 notice sufficiently in advance, do our due  
8 diligence and be able to approve the transfer. We  
9 have recently done a transfer of registration for  
10 the Minneapolis Grain Exchange and that regulation  
11 in fact formalizes and codifies what we did in  
12 that situation and we think it's very helpful to  
13 put the public on notice if you intend to request  
14 a transfer, here's what has to take place and so  
15 that everybody on notice. Again it seems like  
16 we're adding something, but in fact we're  
17 streamlining what we already do.

18 COMMISSIONER DUNN: Mister Chairman, if  
19 I can summarize what I'm hearing from staff on  
20 this is that it's not unusual for an applicant to  
21 come in and provide a partially completed  
22 application and the assumption is that staff will

1 do the work telling here is where you're short,  
2 this is what you've got to do. In fact, they're  
3 asking the staff to do the work of the consultant  
4 or the attorney they may have hired to prepare  
5 this application. I submit, Mister Chairman, we  
6 no longer had the luxury of having staff that can  
7 do that type of job for those applications. If  
8 we're not getting fully funded then these  
9 applications are going to go into a queue in my  
10 opinion is where they should go and we'll get to  
11 them as soon as practical.

12 I have four sons and when they say  
13 they're going to take out the trash as soon as  
14 practical, one may do it right away, one may do it  
15 when they finish what they're doing, the third may  
16 do it the next day and the fourth may get it out  
17 in time for next week's collection. Industry  
18 should be aware that this process although it has  
19 been established over the years as a convenience  
20 to the industry, we no longer have the luxury of  
21 being able to do that and as a result of that  
22 there may be hold-ups on these applications being

1 processed. Thank you.

2 CHAIRMAN GENSLER: Thank you,  
3 Commissioner Dunn. I think also what staff is  
4 recommending meets a lot of what I know you've  
5 been saying in many meetings for the last year and  
6 half, to have the public have a little bit more  
7 transparency into our process. So I applaud staff  
8 on your thoughts that a couple weeks from now we  
9 might have an application form and that everybody  
10 would know what you think is important and then  
11 we'll have to see if we vote for it. I think  
12 that's a good thing that the public will see that  
13 transparency. As you say, you've taken the  
14 Minneapolis situation and you've put it down and  
15 said this is the process. Commissioner Sommers?

16 COMMISSIONER SOMMERS: Thank you, Mister  
17 Chairman. I have a question regarding the  
18 portfolio margining program. It's been the  
19 subject of interest to me since I've been here.  
20 My question is to explain if we're asking a DCO to  
21 submit their rules to us for approval of the  
22 program before we've reached agreement with the

1 SEC on the requirements of the program, are we in  
2 a place to approve the rules or how is that going  
3 to work?

4 MR. LAVE: Right now we're talking about  
5 portfolio margining in a futures account and what  
6 the Dodd- Frank Act says is that the SEC may allow  
7 a futures commission merchant/broker dealer to put  
8 securities in an FCMBD if the portfolio margining  
9 program is approved by the Commission so that we  
10 are setting forth the rules for approval by the  
11 Commission. If the FCMBD wants to put securities  
12 in that account they're going to need to get  
13 approval from the SEC so that we're doing one  
14 piece of the rulemaking.

15 MS. DIETZ: To follow-up on that, as  
16 Jonathan said, in order for the SEC to grant an  
17 exemption to approve putting securities into the  
18 futures portfolio margining account, there's a  
19 reference here in the statute to pursuant to a  
20 portfolio margining program approved by the  
21 Commodity Futures Trading Commission. Right now  
22 we have two different tracks as you know for

1 filing rules, you could self-certify or you can  
2 get approval. Under our rules absent what we are  
3 proposing today, a portfolio margining program  
4 implemented through rules, could just be  
5 self-certified. That won't do the trick for the  
6 SEC's approval. So what we are doing is we are  
7 laying the foundation purely procedurally saying  
8 if you intend to do a portfolio margining program,  
9 you're put on notice that you must get prior  
10 approval or the other chain of events won't take  
11 place.

12 COMMISSIONER SOMMERS: Do we know if the  
13 SEC is in a place to propose their requirements  
14 for a portfolio margining program?

15 MS. DIETZ: They do have the portfolio  
16 margining program now under NYSE Rule 431 so we  
17 have had discussions with them, but I don't  
18 believe that either staffs are at a point where  
19 we're down to discussing substantive issues.

20 COMMISSIONER SOMMERS: Requirements for  
21 this?

22 MS. DIETZ: Requirements for either the

1 futures account, what would they require in order  
2 to give the green light on the futures account,  
3 similarly what we would require in order to permit  
4 futures into the securities portfolio margining  
5 account. For us this is a first step. On the SEC  
6 side my understanding is that all rule submissions  
7 of this type would have to be approved so that we  
8 are the ones who now want to put this in place  
9 because otherwise they would be certified.

10 CHAIRMAN GENSLER: Thank you,  
11 Commissioner Sommers. I look forward to any work  
12 staff can move forward with the Securities and  
13 Exchange Commission on portfolio margining. I'm  
14 guessing I'm speaking for all of us. I think we  
15 all do. Commissioner Chilton?

16 COMMISSIONER CHILTON: I don't have any  
17 questions. I support the rule and thank the staff  
18 for their hard work. Thank you.

19 CHAIRMAN GENSLER: Thank you,  
20 Commissioner Chilton. COMMISSIONER O'Malia?

21 COMMISSIONER O'MALIA: I don't have any  
22 questions. This is a very good rule. Thank you

1 for your hard work on this.

2 CHAIRMAN GENSLER: I think then I will  
3 call the motion. All those in favor of publishing  
4 in the Federal Register the staff recommendation  
5 on the proposed rule on legal and compliance for  
6 clearinghouses? I think I didn't read something  
7 earlier when I was going to do, a unanimous  
8 consent about putting all recorded votes in the  
9 Federal Register. I can't find the script. I  
10 wanted by unanimous consent to make sure that all  
11 recorded votes are put in the Federal Register.  
12 If I don't hear an objection then that passes.  
13 Then that sets you up to be able to ask for a  
14 recorded vote I think. I'm trying to follow  
15 Robert's Rules of Order.

16 COMMISSIONER SOMMERS: I understand.

17 CHAIRMAN GENSLER: All those in favor,  
18 if you can indicate by saying aye.

19 (Chorus of ayes.)

20 CHAIRMAN GENSLER: Are there any  
21 opposed? It appears that the yes have it.

22 COMMISSIONER SOMMERS: Mister Chairman,

1 I'd like to ask for a recorded vote.

2 CHAIRMAN GENSLER: Do I do this with  
3 Dave Stawik?

4 MR. STAWIK: Commissioner O'Malia?

5 COMMISSIONER O'MALIA: Aye.

6 MR. STAWIK: Commissioner O'Malia, aye.  
7 Commissioner Chilton?

8 COMMISSIONER CHILTON: Aye.

9 MR. STAWIK: Commissioner Chilton, aye.  
10 Commissioner Sommers?

11 COMMISSIONER SOMMERS: Aye.

12 MR. STAWIK: Commissioner Sommers, aye.  
13 Commissioner Dunn?

14 COMMISSIONER DUNN: Aye.

15 MR. STAWIK: Commissioner Dunn, aye.

16 Mister Chairman?

17 CHAIRMAN GENSLER: Aye.

18 MR. STAWIK: Mister Chairman, on this  
19 vote the ayes are five and nays are zero.

20 CHAIRMAN GENSLER: Did we follow  
21 Robert's Rules?

22 MR. STAWIK: Yes, sir.

1                   CHAIRMAN GENSLER: Thank you. With  
2 that, if we can turn to next up on the agenda is  
3 the notice of proposed rulemaking on the  
4 recordkeeping or information management of  
5 designated DCOs, again clearing organizations.  
6 Thank you, Jonathan. We have also Julie Mohr  
7 joining. Ananda and Phyllis are back for repeat.  
8 Jake, I don't want to garble the last name.

9                   MR. PREISEROWICZ: Preiserowicz.

10                  CHAIRMAN GENSLER: What's that?

11                  MR. PREISEROWICZ: Preiserowicz.

12                  CHAIRMAN GENSLER: Thank you. Team,  
13 you're up.

14                  MS. DIETZ: I am pleased to recommend  
15 that the Commission approve for publication in the  
16 Federal Register proposed regulations that would  
17 implement certain core principles for derivatives  
18 clearing organizations. These regulations would  
19 establish standards for compliance with DCO core  
20 principles relating to reporting, recordkeeping,  
21 public information and information sharing. Jake  
22 Preiserowicz has been the lead attorney on this

1 rulemaking and he will present an overview of the  
2 proposed rules. Julie Mohr, our Associate  
3 Director for DCO Reviews, is also joining us from  
4 Chicago. She and other team members in Chicago  
5 have contributed enormously to this rulemaking  
6 initiative. I'd like to take a moment to thank  
7 all of our team members in D.C. as well as Chicago  
8 for their many important contributions to the  
9 development and drafting of this proposed  
10 rulemaking. Thank you.

11 MR. PREISEROWICZ: Thank you, Phyllis.  
12 Good morning, Mister Chairman and Commissioner.  
13 As Phyllis mentioned, this rulemaking covers the  
14 reporting, recordkeeping, public information and  
15 information sharing core principles. The proposed  
16 rulemaking implements these core principles and  
17 expands on the regulatory and statutory language  
18 primarily for the reporting core principle and to  
19 a lesser extent recordkeeping. While it proposes  
20 to adopt the statutory language of Core Principles  
21 L and M, public information and information  
22 sharing, they are more or less the same form.

1           I would first like to address Core  
2 Principle J, reporting. The proposed regulations  
3 have been divided into two types of reporting  
4 requirements, one being periodic reports and two  
5 being event-specific reports, meaning the  
6 reporting requirement would be triggered by a  
7 current specific event. There is still regulatory  
8 language which would continue to allow the  
9 Commission to obtain additional information not  
10 specified in the regulations as necessary.

11           First, periodic reporting, which has  
12 been divided into three different timeframes,  
13 daily, quarterly and annually. Daily reporting  
14 requirements would require certain information  
15 regarding margin, cash-flows and end- of-day  
16 positions to be reported to the Commission on a  
17 daily basis by the following business day morning.  
18 These margin and other information reporting  
19 requirements provide essential information to the  
20 Commission which a DCO has readily available as  
21 part of its regular business activities. Also  
22 several DCOs already provide such data to the

1 Commission on a regular basis. By making this a  
2 uniform requirement for all DCOs, Commission staff  
3 will receive a more complete set of data on a  
4 timely basis which lead to more effective  
5 oversight of DCOs and assist with the early  
6 detection of any issues.

7           Next, the quarterly reporting  
8 requirements which simply restate the quarterly  
9 reporting requirements which have already been  
10 proposed in the financial resources for DCOs'  
11 rulemaking back in October where certain reports  
12 related to financial resources are required on a  
13 quarterly basis. Next, annual reporting  
14 requirements addressing DCOs' annual compliance  
15 report as required by the Dodd- Frank Act is  
16 simply a cross-reference to DCO report that  
17 Jonathan had just discussed. The other annual  
18 reporting requirement is for each DCO to file  
19 annual financial statements at year end with the  
20 Commission.

21           Next are event-specific reports, the  
22 second category of reporting requirements.

1 Generally the reporting requirements are minimal.  
2 When more extensive reports are required by the  
3 proposed regulations, it will generally be in  
4 situations where the DCO has this information  
5 readily available in the ordinary course of its  
6 business or in connection with other regulations.  
7 Most of the event-specific reporting requirements  
8 can be categorized into two different categories,  
9 either relating to significant financial changes  
10 at the DCO or problems arising with a clearing  
11 member. In staff's experience, these are  
12 situations which rarely occur and will be expected  
13 to rule in only a handful or reports from all DCOs  
14 over the course of the year. The first example of  
15 a significant financial change would be an  
16 ownership equity decrease of 20 percent or more  
17 which would require the filing of pro forma  
18 financial statements no later than 2 business days  
19 prior to the anticipated decrease. This type of  
20 decrease is generally due to a planned corporate  
21 event such as a dividend payment which the DCO  
22 generally has advanced knowledge of and has all

1 the information necessarily which it would have to  
2 provide to the Commission as part of that  
3 transaction and other such reporting requirements  
4 where there is a sudden drop in financial  
5 resources or a deficit in the 6-month liquid asset  
6 requirement for DCOs that was also proposed in the  
7 financial resources proposed rulemaking. Both are  
8 situations where the DCO is already required to  
9 have such information readily available to them  
10 and the reporting requirement is a simple notice  
11 to the Commission. The second category of  
12 event-specific reports with clearing members  
13 requires a report to the Commission when there are  
14 issues ranging from a clearing member delaying  
15 initial margin payments to a clearing member  
16 default. These are rare occurrences and would  
17 require the DCO to notify the Commission of the  
18 event.

19 I also wanted to point out two other  
20 event-specific reporting requirements which don't  
21 fit into these two categories. The first is  
22 certain organizational or corporate changes to the

1 DCO. Staff proposes advanced notice. These are  
2 planned events that a DCO will know about far in  
3 advance. Here too the reporting requirement  
4 requires information that is readily available to  
5 the DCO as a result of this planned change. Next  
6 is the requirement to report intraday initial  
7 margin calls. This requirement goes hand in hand  
8 with the daily reporting requirements and  
9 supplements daily information. If there are  
10 certain clearing member positions that could  
11 affect the ability of a DCO to meet its  
12 end-day-financial obligation, receiving the data  
13 the next morning sometimes may not be soon enough.  
14 Having this data would almost immediately alert  
15 the Commission to positions that compose greater  
16 risk. This especially important given that  
17 intraday initial margin calls are unusual and are  
18 often due to increasing position size.

19 The next core principle that staff is  
20 proposing to codify is recordkeeping. The  
21 proposed regulations codify the statutory language  
22 with some additional clarification. The

1 recordkeeping requirement is intended to require  
2 maintenance of all records generated pursuant to  
3 Part 39, and for additional clarification the  
4 proposed rulemaking also specifies requirements to  
5 maintain records related to swaps. The rulemaking  
6 also includes a cross- reference to the  
7 Commission's technical and procedural  
8 recordkeeping requirements in Regulation 131.

9           The third core principle staff is  
10 proposing to codify in this rulemaking is public  
11 information. The proposed regulations codify the  
12 core principle language also with some additional  
13 clarification. There are two additions to the  
  
14 core principle language in the proposed  
15 requirements. A DCO would be required to publicly  
16 disclose its rule book and a list of its clearing  
17 members. Although both are already done by both  
18 many DCOs, this requirement furthers the core  
19 principle mandate that a customer be able to fully  
20 understand the risks associated with a particular  
21 DCO. The clearing members of a DCO and its rules  
22 are a critical component of this in understanding

1 the financial integrity of a DCO.

2 The final core principle addressed by  
3 this rulemaking is information management. The  
4 proposed rules would essentially codify the  
5 statutory provisions of Core Principle M,  
6 information sharing, in substantially the same  
7 manner. The language affords each DCO the  
8 appropriate level of discretion regarding the  
9 necessarily information-sharing agreements to  
10 enter into and staff does not perceive the need to  
11 articulate more specific requirements. This  
12 concludes my presentation and I'll be happy to  
13 take any questions.

14 CHAIRMAN GENSLER: Jake, I thank you.  
15 Before I'll entertain a motion I'm going to ask to  
16 clean up what I just did. I'm going to ask  
17 unanimous consent that all final votes for  
18 publishing proposed or final rules to implement  
19 the Dodd-Frank Act conducted in a public meeting  
20 of this Commission be recorded votes. Not hearing  
21 any objection, it's unanimous consent that they're  
22 all recorded votes if they're on Dodd-Frank in a

1 public meeting. Now I'll entertain a motion on  
2 staff's recommendation on information management  
3 of clearinghouses.

4 COMMISSIONER DUNN: So moved.

5 COMMISSIONER SOMMERS: Second.

6 CHAIRMAN GENSLER: I support the rule  
7 and I'll have a short statement that will go in  
8 the record. One of the pieces of the rule that I  
9 think I wanted to highlight and confirm is that  
10 Congress mandated that clearinghouses on a daily  
11 basis publish settlement prices and open interest  
12 on all of their contracts. I think this is a  
13 really important feature. Congress did it and  
14 we're putting it in the rules to promote  
15 transparency in the marketplaces that the public  
16 can actually see. Of course there is a lot in  
17 this rule for regulators to see that will help us  
18 help the markets be safer because we'll know  
19 what's happening in the clearinghouses. I think  
20 that largely happens now. I have two questions.  
21 One is am I right about the first part, public  
22 transparency on settlement prices and open

1 interest on a daily basis?

2 MR. RADHAKRISHNAN: Yes. Everything  
3 that's critical.

4 CHAIRMAN GENSLER: Secondly, most of the  
5 rest of it relates to transparency to regulators  
6 and not to the public though more of this may be  
7 brought into specificity, but that's consistent  
8 with what you as staff of a regulator already  
9 receive from the best regulated clearinghouses.  
10 Is that right?

11 MR. RADHAKRISHNAN: Yes.

12 CHAIRMAN GENSLER: Commissioner Dunn?

13 COMMISSIONER DUNN: Thank you, Mister  
14 Chairman. I support this proposed rule. Ananda,  
15 I would like you to tell me what are you going to  
16 do with all this information and who is going to  
17 plow through it?

18 MR. RADHAKRISHNAN: I'll have Julie talk  
19 about that.

20 MS. MOHR: The Risk Surveillance Group  
21 and the DCO Review Group in Chicago are the groups  
22 that are going to be primarily looking at the

1 information on a daily basis. We'll be enhancing  
2 our existing financial surveillance of the  
3 marketplace and we're going to be able to help  
4 identify proactively issues that might be  
5 occurring in an effort to try to mitigate or ask  
6 questions before the issue blows up and becomes  
7 something that's more newsworthy. We think this  
8 helps protect market participants and the general  
9 public as a whole. It will also allow us to look  
10 at the health of the DCO and ensure that it is  
11 following all the procedures that they said they  
12 were doing on a daily basis.

13 COMMISSIONER DUNN: Can you do that with  
14 existing staff?

15 MS. MOHR: Right now we think with the  
16 existing rules in place that are proposed we would  
17 need one additional person who would help us out  
18 who would be looking at all the data coming in  
19 daily.

20 MR. RADHAKRISHNAN: But the unknown  
21 factor is once swaps clearing goes full steam  
22 ahead, then the answer is no. That's why we asked

1 for more staff.

2 CHAIRMAN GENSLER: Thank you,  
3 Commissioner Dunn. Commissioner Sommers?

4 COMMISSIONER SOMMERS: I don't have any  
5 questions. Thank you.

6 CHAIRMAN GENSLER: Thank you.  
7 Commissioner Chilton?

8 COMMISSIONER CHILTON: No questions.  
9 Thank you.

10 CHAIRMAN GENSLER: Thank you.  
11 Commissioner O'Malia?

12 COMMISSIONER O'MALIA: I have one  
13 question. Rule 39.19(c)(4)(xiii) requires the DCO  
14 to provide the Commission with a notice of its  
15 initiation of a rule enforcement action against a  
16 clearing member or imposition of sanctions against  
17 a clearing member no later than 2 business days  
18 after. This occurs to me maybe as a result of our  
19 becoming more perspective that we're trying to  
20 define dates and times and as a result we may  
21 delay the process in which the Commission receives  
22 information during an investigative stage. It

1 appears to be that this rule would require 2 days  
2 after sanctions of a clearing member. Will that  
3 impact our ability to work during the  
4 investigative process to share information and  
5 cooperate with clearing members or because we're  
6 being prescriptive they're going to say it said 2  
7 days after so we're not going to talk to you until  
8 then? I'm a little concerned that we're being too  
9 rigid and that might undermine our ability. How  
10 will we get over that to make sure that we have  
11 good communications and we see these things in the  
12 investigative stage as opposed to some back-dated  
13 arbitrary date that we've set in these  
14 rulemakings?

15 MS. DIETZ: To clarify, as to the  
16 provision, there are two parts to it. It's when  
17 they initiate rule enforcement and then when they  
18 impose the sanction.

19 COMMISSIONER O'MALIA: So there's an  
20 earlier trigger that they have to notify us?

21 MS. DIETZ: Yes.

22 MR. RADHAKRISHNAN: If we get notice of

1 the imposition of the sanction, we would have  
2 already received notice of the initiation of the  
3 action against the clearing member because they  
4 are obliged to do both.

5 COMMISSIONER O'MALIA: Thanks.

6 CHAIRMAN GENSLER: Let me ask does it  
7 say no later than 2 days or?

8 COMMISSIONER O'MALIA: It says no later.

9 MR. RADHAKRISHNAN: Yes, no later than 2  
10 days.

11 CHAIRMAN GENSLER: If there are no  
12 further questions, I'm going straight for the  
13 recorded vote. I think that could work in  
14 Robert's Rules because we had unanimous consent  
15 earlier.

16 MR. STAWIK: Commissioner O'Malia?

17 COMMISSIONER O'MALIA: Aye.

18 MR. STAWIK: Commissioner O'Malia, aye.  
19 Commissioner Chilton?

20 COMMISSIONER CHILTON: Aye.

21 MR. STAWIK: Commissioner Chilton, aye.  
22 Commissioner Sommers?

1 COMMISSIONER SOMMERS: Aye.

2 MR. STAWIK: Commissioner Sommers, aye.  
3 Commissioner Dunn?

4 COMMISSIONER DUNN: Aye.

5 MR. STAWIK: Commissioner Dunn, aye.  
6 Mister Chairman?

7 CHAIRMAN GENSLER: Aye.

8 MR. STAWIK: Mister Chairman, aye.  
9 Mister Chairman, on this vote the ayes are five  
10 and nays are zero.

11 CHAIRMAN GENSLER: We'll send it to the  
12 Federal Register. Thank you all, clearinghouse  
13 team. We see you again I believe on December 16  
14 if we can get through all of this and in  
15 clearinghouse land it will be risk-management  
16 rules and there may be some other things beyond  
17 risk management on the 16th. Is that right,  
18 Phyllis?

19 MS. DIETZ: Some procedural matters.

20 CHAIRMAN GENSLER: Some procedural  
21 things, but primarily related to risk management  
22 for the clearinghouses and for the systemically

1 important clearinghouses. For those listening,  
2 we're giving a moment for one group of staff to  
3 move out and another group to come in, but we're  
4 going to be reviewing staff recommendations on  
5 designated contract markets. These are the  
6 exchanges is what most people would call them in  
7 public, but they've been called designated  
8 contract markets I think since the 1920s and  
9 certainly the 1930s in our regulations.

10 Next up from the Division of Market  
11 Oversight we have Nancy Markowitz who is the team  
12 lead, Rick Shiltz who is the head of the division  
13 and Nadia Zakir who has been every present, but  
14 there are probably 10 or 15 other people on this  
15 team as well. Thank you and why don't you present  
16 your recommendations?

17 MS. MARKOWITZ: Thank you. Good  
18 morning, Mister Chairman and Commissioners. Today  
19 staff is recommending for publication the  
20 rulemaking entitled Core Principles and Other  
21 Requirements for Designated Contract Markets. I  
22 first want to thank all the members of this team

1 particularly my deputy Nadia Zakir and everybody  
2 else who read the 252 pages of this rulemaking.

3           Current Section 5 of the Commodity  
4 Exchange Act sets forth eight designation criteria  
5 and 18 core principles that designated contract  
6 markets or DCMs are required to comply with as a  
7 condition of obtaining and maintaining designation  
8 as a contract market. Section 735 of the  
9 Dodd-Frank Act amended Section 5 by eliminating  
10 the eight standalone designation criteria,  
11 revising many of the existing 18 core principles  
12 and adding five new core principles thereby  
13 requiring applicants and existing DCMs to comply  
14 with a total of 23 core principles as a condition  
15 of obtaining and maintaining designation as a  
16 contract market. The Dodd-Frank Act also amended  
17 the Commodity Exchange Act to require that the  
18 execution of swaps subject to the clearing  
19 requirement must occur either on a DCM or on a new  
20 type of facility called a Swap Execution Facility  
21 or also referred to as a SEF.

22           The rules proposed today implement the

1 new and revised regulatory obligations of DCMs and  
2 also provide for the listing and trading of swaps  
3 on DCMs. To implement the provisions of the  
4 Dodd-Frank Act pertaining to DCMs, staff first  
5 undertook a comprehensive evaluation of existing  
6 regulations, guidance and acceptable practices  
7 associated with general designation provisions and  
8 core principles to determine which core principles  
9 would benefit from new or revised guidance or  
10 acceptable practices and which core principles  
11 would be better served by the certainty of  
12 regulation. Based on that review, staff proposes  
13 revised guidance and acceptable practices for some  
14 core principles and codification of new  
15 regulations in lieu of guidance and acceptable  
16 practices for other core principles. Staff also  
17 proposes new and revised regulations relating to  
18 the designation process for contract markets. The  
19 revised guidance and acceptable practices are  
20 based on staff's regulatory experience and also on  
21 industry practice and developments. The proposed  
22 regulations largely implement new statutory

1 mandates, are codified commonly accepted industry  
2 practices in order to provide greater transparency  
3 and regulatory certainty for applicants and  
4 existing DCMs. In many instances the proposed  
5 regulations are derived from the existing guidance  
6 and acceptable practices or codify requirements  
7 and practices that are commonly accepted in the  
8 industry today and that based on its experience in  
9 conducting routine surveillance and rule  
10 enforcement reviews staff has found to represent  
11 the exclusive or best means of complying with the  
12 core principle.

13           It should be noted that while these  
14 proposed regulations prescribe the compliance  
15 obligations of DCMs with respect to certain core  
16 principles, for the most part the proposed  
17 regulations preserve the flexibility for DCMs to  
18 determine the specific manner in which they may  
19 carry out their obligations. In the interest of  
20 time I will provide a general overview of selected  
21 aspects of the proposed rulemaking.

22           As an initial matter, staff is proposing

1 new and modified regulations in Part 38 pertaining  
2 to the process of applying for designation as a  
3 contract market and to certain other  
4 designation-related requirement. Staff proposes  
5 to eliminate the accelerated approval procedures  
6 for DCM applications, requiring instead that all  
7 applications be reviewed under the 180-day  
8 statutory review period. Since implementing the  
9 90-day review process in 2004, staff has  
10 determined that the expedited timeline is  
11 inefficient and rarely feasible as applicants  
12 seeking to meet the accelerated approval line  
13 often file incomplete or draft applications.  
14 Under our proposed rule, all DCM applications will  
15 now be reviewed within 180 days.

16 With respect to the DCM application  
17 process and to provide applicants with greater  
18 certainty of the types of information that is  
19 required to support a DCM application, staff also  
20 proposes to include a new application form with  
21 comprehensive instructions and a specified list of  
22 documents and information that just accompany the

1 application. The majority of information required  
2 under the form application consists of information  
3 that historically has been required under the  
4 Commission's regulations or by Commission staff in  
5 its review of the DCM applications. Staff is also  
6 proposing new regulations associated with the DCMs  
7 listing and trading of swaps including reporting  
8 obligations and recordkeeping requirements as  
9 required under the Dodd-Frank Act. Staff also is  
10 proposing rules providing that a board of trade  
11 that operates a designated contract market may  
12 also operate a SEF provided that it separately  
13 registers the SEF, meets the SEF registration  
14 requirements and complies on an ongoing basis with  
15 the SEF rules and core principles under Section  
16 5(h) of the Commodity Exchange Act.

17 For the 23 core principles, I briefly  
18 highlight some of the key proposals as related to  
19 their general regulatory requirements. There are  
20 five core principles that set forth a DCM's  
21 obligations to impose rules and ensure compliance  
22 with those rules in a number of areas. Amended

1 Core Principle 2, for examples, requires a DCM to  
2 establish, monitor and enforce rules relating to  
3 access requirements, terms and conditions of the  
4 contracts to be traded on its system and rules  
5 prohibiting abuse trading practices. The core  
6 principle also requires the DCM to have the  
7 ability to detect rule violations and sanction  
8 persons who violate the rules. To implement  
9 Amended Core Principle 2 staff proposes  
10 regulations that will require DCMs to prohibit a  
11 list of abusive trade practices all of which are  
12 already prohibited by DCMs to date or to prohibit  
13 those by statute or Commission regulation.

14 Another proposed regulation requires  
15 DCMs to maintain sufficient compliance resources  
16 and staff to carry out its obligations under this  
17 core principle. This is a flexible regulation  
18 that does not prescribe how large staff should be  
19 but provides a number of factors that DCMs must  
20 take into account in determining the correct size  
21 of their compliance staff. Staff also proposes  
22 regulations that codify existing industry

1 practices including those requiring automated  
2 trail surveillance systems and their minimum  
3 capabilities, real-time market monitoring and  
4 regulations pertaining to investigations and  
5 investigation reports.

6 Amended Core Principle 6 imposes  
7 compliance obligations on DCMs with respect to  
8 emergency actions. Under the core principle, a  
9 DCM is required to have rules to provide for the  
10 exercise of emergency intervention in the market.  
11 Recognizing that DCMs may have different  
12 procedures for taking emergency action, staff  
13 believes that it is appropriate to maintain an  
14 expanded version of the existing guidance that  
15 includes provisions emphasizing cross-market  
16 coordination of emergency action and to have  
17 alternative lines of communication and approval  
18 procedures in order to be able to address in real  
19 time emergencies that may arise. Staff believes  
20 that this is an important obligation given today's  
21 fact-paced trading systems and the need for DCMs  
22 to be able to react quickly to market events and

1 to intervene without delay. Over the years DCMs  
2 have developed certain best practices for  
3 emergency programs and staff is proposing those  
4 are acceptable practices.

5 Amended Core Principle 14 requires DCMs  
6 to establish and enforce rules regarding  
7 alternative dispute resolution. Staff proposes to  
8 maintain the guidance and acceptable practices  
9 with certain revisions to enable DCMs to structure  
10 their appropriate dispute resolution programs.

11 Amended Core Principle 9 requires that a  
12 DCM provide a competitive, open and efficient  
13 market and mechanism for executing transactions  
14 that protect the price discovery process of  
15 trading in a centralized market. The amended core  
16 principle recognizes that off-exchange  
17 transactions are permitted for bona fide business  
18 purposes if authorized by the DCM's rules. To  
19 implement this amended core principle, staff  
20 proposes among other things a regulation that  
21 updates the existing regulation with respect to  
22 the types of transactions that may be executed of

1 a DCM centralized market. Other new regulations  
2 are being proposed to address the specific  
3 statutory requirement under the Dodd-Frank Act of  
4 protecting the price discovery function of trading  
5 on the centralized market. New proposed  
6 regulations impose minimum requirements for  
7 trading on a DCM centralized market for contracts  
8 that are listed on the DCM, mandatory delisting of  
9 contracts if the requirements are not met,  
10 specified procedures for treatment of contracts  
11 existing prior to the effective date of these  
12 rules and limited exemptions for contracts based  
13 on petition to the Commission. In addition,  
14 regulations are being proposed to codify already-  
15 established practices and requirements for block  
16 trades for futures and other off-exchange  
17 transactions. The proposed rule sets forth block  
18 trade requirements for future contracts and  
19 options including who may enter into block trade  
20 transactions, conditions for block trades between  
21 affiliated parties, aggregation, recordkeeping and  
22 reporting procedures. In addition, a new

1 acceptable practice is being proposed for DCMs in  
2 determining the minimum size of block transactions  
3 for individual contracts and the manner of pricing  
4 block trades and other off- exchange transactions.  
5 By proposing these acceptable practices, staff  
6 recognizes the need for flexibility as the  
7 appropriate minimum size and pricing of block  
8 trades varies among contracts and across DCMs.

9 Another group of core principle address  
10 requirements that must be met by contracts listed  
11 and traded on a DCM and the DCM's obligation to  
12 monitor trading activities. For Core Principle 3  
13 dealing with contracts not readily subject to  
14 manipulation, staff proposes to maintain the  
15 existing guidance with necessarily revisions to  
16 provide greater detail to DCMs regarding relevant  
17 considerations when designing a contract including  
18 swap contracts. Amended Core Principle 5 dealing  
19 with position limits or accountability requires  
20 DCMs to adopt for each contract as is necessary  
21 and appropriate position limitations or position  
22 accountability and requires that this limit cannot

1 be higher than the position limitation established  
2 by the Commission for any contract. The proposed  
3 regulation in this rulemaking requires that each  
4 DCM comply with the Commission's regulations  
5 pertaining to position limits.

6 Amended Core Principle 4, prevention of  
7 market manipulation, was amended to require DCMs  
8 to take an active role not only in monitoring  
9 trading activities within their market but also in  
10 preventing market disruption. As to this core  
11 principle, staff proposes to codify relevant  
12 proposes of the current guidance on acceptable  
13 practices and to include new requirements that  
14 take into consideration the amended language and  
15 developments within industry. To comply with this  
16 core principle, a proposed rule requires DCMs to  
17 have the ability to conduct real-time trade  
18 monitoring and comprehensive trade reconstruction.  
19 In order to prevent market disruptions due to  
20 suddenly volatile price movements, the proposed  
21 rules require DCMs to establish and enforce trade  
22 risk controls including but not limited to market

1 restrictions that pause or halt trading under  
2 certain conditions. Pauses and halts are just one  
3 type of risk control, and accordingly the  
4 rulemaking requests public comment as to the  
5 appropriateness of a variety of trade risk  
6 controls that may be necessary to reduce the risk  
7 of market disruption.

8           Two core principles impose financial  
9 integrity obligations on DCMs. Amended Core  
10 Principle 11 requires DCMs to establish and  
11 enforce rules and procedures for ensuring the  
12 financial integrity of transactions entered into  
13 on or through the DCM including the clearing and  
14 settlement of the transactions with a derivatives  
15 clearing organization. This core principle also  
16 requires DCMs to establish and enforce rules to  
17 ensure the financial integrity of any futures  
18 commission merchant and introducing broker. For  
19 the most part, the proposed regulations codify  
20 language in the existing regulations in Section  
21 1.52 and application guidance for Core Principle  
22 11 and the guidance for former Designation

1 Criteria 5. New Core Principle 21, financial  
2 resources for DCMs, requires a DCM to have  
3 adequate financial resources to discharge its  
4 responsibility and to maintain financial resources  
5 sufficient to cover operating costs for a period  
6 of at least 1 year calculated on a rolling basis.  
7 Staff proposes regulations including those  
8 relating to the types of financial resources  
9 available to DCMs to satisfy their financial  
10 requirements, valuation and need calculation  
11 requirements that the DCM must make but can use  
12 its own methodology and financial resources  
13 reporting requirements.

14 Finally, new Core Principle 20, system  
15 safeguards, establishes operational and system  
16 safeguard requirements for all DCMs. Among other  
17 things, the proposed rules require that DCMs  
18 establish and maintain a program of risk analysis  
19 and oversight to identify and minimize sources of  
20 operational risk and have emergency backup  
21 procedures. The proposed rules also require DCMs  
22 to notify Commission staff of various system

1 security-related events and to conduct regular  
2 objective testing and review of its automated  
3 systems. These regulations will provide certainty  
4 and transparency to DCMs as to their system-  
5 related obligations and more security to their  
6 systems. Staff encourages and looks forward to  
7 hearing from the public on all aspects of this  
8 proposed rulemaking and in particular with respect  
9 to the specific questions posed in the proposed  
10 rulemaking. I'd be happy to answer any questions  
11 at this time.

12 CHAIRMAN GENSLER: Thank you, Nancy.  
13 With that I'll entertain a motion on the staff  
14 recommendation on DCM core principles.

15 COMMISSIONER DUNN: So moved.

16 COMMISSIONER SOMMERS: Second.

17 CHAIRMAN GENSLER: I support the  
18 proposed rulemaking to update rules and guidance.  
19 I note that there is a lot of guidance in this,  
20 that this is not just a proposed rule, but  
21 proposed guidance with designated contract  
22 markets. The Dodd-Frank Act updated language.

1       There were core principles that were put in place  
2       just 10 years ago and I think that there were if I  
3       recall 15 or 16 core principles -- 18 core  
4       principles, and now there are 23, and even amongst  
5       those 18 some of them were amended by Congress.  
6       So I think it's important to update our rules and  
7       guidance to reflect the changes that there are now  
8       23 core principles and even amongst the original  
9       18 there is changed language.

10                 Further, I think that the Dodd-Frank Act  
11       for the first time allows DCMs, these contract  
12       markets, to also trade swaps or a market  
13       designated contract maybe to be affiliated with a  
14       swap execution facility as staff walked through.  
15       So I think it's important to update the rules and  
16       guidance of these contract markets to these two  
17       really important changes. One, there are now 23  
18       core principles and not 18, and even 18 were  
19       changed. And two, that there are going to be some  
20       contract markets that want to trade swaps and of  
21       course they're going to be swap execution  
22       facilities. We will be considering I think

1        hopefully next week, I see Reva here -- I think  
2        we're going to try to consider proposed rules and  
3        guidance for swap execution facilities next week  
4        or at the latest 2 weeks from now so that I think  
5        it's also important that we have in place new  
6        rules and guidance on this one.

7                    I do have a couple of questions to  
8        highlight a topic or two. I know that some people  
9        have mentioned that these rules are more  
10       prescriptive than we've been in the past and that  
11       may well be the case. There are now 23 core  
12       principles and there are not 18. But one area  
13       that's been I think important to this Commission  
14       is convergence in wheat contracts and convergence  
15       in other contracts. I think it's at the core of a  
16       well-functioning futures market. This is before  
17       you get to swaps. But I think it's at the core of  
18       a well-functioning futures market that market  
19       participants, farmers, ranchers, grain elevator  
20       operators, investors, even speculators, have  
21       confidence that this contract that we call a  
22       future which is just a derivative actually at some

1 point in time for even a short moment converges  
2 with the actual price of the physical commodity.  
3 I think that's at the core of this invention that  
4 was about 150 years ago called futures. So I was  
5 glad that staff recommended that in the rules that  
6 it says that a designated contract market must  
7 continually, and this is in Rule 38.252, monitor  
8 the appropriateness of the contract terms and  
9 conditions including the delivery instrument, et  
10 cetera. So we're saying it is prescriptive, they  
11 have to monitor. Then it says the designated  
12 contract market must address conditions that are  
13 interfering with convergence or causing price  
14 distortions, et cetera. We don't say how they  
15 have to address it, but we say they have to  
16 monitor and address.

17 I'm interested in public comments on  
18 this, but this is one place where I think it was  
19 worthwhile to make a proposal, see what the public  
20 things, convergence is the core of our futures  
21 market. I use it as an example. I think it's  
22 important that the public comments not only on

1 38.252, but on each of the pieces that staff I  
2 think thoughtfully put forward. I don't have  
3 questions.

4 MS. MARKOWITZ: I'll also add to that  
5 that we add in our preamble that one of the things  
6 people will get for convergence is delivery terms  
7 and we've asked the public specifically in looking  
8 at convergence factors what are other factors  
9 besides delivery standards should they look at to  
10 make sure that there is convergence.

11 CHAIRMAN GENSLER: I by the way don't  
12 think it's too much to say they need to monitor  
13 and they should address but it doesn't say how.  
14 They have to address.

15 MS. MARKOWITZ: It doesn't say ensure  
16 either.

17 CHAIRMAN GENSLER: It doesn't even say  
18 ensure convergence. That's why this is just a  
19 proposal and we'll see what others think about it.  
20 One other question. I know it's not a percentage  
21 test, but how much of this is guidance versus  
22 proposed rules because I keep stressing that this

1 is both guidance and rules. Maybe you don't have  
2 a percentage.

3 MS. MARKOWITZ: I would say about 30  
4 percent continued guidance or 35 percent continued  
5 guidance.

6 CHAIRMAN GENSLER: We already had some  
7 rules though.

8 MS. MARKOWITZ: Correct. Part 38 was  
9 all regulations.

10 CHAIRMAN GENSLER: Part 38 was all  
11 regulations.

12 MS. MARKOWITZ: Correct. And many of  
13 the regulations, and I could go through a number  
14 of them, are incredibly flexible in terms of how  
15 you comply with those, it's setting out what you  
16 need to do to comply but we leave a lot of  
17 flexibility in how one goes about doing it.

18 CHAIRMAN GENSLER: Commissioner O'Malia  
19 was very helpful in the language and I know  
20 Commissioner Chilton weighed in a lot on the  
21 language that says that contract markets should  
22 have mechanisms for market pauses and risk

1 mitigants, but we ask a whole series of questions  
2 as to how to get this right for the final rule.  
3 We're going to have enormous input from our Joint  
4 Advisory Committee on the May 6 events, we're  
5 going to have enormous input from what's called  
6 the Technology Advisory Committee and through this  
7 60-day public comment period. I think that's a  
8 really important feature of this. I know that you  
9 might be voting against it.

10 COMMISSIONER O'MALIA: That's a good  
11 part of this rule.

12 CHAIRMAN GENSLER: I think that's a  
13 really important piece and I do think that come  
14 the final rule we'll probably be prescriptive  
15 about some pieces of that. Commissioner Dunn?

16 COMMISSIONER DUNN: Thank you, Mister  
17 Chairman. I do believe that one of the most  
18 important parts of the futures market is price  
19 discovery and Core Principle 9 which zeroes in on  
20 that is an important aspect of this and I  
21 appreciate staff working on that particular area.  
22 I do have concern as I said in my opening

1 statements about us moving to a more prescriptive  
2 rather than a principle-based regulatory regime.  
3 I am looking for public comment on this from the  
4 industry that if in fact they're in fact saying we  
5 need a safe harbor and that's what you're  
6 providing us with, I can understand that. But if  
7 I hear what you're doing is giving us more  
8 problems and more hoops to jump through and we  
9 can't be as nimble as we need to be to be  
10 competitive, then I will have concerns. I notice,  
11 Phyllis, that there is also similar to DCIO you're  
12 doing away with the 90-day and asking for 180  
13 days.

14 MS. MARKOWITZ: Correct.

15 COMMISSIONER DUNN: Is it a similar type  
16 of problem of incomplete applications coming in?

17 MS. MARKOWITZ: Absolutely, and it's  
18 like what you've said before that we become their  
19 lawyers and representatives and take them through  
20 the entire process and the back and forth. We've  
21 gotten applications that are not even close to  
22 complete and it's a back and forth and it's an

1 enormous amount of resources that takes us away  
2 from other things so that it's rarely feasible  
3 that they do this within the 90-day period.

4 COMMISSIONER DUNN: Thank you, Nancy.  
5 Rick, as I look at this, it's so important for  
6 core principles that we have adequate staffing to  
7 do the RERs. Do we have it at the present time  
8 especially as we're going in to assess other  
9 exchanges?

10 CHAIRMAN GENSLER: Rick, you might want  
11 to say what an RER is for the public.

12 MR. SHILTZ: An RER is what we call a  
13 rule enforcement review. It's an examination of  
14 an exchange's ability to comply with various core  
15 principles and their regulatory requirements, and  
16 I think the short answer is no. With the large  
17 number of SEFs that are expected to come in  
18 including SDRs and combine that with all of the  
19 existing DCMs and new DCMs to carry out reviews on  
20 any sort of a routine basis we would need more  
21 staff and that's what we've requested in the  
22 various budget requests going forward for fiscal

1 year 2011 and 2012. If we don't get that then  
2 somehow we'd have to prioritize which reviews we  
3 do and what adjustments we make in terms of some  
4 of the other missions of the division. But I  
5 would say that at the moment we don't have  
6 sufficient staff to carry out those reviews.

7 COMMISSIONER DUNN: I have suggested in  
8 the past that we have a couple of choices to make,  
9 one, that we can ask the SROs to do more and step  
10 up to the plate or we can become more prescriptive  
11 as some may say we're doing here already.

12 MR. LAVE: I'd like to make a comment  
13 when you brought up the rule enforcement reviews  
14 or the RERs, that in terms of what we looked at in  
15 developing these proposed regulations and  
16 guidance. In many cases they were derived from  
17 the conclusions that we made in doing these  
18 examinations, the thought being that if an  
19 exchange didn't have some sort of an automated  
20 surveillance system or some other program in  
21 place, we would come back and recommend to the  
22 Commission that they're not in compliance with the

1 core principles. To some extent what we were  
2 trying to do when Nancy provide this clarity is to  
3 say that if you don't have these provisions in  
4 place or mechanisms for oversight then staff would  
5 recommend that they're not in compliance reserving  
6 whatever flexibility. That's the motivation  
7 behind what we were thinking when we went through  
8 the review.

9 COMMISSIONER DUNN: The RERs in fact  
10 become a bellwether to the industry that says this  
11 is what the Commission is interested in and they  
12 are publicly published so that the industry can  
13 say this is what they're looking at. My question  
14 to you is how frequently do we do these RERs? Is  
15 it once every 6 months? Once a year? Every 18  
16 months? Or are we on a 3-year cycle?

17 MR. LAVE: I guess the short answer is  
18 not often enough. I think if you go back about 10  
19 years or so, the goal was to do each exchange  
20 every 2 years and I think over the last 10 years  
21 the frequency has declined because we haven't been  
22 able to have sufficient staff to do that. I know

1 the Chairman has said and our goal is to  
2 ultimately be able to have sufficient staff to  
3 look at each exchange, at least all the major  
4 exchanges, on an annual basis and have some sort  
5 of a review ongoing. But again going back to your  
6 first question, it's a question of having adequate  
7 staff to do that.

8 COMMISSIONER DUNN: Thank you.

9 CHAIRMAN GENSLER: Thank you,  
10 Commissioner Dunn. I think the statistics are,  
11 and I see Rachel there who runs our RER program,  
12 her whole group of people who do it, is it once  
13 about every 3 years now at best? With the larger  
14 ones maybe a little bit more frequently and the  
15 smaller ones less. Commissioner Sommers?

16 COMMISSIONER SOMMERS: Thank you, Mister  
17 Chairman. I have some questions regarding Core  
18 Principle 9 and I think that although I realize  
19 that the amendments that were made to Core  
20 Principle 9 in Dodd-Frank are requiring us to  
21 adopt these subpart J proposals, I have questions  
22 about how we have interpreted the language. I

1 would respectfully suggest that although Congress  
2 put this language in that there may be some  
3 contracts that trade right now that actually may  
4 not perform a price discovery function. In us  
5 interpreting what that language said, I have many  
6 concerns about what we're doing in this particular  
7 area. One, in the requirements under this new  
8 38.502, we are proposing minimum requirements for  
9 trading on the centralized market, and if you  
10 could go through with us because I'm not sure it's  
11 actually explained in here how we came to the 85  
12 percent. If you could talk about the 85 percent  
13 and I would ask that people who are commenting  
14 specifically on this rule to let us know whether  
15 that is an appropriate number or if there are  
16 concerns in this area.

17 MS. MARKOWITZ: Thank you. I wanted to  
18 first note that your statement that there are  
19 contracts that trade that may not provide the  
20 price discovery function, that contracts that are  
21 really going to be impacted by this core principle  
22 never trade, there is 100-percent off- exchange

1 trading and that's what the proposed rule is  
2 trying to address.

3 COMMISSIONER SOMMERS: That's my point.

4 MS. MARKOWITZ: In essence what we did  
5 is we looked at the new provisions of the  
6 Dodd-Frank Act that said that there should be a  
7 competitive, open and efficient market and  
8 mechanism that protects the price discovery  
9 process of trading on the centralized market,  
10 obviously Congress recognized that there is a  
11 price discovery function from trading and that in  
12 order to implement this we thought that there had  
13 to be some trading on the centralized market to  
14 protect the price discovery process. We thought  
15 it would provide regulatory certainty and clarity  
16 if we gave a certain percentage number. What we  
17 did is we had our trade specialists in Chicago  
18 come up and do a survey of 570 contracts over a  
19 3-month period. These are 10 different asset  
20 classes involving various levels of open interest,  
21 we provided a cross-market sampling of the types  
22 of contract and involved each contract market.



1       that position initially. We note that the FIA has  
2       a policy that requires no more than 10-percent  
3       off-exchange trading so that we felt we were  
4       fairly with a good ballpark figure. FSA, I'm  
5       sorry. Did I say FIA? We do though as you have  
6       said ask for public comment as to whether there  
7       was another percentage that would be more  
8       appropriate and asking commenter specifically to  
9       say why that would. We also note that we asked  
10      for comments as to whether there should be a  
11      lesser amount if it is a price discovery contract  
12      but a lesser amount on the exchange and whether  
13      there should be an exemption for those types of  
14      contracts.

15                Let me say that there is a third  
16      category we came up with which was not the extreme  
17      of no trading but it wasn't up to 85 percent  
18      on-exchange trading and there's a middle ground.  
19      We recognize that there are contracts,  
20      particularly new contracts, that take time to get  
21      traction on the centralized markets, some that  
22      have 50 or 60 or even lower, and we do incorporate

1 a provision in our rules that says in those  
2 situations they could petition the Commission to  
3 allow these contracts more time to gain traction  
4 and get more trading on the centralized market so  
5 that they wouldn't have to go off the market  
6 before that time.

7 COMMISSIONER SOMMERS: Thank you, Nancy.  
8 I want to clarify that I was referring to those  
9 specific contracts that are contracts that don't  
10 trade often and that have specific terms that I  
11 don't believe have price discovery function that  
12 serves a public good, that everybody is going to  
13 specifically care about what the price of that  
14 little contract is. Those contracts are cleared  
15 now and listed in an exchange and I don't think  
16 we've had a problem with that so I have concerns  
17 about this interpretation.

18 CHAIRMAN GENSLER: Thank you,  
19 Commissioner Sommers. Commissioner Chilton?

20 COMMISSIONER CHILTON: Thanks, Mister  
21 Chairman. I think the team has done a great job,  
22 that Nancy has done a super job, on this. But I

1 was thinking and this was granted the eleventh  
2 hour that these core principles are the Holy Grail  
3 of our regulatory regime and with the advent of  
4 high-frequency trading and robotic trading, there  
5 is really no mention of that in these core  
6 principles at all. There is a story I think  
7 probably people read, that my colleagues read, by  
8 Jeremy Grant in the "FT" this morning. The  
9 headline was something "Super-Fast Traders Post  
10 Risk to Clearing" and they talk about how in the  
11 E.U., 50 percent of the intraday trading is  
12 high-frequency trading. Even here our economists  
13 at the CFTC say that high-frequency trading on the  
14 traditional exchanges, what we regulate currently  
15 as of this beginning of this year, now accounts  
16 for at least a third of all on-exchange trading  
17 and perhaps more, so a third here, 50 percent in  
18 Europe. High- frequency trading is a big deal,  
19 it's arrived and so I'm thinking that we should  
20 add place in here perhaps in the General  
21 Requirements 38.251 and in the Automated Trade  
22 Surveillance System's Section 38.156, some

1 appropriate reference to high-frequency trading.  
2 I'm wondering, Nancy, if you think that would  
3 create and problem from your point of view.

4 MS. MARKOWITZ: I don't believe it will.  
5 I also want to note that in our discussion of  
6 having an Automated Trade Surveillance System we  
7 do note that it's important to have an automated  
8 system given the fast pace of trading including  
9 the existence of high-frequency traders so that I  
10 think a reference in this section would be very  
11 helpful.

12 COMMISSIONER CHILTON: Mister Chairman,  
13 I don't know if anybody wants to discuss it, but I  
14 would make a motion that we let staff at the  
15 appropriate place in the two sections I noted add  
16 an appropriate reference to high- frequency  
17 trading.

18 CHAIRMAN GENSLER: You're talking about  
19 in the preamble?

20 COMMISSIONER CHILTON: I'm talking about  
21 in Sections 38.251 where it says General  
22 Requirements, and 38.156 where it talks about

1 Automated Trade Surveillance Systems.

2 MS. MARKOWITZ: It's Principle 4 rules.

3 CHAIRMAN GENSLER: Nancy, could you help  
4 with Commissioner Chilton's question? Maybe I'm  
5 mistaken and it might be in the preamble, I  
6 thought we referred to high- frequency trading  
7 somewhere.

8 MS. MARKOWITZ: We do in the preamble  
9 but we don't in the rule. What we're proposing  
10 here is --

11 CHAIRMAN GENSLER: What the Commissioner  
12 is proposing?

13 MS. MARKOWITZ: Yes, what the  
14 Commissioner is proposing. I think what we had  
15 proposed is in 38.251.

16 CHAIRMAN GENSLER: Do you have a page  
17 number?

18 MS. MARKOWITZ: 164. The third-to-last  
19 line right after unusual trading volumes.

20 CHAIRMAN GENSLER: This is in the rule,  
21 that monitoring of intraday trading must include  
22 the capacity to detect abnormal price movements,

1 unusual trading volumes, impairments to market  
2 liquidity and position limit violations.

3 MS. MARKOWITZ: What I believe the  
4 Commissioner is proposing is that the monitoring  
5 of intraday trading must include the capacity to  
6 detect abnormal price movements, unusual trading  
7 volumes, the extent of high- frequency trading,  
8 impairments to market liquidity and then the rest  
9 of the sentence is the same, and position limit  
10 violations.

11 CHAIRMAN GENSLER: The words are "the  
12 extent"?

13 MS. MARKOWITZ: The extent of  
14 high-frequency trading.

15 COMMISSIONER O'MALIA: May I ask?

16 CHAIRMAN GENSLER: Yes. The Chair  
17 recognizes Commissioner O'Malia.

18 COMMISSIONER O'MALIA: Thank you. I  
19 know that Commissioner Chilton had circulated some  
20 language before. How would the DCM do that to  
21 detect the extent of high- frequency trading?

22 COMMISSIONER CHILTON: I'll let staff

1 answer, Commissioner O'Malia, but when I spoke  
2 with CME when we were in Chicago last month or  
3 several weeks ago, they acted like they're all  
4 over this already. They told me about their 18  
5 years of experience looking at algorithmic trading  
6 and automated trading and they say that they are  
7 looking at this and they are well aware of what's  
8 going on so that I don't really think it's  
9 anything that would be novel to the exchanges and  
10 of course that's why we get comments on it. But I  
11 think it's something they already do and that it  
12 would just be recognized by some insertion in our  
13 core principles. Nancy, did you want to add  
14 further?

15 MR. SHILTZ: We're not aware now or sure  
16 whether the exchanges have those capabilities in  
17 place to do that but it would be something if it  
18 were required they would have to develop some  
19 mechanism to monitor for that.

20 COMMISSIONER CHILTON: Rick, let me ask,  
21 you're not aware of whether or not they have  
22 systems that monitor algorithmic and

1 high-frequency trading?

2 MR. SHILTZ: Yes, we're not whether all  
3 the exchanges do now or not. They may be in the  
4 process of developing tools to monitor for that  
5 but I don't know off the top of my head and we're  
6 not sure here.

7 COMMISSIONER CHILTON: That's an issue  
8 too and even more reason for adding some of this.  
9 By the way, I don't think that I circulated any  
10 particular language as Commissioner O'Malia was  
11 saying. However staff feels appropriate to  
12 reference high-frequency traders, that's all I'm  
13 trying to get at. I think it would be obvious  
14 that we are missing something if we don't. I'm  
15 not wedded to any particular language, I just want  
16 to reference the high- frequency traders and it  
17 seemed that those two spots made the most sense.

18 CHAIRMAN GENSLER: The two spots again  
19 are 251, and what was the other one?

20 COMMISSIONER CHILTON: 156, the General  
21 Requirement, and then 156 is the Automated Trade  
22 Surveillance System, Mister Chairman.

1                   CHAIRMAN GENSLER: I know we're doing  
2 this ad hoc, but would you be amenable because of  
3 the late moment that we ask a question regarding  
4 38.156 which is Automated Trade Surveillance and  
5 with regard to General Requirements and we'd be  
6 asking whether it would be appropriate to require  
7 them to in 251 to have the capacity to monitor for  
8 high-frequency trading and the similar question in  
9 156?

10                   COMMISSIONER CHILTON: Are you  
11 suggesting that we put it in as a question, Mister  
12 Chairman?

13                   CHAIRMAN GENSLER: Yes, and then  
14 depending on what people say. I'd ask the General  
15 Counsel, but we'd then put people on notice that  
16 we're seriously considering it.

17                   COMMISSIONER CHILTON: To be honest, it  
18 seems incredible that we're not sure if whether or  
19 not all exchanges have systems to monitor  
20 high-frequency trading. It's 30 percent of our  
21 markets, a third of our markets, and 50 percent of  
22 the European markets. It seems to me that this is

1 something that's prima facie stuff we should be  
2 doing. Mister Chairman, if you object to  
3 inserting this, I'll withdraw my motion.

4 CHAIRMAN GENSLER: No, I'm supportive,  
5 but right now the words aren't in front of us so  
6 that I'm trying to find a way to do it that best  
7 accommodates getting the support of this  
8 Commission. I'm supportive that exchanges have  
9 some sense of what's going on. You and  
10 Commissioner O'Malia worked hard, you were both  
11 working on the risk monitoring and market pauses  
12 that are really important. They're not isolated  
13 to high-frequency traders, but it's broadly  
14 applicable. I'm supportive, but I'm trying to  
15 find a way through to get the document amended to  
16 help on this point.

17 COMMISSIONER CHILTON: We've given  
18 staff, Mister Chairman, some discretion on various  
19 things that we've done in our public meetings. If  
20 folks aren't comfortable with giving them the  
21 discretion, perhaps we could ask them to come up  
22 with some suggested language before we conclude

1 here today. If that's not acceptable, we could do  
2 it as a question, but I assume we'd want to see  
3 that question also. But either way it seems that  
4 if staff could come up with something, it would be  
5 helpful. Mister Chairman, I'll do whatever you'd  
6 like in this regard.

7 CHAIRMAN GENSLER: I'm looking at Dan  
8 Berkovitz. I want to ask the question the right  
9 way. What I'm suggesting is to capture  
10 Commissioner Chilton's question in a way that we  
11 appropriately put the public on notice that we're  
12 considering this and that we find what the public  
13 thinks on whether exchanges monitor and have the  
14 capacity to monitor the amount of high-frequency  
15 trading on their platforms.

16 MR. BERKOVITZ: Asking the question in  
17 that manner would certainly be appropriate to get  
18 public comment on that issue. What response the  
19 Commission would take in terms of a new regulation  
20 in response to such comments would have to be  
21 related to the rule as it currently is proposed if  
22 you're not actually amending the rule itself.

1                   CHAIRMAN GENSLER: It's just a question  
2 of whether in this one section should they monitor  
3 the amount of high-frequency trading on their  
4 platforms. I think that's it as I understanding  
5 it.

6                   MR. BERKOVITZ: And depending on how the  
7 final rule is crafted, the Commission may be able  
8 to do it.

9                   CHAIRMAN GENSLER: Commissioner Dunn, do  
10 you have some help here? I'm going to ask one  
11 more question. Nancy, it may be page 150, but  
12 it's 38.251. I'm sorry. I had the wrong one.  
13 251, does not already say that they have to  
14 collect and evaluate data on individual traders'  
15 market activity on an ongoing basis in order to  
16 detect and prevent manipulation?

17                   MS. MARKOWITZ: Yes, it says that.

18                   CHAIRMAN GENSLER: Doesn't that give a  
19 way to collect information on high-frequency  
20 traders? We've been maybe more prescriptive than  
21 Commissioner Chilton is suggesting, but this says  
22 they have to collect and evaluate data on

1 individual traders' market activity. I guess the  
2 only additional question is whether they have to  
3 aggregate a class of traders. Commissioner  
4 Chilton, if you'd be all right, I'd suggest adding  
5 a question that staff can draft but specific  
6 enough that would say the Commission is  
7 considering and would like public comment on  
8 whether we should add that they aggregate such  
9 data so that they can monitor high-frequency  
10 traders more broadly in the aggregate.

11 COMMISSIONER CHILTON: That's fine with  
12 me.

13 CHAIRMAN GENSLER: I'll ask for  
14 unanimous consent for that amendment. Not hearing  
15 any objection, it's so moved. Are there other  
16 questions? Commissioner Chilton was asking his  
17 questions. Commissioner O'Malia?

18 COMMISSIONER O'MALIA: Thank you. By  
19 coincidence I scheduled a meeting in Delaware on  
20 the day before we had over 500 pages of rulemaking  
21 to approve, but it was a helpful meeting. I was  
22 able to go and join Commissioner Phil Moeller from

1 the FERC and to speak to the PJM board meeting and  
2 the discussion built on our previous meeting that  
3 Commissioner Moeller and I held here in this  
4 hearing room on clearing in energy markets. I  
5 want to build on what Commissioner Sommers has  
6 said about the importance of Core Principle 9 and  
7 the impacts this change will have on energy  
8 markets. At the discussion, obviously these are  
9 end users and these are people who are exempt from  
10 clearing and the exchange trading mandate in the  
11 bill but do find and have found for the past 8-1/2  
12 years using the ClearPort system to clear trades  
13 bilateral trades, energy trades. You mentioned  
14 410 contracts, and the fact that we've created  
15 this unique class is part of this exchange for  
16 swaps, EFS. We have clearing but they don't  
17 trade, but the nice thing about these products are  
18 that they do manage risk through clearing,  
19 bilateral risk, they're capital efficient as a  
20 result of the netting arrangements they're able to  
21 do with portfolio margining within their accounts  
22 and on the CME platforms so that these end users

1 really found significant benefit. They're not  
2 under mandate now and they won't be under mandate  
3 in the future. Maybe you have the number. What  
4 is the notional value? I've heard a massive  
5 number of what these over 400 energy contracts are  
6 worth.

7 MS. MARKOWITZ: I don't know the  
8 notional value.

9 COMMISSIONER O'MALIA: Somebody  
10 mentioned that it was multiple times, the futures  
11 value of these similar energy contracts so that  
12 we're talking a big collection of products here  
13 it's all clearing which is the goal of this Act.  
14 Now we have a rulemaking that I'm afraid will  
15 jeopardize that and I think this 85 percent litmus  
16 test and I think that if we're kicking them out in  
17 90 days if they don't meet that is kind of  
18 throwing the baby out with the bathwater. I'm  
19 very concerned about the implications of what will  
20 happen. I've asked staff to go through the rule  
21 and see if we even asked this question, What are  
22 the implications on portfolio margining and what

1 are the implications of the tax treatment of not  
2 treating these as futures but as swap? I  
3 understand that the bill provides a significantly  
4 different tax treatment. Did we include any  
5 questions specifically on portfolio margining and  
6 taxes as a result of this change assuming none of  
7 these are going to be EFSes?

8 MS. MARKOWITZ: Let me first say that  
9 under our proposed rules the end users will still  
10 be able to enter into these contracts as long as  
11 it doesn't exceed a certain percentage which would  
12 be the 15 percent. These contracts are entered  
13 into solely to take advantage of the clearing  
14 aspect of it in terms of using the segregated  
15 customer account, portfolio margining and tax  
16 benefits. These provisions, like I said, they  
17 will continue to be able to trade on the DCM, not  
18 trade, but actually list and then clear through  
19 the DCM as long as it doesn't exceed 15 percent.  
20 However, if it goes beyond 15 percent, they can  
21 execute on a SEF. It's SEF's understanding that  
22 there are going to be provisions proposed or I

1 know staff is thinking about having a segregated  
2 swap customer account that will provide bankruptcy  
3 protection as well as staff is thinking of  
4 propounding a rule allowing futures into the swap  
5 accounts so there will be portfolio margining. So  
6 there are alternatives.

7 COMMISSIONER O'MALIA: But if we don't  
8 change Core Principle 9, they get that benefit  
9 today, they may not get this benefit going  
10 forward. You've laid out a couple of options and  
11 things we may approve and consider, but betting  
12 that this will all fall into place and that they  
13 will not choose to use their end user exemption to  
14 go back into a bilateral space. They're end  
15 users. They're electricity companies and energy  
16 companies.

17 MS. MARKOWITZ: The difference  
18 post-Dodd-Frank is that they now have a clearing  
19 solution, that they can now have their contracts  
20 cleared which is why initially they opted to list  
21 through EFS process on the DCM, it was purely to  
22 get the clearing aspect of and now their contracts

1 can be cleared so that I'm not sure they're going  
2 to be harmed in any way in terms of this  
3 percentage requirement because they are going to  
4 be cleared which is why they initially went on --

5 COMMISSIONER O'MALIA: But what is the  
6 impact on taxes and portfolio margining as a  
7 result of all of this?

8 MS. MARKOWITZ: As I said and as I  
9 understand, staff is considering allowing futures  
10 to be in the swap account which will allow  
11 portfolio margining. And in terms of the tax  
12 benefits, our rule implemented the Commodity  
13 Exchange Act and we didn't deal with the tax code  
14 and what the tax consequences are.

15 COMMISSIONER O'MALIA: But it is a  
16 factor. It's got to be a factor.

17 MS. MARKOWITZ: It's a factor for these  
18 entities I assume.

19 MR. LAVE: I don't know if it's a  
20 factor. I don't know how we can take account of  
21 the tax code in our regulations in implementing  
22 the Commodity Exchange Act.

1                   COMMISSIONER O'MALIA: Can we ask a  
2 question to find out? Do we ask the question?

3                   MS. MARKOWITZ: No, we don't ask the  
4 question.

5                   COMMISSIONER O'MALIA: We don't ask the  
6 question. I have asked staff to take the liberty  
7 of drafting two questions here and I think it's  
8 appropriate that I'll share with everybody else  
9 rather than read them. I'll pass this down the  
10 line here. I have two questions, one on what is  
11 the impact on portfolio margining in making these  
12 changes, and then one is the impact on taxes.

13                  CHAIRMAN GENSLER: I would say I would  
14 support the first but not the latter. I don't  
15 think we're a tax writing agency and I think we  
16 have to comply with the Commodity Exchange Act.

17                  COMMISSIONER O'MALIA: I don't disagree  
18 with either of those. We are not a tax writing  
19 agency and we will comply with this, but can we  
20 ask the questions of what the industry impacts  
21 might be? This could be a tax increase for a lot  
22 of end users potentially. I don't know.

1           CHAIRMAN GENSLER: I don't know how that  
2 would influence you, but it wouldn't influence me.  
3 I'm saying that I think that we have to comply  
4 with the Commodity Exchange Act and what you have  
5 here is Congress changed Core Principle 9. And by  
6 the way, on portfolio margining, I think that's  
7 subject to self-help. We can make futures swaps  
8 be in similar accounts, that is, the five of us  
9 can as long as we comply with the Commodity  
10 Exchange Act.

11           COMMISSIONER O'MALIA: In developing our  
12 enlightened rule, wouldn't it be helpful to have  
13 the input from the market now or as soon as we can  
14 get it within the next 60 days?

15           CHAIRMAN GENSLER: Absolutely.

16           COMMISSIONER O'MALIA: Let me circulate  
17 this. If you want me to read it, I'd be happy to  
18 read it. If you want to have staff take a look at  
19 it, by all means. I would like to have both  
20 questions asked and I will ask unanimous consent  
21 to do that. While you're taking a look at that,  
22 let me go on to the next question. Reconciling

1 Section 735 which allows boards of trade to have  
2 rules that permit EFS and then also 723 which is  
3 statutory language that allows swaps in futures to  
4 be traded on DCMs, those obviously provide for  
5 having EFS on these things and yet we've got a  
6 very strict limiting rule that would kick them  
7 out.

8 MS. MARKOWITZ: We have two mandates  
9 here in Core Principle 9. One is to protect the  
10 price discovery process of trading on the  
11 centralized market, and the other one is a  
12 recognizing that bona fide off-exchange  
13 transactions are allowed and to marry these two  
14 goals or try to balance them we've proposed the 85  
15 percent with the 15 percent off- exchange, and  
16 again I say propose because we have asked the  
17 public if this is the right amount to do so. I do  
18 not think that requirement is inconsistent with  
19 the statutory requirement that clearable swaps  
20 should be either on a DCM or a SEF because we are  
21 not pushing swaps off the DCM. What we are saying  
22 is though if you are going to trade on the DCM

1 then you have to trade in an open and competitive  
2 manner and I think this is consistent with  
3 Dodd-Frank's overall purpose of having these swaps  
4 be transparently traded either on a SEF or on a  
5 DCM.

6 COMMISSIONER O'MALIA: You do recognize  
7 there is a conflict here, that we have a conflict  
8 that allows for this and yet we're being pretty  
9 strict about the priority of having the exchange  
10 trading requirement?

11 MS. MARKOWITZ: What staff tried to do  
12 is provide a balance with what we saw and based on  
13 --

14 COMMISSIONER O'MALIA: Trying to balance  
15 the two competing factors.

16 MS. MARKOWITZ: The two goals or  
17 recognitions I should say in Core Principle 9, one  
18 is to protect the price discovery process and the  
19 other one is the recognition that in certain  
20 situations bona fide off-exchange transactions  
21 should be allowed as long as they're allowed by  
22 the exchange. As I said before, we tried to come

1 up with a future. We thought an absolute figure  
2 of how much exchange trading should be allowed  
3 would be an appropriate way to provide certainty.  
4 We looked at statistics and based on those  
5 statistics came up with an 85-percentage based on  
6 what the data showed us. Again it was a proposal  
7 and we opened it up to public comment as to  
8 whether that's an inappropriate proposal.

9 MR. LAVE: To add something, the goal  
10 here isn't necessarily to say that these types of  
11 contracts can't be listed on the DCM, it's the  
12 manner of execution and I think the whole  
13 fundamental principle of Dodd-Frank with respect  
14 to swaps is that they're clearable and made  
15 available for trading and they're executed on a  
16 trading facility, a trading system like a SEF or  
17 they can be done on a DCM. It wouldn't  
18 necessarily mean they're not listed on the DCM,  
19 it's that the DCM could find a way so that these  
20 would be executed on their centralized market or  
21 some trading of a trading facility and not done  
22 bilaterally away from some sort of a trading

1 platform. And as I was saying, I think one of the  
2 fundamental goals of Dodd-Frank for swaps is that  
3 they if they're clearable and made available for  
4 trading that they be done on a SEF through a  
5 trading platform and that if they're going to be  
6 done on a DCM as a future then similar types of  
7 open and competitive trading should be required.  
8 And to some extent, many of these same contracts  
9 that have no trading are traded on EIS. A lot of  
10 those were the SPIDICs (?) that we determined so  
11 that it's not obvious that these could not be done  
12 on some sort of a centralized marketplace.

13 COMMISSIONER O'MALIA: I agree. That  
14 brings me to my next point. You have a  
15 requirement of mandatory delisting within 90 days  
16 and 90 days is a pretty quick turnaround after  
17 this determination is made. Should be maybe  
18 consider a longer period of time in order to get  
19 that liquidity once people understand that faced  
20 with this opportunity that they may decide that it  
21 would be better to go with an EFS proposal as  
22 opposed to going with a SEF, whether it's

1 portfolio margining or taxes?

2 MS. MARKOWITZ: Commissioner, the 90  
3 days does not apply to the existing contracts that  
4 are on the market. In fact, we have a fairly  
5 generous I should say provision in there that  
6 allows the existing contracts prior to the  
7 implementation on the effective date of the  
8 Dodd-Frank Act to remain listed on the DCM until  
9 either their positions are closed or they  
10 liquidate, and during any of those periods of time  
11 if they start to trade, they can remain on the  
12 DCM. In the past we've tried to encourage these  
13 contracts to be traded by asking -- the contracts  
14 can implement various programs to generate  
15 interest in trading these like market-maker  
16 programs or incentive programs and none of them  
17 have used this. So during this period of time,  
18 some of these contracts go off for 3 years and  
19 we're allowing them to stay on the exchange, they  
20 can try to get trading.

21 COMMISSIONER O'MALIA: I'm happy to make  
22 the change on the language that takes out the word

1 tax and I would obviously ask any commenters if  
2 they have an opinion on taxes, they may not, to go  
3 ahead and offer them. We won't state specifically  
4 tax treatment and I know we're running this by  
5 Commissioner Chilton to make sure he's comfortable  
6 with it, but until he's fully informed I'd ask  
7 that we hold off on taking a vote until we get  
8 this resolved somehow. I don't want to put him in  
9 a difficult position somehow. I don't want to put  
10 him in a difficult position.

11 CHAIRMAN GENSLER: Commissioner Chilton,  
12 do you want us to read the suggested two questions  
13 to you verbally? It was just sent to you  
14 electronically. Why don't you take a look at it?  
15 I was going to say a few words on this Core  
16 Principle 9. Again I do this for the public.  
17 There's a lot to learn when you get into one of  
18 these jobs, but as I understand it some number of  
19 years ago the energy markets and then some other  
20 markets but it started in the energy markets  
21 wanted to bring swaps to clearinghouses and the  
22 way that that was facilitated was through this

1 exchange of futures for swaps or EFS mechanism. I  
2 don't know why it's not called ESF, exchange swap  
3 for future. And this mechanism actually helped  
4 lower risk in the marketplace where swaps were  
5 being cleared but the only way to actually clear  
6 them was to call them a future. That's in essence  
7 what happened 7, 8 or 9 years ago as I understand  
8 it in some of the markets.

9 COMMISSIONER O'MALIA: One important  
10 factor in all of this and why this took off was we  
11 had the meltdown or Enron and credit quality was a  
12 significant factor and clearing was a great  
13 solution.

14 CHAIRMAN GENSLER: I think Commissioner  
15 O'Malia is right. Now with the passage of  
16 Dodd-Frank we have a lot of changes. One is a  
17 full regulatory regime for clearing of swaps, a  
18 full regulatory regime for the trading of swaps on  
19 either swap execution facilities or designated  
20 contract markets and new Core Principle 9 about  
21 open and competitive markets on futures markets,  
22 designated contract markets I'm saying loosely,

1 brings these cleared-only products because most of  
2 them, 410, don't really trade, into focus. What  
3 the staff has recommended is that in compliance  
4 with Core Principle 9 since there really isn't any  
5 trading, it walks like a duck, it quacks like a  
6 duck, that it's a swap. The difference between  
7 swap and futures is in some economic way not  
8 anything different, but one difference Congress  
9 made was Core Principle 9 that says you've got to  
10 have an open and competitive market for the price  
11 discovery function and I'm supporting this because  
12 staff is saying when there's no trading it doesn't  
13 comply with Core Principle 9. I think you raised  
14 legitimate questions about portfolio margining. I  
15 think that's subject to self-help. I think that  
16 we can ask staff to come forward with very robust  
17 ways that these things can still be portfolio  
18 margined.

19 I think staff has also recommended a  
20 long phase period. If it's a 3-year contract,  
21 they can continue to list it, trade out of it and  
22 so forth for those 3 years or even if it's a

1 longer period of time. I'm supporting it because  
2 I think it promotes clearing but there will be  
3 called swaps probably instead of futures. I don't  
4 know if the 85-percent test is going to be in the  
5 final rule, but if there is some percentage in the  
6 final rule it's going to be more than zero percent  
7 and that's what they're trying to address.

8 COMMISSIONER O'MALIA: I appreciate that  
9 and I appreciate the explanation. I think you're  
10 absolutely right. My concern is something where  
11 we have a good advantage. It's a great  
12 opportunity and we've got billions or dollars that  
13 are being cleared.

14 CHAIRMAN GENSLER: I share your view that  
15 we want to keep that in the clearinghouses.

16 COMMISSIONER O'MALIA: I'm concerned  
17 that using the end user exemption which they're  
18 perfectly entitled to that they could walk away  
19 from it and we may not get exchange trading, but  
20 we may also lose clearing and I think that would  
21 be a big loss. One of the reasons why I will  
22 oppose this rule, but I have one more question if

1 I may so I can keep dancing.

2 CHAIRMAN GENSLER: Absolutely.

3 COMMISSIONER O'MALIA: The proposal for  
4 Core Principle 9 contains a regulatory requirement  
5 regarding block trades and the preamble notes that  
6 these requirements were noticed before in 2008 in  
7 a separate NOPR clearly predating my time here. I  
8 under that that NOPR didn't go forward, that we  
9 didn't implement it. What were some of the  
10 criticisms then that we should be mindful of  
11 today?

12 MS. MARKOWITZ: Many of the comments  
13 were against block trades and many of them were  
14 that the block trade sizes were too large, that  
15 there should be regulations as to block sizes. I  
16 would say that would be 95 percent of the comments  
17 that were against block trades or that there be a  
18 more prescriptive number or size. The feeling was  
19 that guidance in many respects was easy to get  
20 around and would be manipulated and they found a  
21 lack of liquidity on the market because of all the  
22 off-exchange trading.

1                   CHAIRMAN GENSLER: Commissioner Chilton?  
2 Commissioner O'Malia has two questions, one on  
3 portfolio margining and one on any other negative  
4 consequences.

5                   COMMISSIONER CHILTON: I don't have any  
6 objection to adding the questions. I do think the  
7 proposal was intended to promote transparency as  
8 to what the goal of the bill and I think the  
9 proposal does that, but I don't have any  
10 objections to the questions.

11                  CHAIRMAN GENSLER: I think there is a  
12 unanimous consent request to add two questions,  
13 one on portfolio margining and one on whether  
14 there's any negative consequences. It doesn't  
15 mention taxes anymore. Not hearing any objection,  
16 the unanimous consent motion is passed.

17                  COMMISSIONER O'MALIA: I think my  
18 colleagues for their indulgence.

19                  CHAIRMAN GENSLER: With that I will move  
20 the original question that had been properly made  
21 and seconded. Dave Stawik, will you call the  
22 roll?

1 MR. STAWIK: Commissioner O'Malia?

2 COMMISSIONER O'MALIA: No.

3 MR. STAWIK: Commissioner O'Malia, no.

4 Commissioner Chilton?

5 COMMISSIONER CHILTON: Aye.

6 MR. STAWIK: Commissioner Chilton, aye.

7 Commissioner Sommers?

8 COMMISSIONER SOMMERS: No.

9 MR. STAWIK: Commissioner Sommers, no.

10 Commissioner Dunn?

11 COMMISSIONER DUNN: Aye.

12 MR. STAWIK: Commissioner Dunn, aye.

13 Mister Chairman?

14 CHAIRMAN GENSLER: Aye.

15 MR. STAWIK: Mister Chairman, on this  
16 matter the votes are three ayes, two no's.

17 CHAIRMAN GENSLER: Thank you. Thank you  
18 very much, Nancy, Rick, Nadia and the other 15  
19 people. This is a really important process. I  
20 think all of the Commissioners too because this  
21 one is going to be very important to get public  
22 comment and get it right come next spring or

1 summer. With that we're going to invite up the  
2 next team unless the Commissioners want to take  
3 any breaks or we just keep moving. For the  
4 public, we're going to take a 5- or at most  
5 10-minute break as the teams are switching out.

6 (Recess)

7 CHAIRMAN GENSLER: Thank you for coming  
8 back today. These cupcakes are small and I don't  
9 want you think it's because we don't have much  
10 funding. Is Commissioner Chilton with us as well?  
11 Make sure he knows we're back on.

12 Sarah Josephson from the Division of  
13 Clearing and Intermediary Oversight will now  
14 present the staff report on the proposed rule  
15 relating to reporting, recordkeeping, daily  
16 trading records, requirement of swap dealers and  
17 major swap participants, and Ananda Radhakrishnan  
18 who runs the division. Sarah, we thank you  
19 because this is your second time in the chair and  
20 in terms of scheduling, on the business conduct  
21 rules we have the External Business Conduct Rule  
22 team with Phyllis Cela. I think you are going to

1 be up in the chair next week. Again, this could  
2 be 2 weeks away, but we're hopefully scheduling  
3 that for this December 9 meeting. I think we're  
4 looking to do the SEF rules also December 9 and  
5 the end user piece, and there is also another  
6 price of governance. I think those are the four.  
7 Is Bart back on?

8 COMMISSIONER CHILTON: I'm here, Mister  
9 Chairman.

10 CHAIRMAN GENSLER: Great. Also on  
11 business conduct, the internal rules, Sarah and  
12 Ananda, you'll be back in front of us I guess on  
13 December 16 with some rules. We're going to do  
14 all the documentation rules then. We've decided  
15 now in the last couple of days maybe to delay some  
16 of the documentation because the capital margin is  
17 delayed until January and we thought as it related  
18 to documentation for what's called credit support  
19 agreements, master netting agreements and  
20 valuation and dispute resolution, that piece of it  
21 we're going to delay into January to get the  
22 benefit of any roundtable thoughts that come from

1 that. But on December 16 you are also in the  
2 chair again on confirmations so that some piece of  
3 the documentation piece such as confirmations and  
4 portfolio compression. Why don't I now turn it  
5 over since I've filibustered a bit there?

6 MS. JOSEPHSON: Good afternoon, and  
7 while it's just Ananda and me at the table today,  
8 I have an excellent team and there wouldn't be  
9 enough chairs if we had brought them all up here.  
10 They've all been incredibly helpful and it's been  
11 a collaborative effort so that I wanted to  
12 recognize them and also thank the Commissioners  
13 and their staff people for very, very helpful  
14 comments as we go through this process.

15 Today staff is presenting for the  
16 Commission's consideration one notice of proposed  
17 rulemaking for publication in the Federal Register  
18 regarding reporting, recordkeeping and daily  
19 trading records for swap dealers and major swap  
20 participants. Section 731 of the Dodd-Frank Act  
21 amended the CEA, Commodity Exchange Act, by  
22 inserting a new Section 4(a). Today the rules

1 that we'll be proposing relate to Section 4(s)(F),  
2 a recordkeeping and reporting section, and  
3 4(s)(G), the daily trading records section.

4 Section 4(s)(F) requires that swap  
5 dealers and major swap participants make reports  
6 regarding transactions, positions and financial  
7 condition of the registered swap dealer or major  
8 swap participant. This section also authorizes  
9 the Commission to set forth books and records  
10 requirements for, and I'm quoting here, "All  
11 activities related to the business of the swap  
12 dealer or the major swap participant regardless of  
13 whether or not that entity has a prudential  
14 regulator in addition to the Commission or if the  
15 Commission is the sole regulator of the swap  
16 dealer or major swap participant." All books and  
17 records are to be open to inspection and  
18 examination by representatives of the Commission  
19 and for records that relate to security-based swap  
20 agreements, those records must also be open to  
21 inspection by representatives of the Securities  
22 and Exchange Commission.

1           Section 4(s)(G) requires that swap  
2       dealers and major swap participants maintain daily  
3       trading records of their swaps and all related  
4       records including records of related cash and  
5       forward transactions. This section also requires  
6       swap dealers and major swap participants to  
7       maintain recorded communications including  
8       electronic mail, instant messages and recordings  
9       of telephone calls. Finally, Section 4(s)(G)  
10      requires that daily trading records for swaps be  
11      identifiable by counterparty and transaction and  
12      specifies that swap dealers and major swap  
13      participants maintain a complete audit trail for  
14      conducting comprehensive and accurate trade  
15      reconstructions.

16           Staff is recommending one NPRM, but it  
17      contains separate rules. Four of those rules  
18      relate to recordkeeping, only two of them are  
19      reporting requirements. The two reporting  
20      requirements are Rules 23204 and 23205 and those  
21      would require that swap dealers and major swap  
22      participants report in accordance with the

1 real-time public reporting rules and the swap data  
2 rules, reporting to swap data repositories. The  
3 substance of those rules was voted on and proposed  
4 by the Commission at its November 19 meeting. In  
5 essence it's a cross-reference. Those are the  
6 reporting requirements, so that now I'll proceed  
7 to describe the required records and I'll note at  
8 the outset here that the first rule, 23200, is  
9 just definitions for the rules that will follow  
10 for this part. I'd like to highlight two of the  
11 definitions and thank the Commissioners' staff for  
12 these excellent recommendations. There is the  
13 complaint definition where we elaborated on the  
14 complains that swap dealers and swap participants  
15 will be required to retain and that will be formal  
16 or informal complaints, grievances or criticisms  
17 communicated to the swap dealer or major swap  
18 participant related to any trading conduct or  
19 behavior. The other definition, and this is  
20 important for the daily trading record, is the  
21 definition of related cash or forward  
22 transactions. There we're proposing a rule that

1 would define that category to be a purchase or  
2 sale for immediate or deferred physical shipment  
3 or delivery of an asset related to a swap where  
4 the swap where the swap and the related cash or  
5 forward transaction are used to hedge, mitigate  
6 the risk of or offset one another.

7 Proposed Rule 23201 is the required  
8 records rule. This relates to transaction and  
9 position information. Records would include and  
10 complete transaction and position information for  
11 all swaps including all documents in which the  
12 trade information is originally recorded. This  
13 would mean generally speaking documents  
14 customarily generated in accordance with market  
15 practice. The records would be required to be  
16 maintained in a manner that is identifiable and  
17 searchable by transaction and by counterparty. As  
18 to swap dealers and major swap participants, we  
19 are proposing the requirement that they keep  
20 general business records, things like board  
21 meeting minutes, organizational charts, audit  
22 documentation and general financial records,

1       although I'll note that this is not the financial  
2       condition reporting rule, this is just the  
3       recordkeeping rule, complaints as I mentioned  
4       before, a record of that complaint and how it was  
5       resolved and marketing and sales materials.

6               Finally, in Rule 23201 there is a  
7       section on keeping records that supports the  
8       reporting to a swap data repository or for  
9       real-time purposes. In particular I'd like to  
10      highlight that for the records that must be  
11      maintained for real-time reporting, that would  
12      include when the swap dealer or major swap  
13      participant has elected to use a less-specific  
14      data field to protect the anonymity of the market  
15      participants and then records relating to  
16      determinations made about block trades and large  
17      notional swaps.

18              Proposed Rule 23202 relates to daily  
19      trading records. The proposed rule would require  
20      swap dealers and major swap participants to ensure  
21      that they preserve all information necessary to  
22      conduct the comprehensive and accurate trade

1 reconstructions for each swap and that they  
2 maintain each record as a separate electronic file  
3 identifiable and searchable again by transaction  
4 and counterparty. What we've done is we've  
5 divided the rule up into preexecution data,  
6 execution data and postexecution data which is  
7 important for swaps because unlike some of the  
8 derivatives that we're used to regulating, the  
9 posttrade transaction data is especially relevant  
10 and the preexecution trade data would include  
11 records of all oral and written communications  
12 that lead to the execution of a swap. This  
13 includes records of all telephone calls, voice  
14 mails, faxes, instant messaging, chat rooms,  
15 email, mobile devices and other digital or  
16 electronic media. This would require swap dealers  
17 and major swap participants to maintain records of  
18 telephone calls and other communications created  
19 in the normal course of its business but would not  
20 establish an affirmative new requirement to create  
21 recordings of all telephone conversations if the  
22 complete audit trail requirement can be met

1 through other means such as electronic messaging  
2 or trading. I would note here, and this is  
3 discussed at some length in the preamble as  
4 Commissioner O'Malia noted at the outset of this  
5 meeting, that many jurisdictions around the world  
6 require recordings of all telephone and electronic  
7 conversations including the United Kingdom, Hong  
8 Kong, Spain, Sweden and France among numerous  
9 other jurisdictions and that's to prevent or to be  
10 able to detect market abuse or fraud manipulation.

11 The execution trade data would include  
12 all terms of each executed swap and the date and  
13 time of execution to the nearest minute and that  
14 is similar to existing CFTC Rule 135 for  
15 designated contract markets. Postexecution data  
16 would include records of all terminations,  
17 novations, reconciliation, margining, a whole  
18 series of posttrade processing events that it's  
19 important to record. Sometimes these are referred  
20 to as life-cycle events but it's all the  
21 postexecution processing. Then there is a section  
22 of this rule on the records related to cash and

1 forward transactions and again generally we've  
2 followed the same preexecution, execution and  
3 postexecution requirements there. Staff believes  
4 that requiring one approach to recordkeeping will  
5 be simpler for swap dealers and participants to  
6 implement and will provide the Commission with the  
7 necessary information for its regulatory  
8 oversight.

9 The last rule is an retention and  
10 inspection rule, how you should keep the data.  
11 For the most part that references an existing  
12 Commission rule, Rule 131, and it says that you  
13 must retain them 5 years overall retention and 2  
14 years readily available. Then there is an  
15 exception for swaps and related cash and forward  
16 positions which must be retained for a longer  
17 period of time and in accordance with Part 45, the  
18 data rules that again the Commission considered at  
19 the November 19 meeting.

20 CHAIRMAN GENSLER: Thank you, Sarah.  
21 The Chair would entertain a motion on this staff  
22 recommendation on swap dealer recordkeeping and

1 reporting.

2 COMMISSIONER DUNN: So moved.

3 COMMISSIONER SOMMERS: Second.

4 CHAIRMAN GENSLER: I support the  
5 proposed rule regarding reporting and  
6 recordkeeping and will have a comment for the  
7 record. I think it establishes important mandates  
8 that Congress recommended that swap dealers and  
9 major swap participants are required to maintain  
10 records. Most of this is for regulators and not  
11 for the public, in fact all of it, though with the  
12 information that might be available to the public  
13 would be reporting to swap data repositories or  
14 possibly through the real-time reporting rule that  
15 we had promulgated and are looking forward to  
16 public comment on. I do think it's important to  
17 promote transparency to the regulators and to  
18 promote market integrity so that I don't have any  
19 questions on it. Commissioner Dunn?

20 COMMISSIONER DUNN: Thank you, Mister  
21 Chairman. I too support those provision. Sarah,  
22 we say that the Commission recognizes that there

1 will be differences in the size and scope of the  
2 business of particular swap dealers and major swap  
3 participants. Therefore, comments are solicited  
4 on whether certain provisions of a proposed  
5 regulation should be modified or adjusted to  
6 reflect the differences among swap dealers and  
7 major swap participants. Could you amplify for me  
8 on what staff deems as differences?

9 MS. JOSEPHSON: This same paragraph  
10 appeared in the rule that we proposed the first  
11 time I appeared before the Commission on the  
12 duties and the goal is to address the concerns  
13 that have been expressed or to invite comment on  
14 the differences that may exist between swap  
15 dealers and major swap participants in terms of  
16 the scale of their operations and the extent to  
17 which they have particular operational capacities.  
18 It's a general invitation to comment specifically  
19 and there are some places in the preamble where we  
20 direct the public's attention to key areas.  
21 That's I think what we're thinking, give us the  
22 information we need to craft the final rule

1 proposal that would be responsive to the needs of  
2 the marketplace.

3 COMMISSIONER DUNN: Thank you.

4 CHAIRMAN GENSLER: Sarah, while we're  
5 not there yet, I'm hopeful that commenters will  
6 share with us if you're a swap dealer and you're  
7 doing hundreds of transactions a year, that might  
8 be a different implementation phase than if you're  
9 a swap dealer doing 200 trades a year. You're  
10 still a swap dealer but maybe by scale the largest  
11 among them would implement this rule a little  
12 faster.

13 MS. JOSEPHSON: Right. I think that's  
14 the other part, that in addition to tailoring the  
15 rules themselves there could be an implementation  
16 phased approach that some of the larger swap  
17 dealers would have more timely implementation and  
18 so that we'd consider and invite comments on the  
19 implementation, the phasing or a tiered approach  
20 is something that we would consider.

21 CHAIRMAN GENSLER: Commissioner Sommers?

22 COMMISSIONER SOMMERS: Thank you, Mister

1 Chairman. I have some questions about the  
2 collection of preexecution data. What do you  
3 believe is the relevance of getting all of that  
4 data and what is typically expected to be captured  
5 when we are asking for all of this? What exactly  
6 are we looking for?

7 MS. JOSEPHSON: I think this elaborated  
8 a bit in the preamble, but to highlight that, our  
9 understanding is that the Enforcement Division has  
10 been very successful in proving market  
11 manipulation and market disruption cases, false  
12 reporting cases where they've had better audit  
13 trails and it's the preexecution information that  
14 contributes to as is required in the statute the  
15 complete and comprehensive audit trail so that  
16 everything that gives rise to an execution of a  
17 swap or a transaction. That's what we're looking  
18 for, and in the rule itself for the daily trading  
19 records, reliable data or information about the  
20 initiation of the trade, the records of all of the  
21 conversations back and forth related to the  
22 prices, the bids, offers at which you would

1 ultimately execute a swap, but that back and forth  
2 especially for swap dealers and major swap  
3 participants who are executing bilaterally, that's  
4 what we're looking at and we think it would be  
5 very helpful for understanding market practice and  
6 also as part of the enforcement regime.

7 COMMISSIONER SOMMERS: I think I  
8 understand for enforcement purposes, but I do have  
9 some questions about if two counterparties are  
10 executing a bilateral swap how we can after the  
11 fact glean from preexecution data say they didn't  
12 accept the best offer or the best bid, how do we  
13 know that there weren't other factors being  
14 contemplated? I'm unclear about how that's  
15 helpful to us.

16 MS. JOSEPHSON: I think I would defer to  
17 my colleagues in Enforcement on how they would  
18 create a case. I think part of your question goes  
19 to the issue of how you would use the information.

20 COMMISSIONER SOMMERS: I understand for  
21 enforcement purposes, but besides that if there's  
22 any other reason why if we plan to audit

1 preexecution data for any other purposes besides  
2 enforcement.

3 MS. JOSEPHSON: I think the primary  
4 reason would be for enforcement purposes.

5 CHAIRMAN GENSLER: Thank you,  
6 Commissioner Sommers. Commissioner Chilton? Is  
7 Commissioner Chilton on?

8 COMMISSIONER CHILTON: Yes, I'm here,  
9 Mister Chairman. We had a couple of questions in  
10 the last rule and I wonder whether or not, Sarah,  
11 this would be an appropriate one to ask the  
12 question on whether or not swap dealers and major  
13 participants should be required to report as a  
14 separate category records relating to  
15 high-frequency trading activity. Would you see  
16 any issue with asking that question?

17 MS. JOSEPHSON: Commissioner Chilton, I  
18 think the way that I would generally respond to  
19 that is that at least my understanding right now  
20 is that high-frequency trading is not prevalent in  
21 the swaps markets and in the over-the-counter  
22 derivatives markets and I think that I would

1 ultimately again refer to some of my colleagues  
2 who are actively working on these issues right  
3 now. But at least my understanding is that  
4 high-frequency trading, that sorts of algorithmic  
5 trading practices that are of concern in organized  
6 markets and the trading platforms are not  
7 prevalent in the OTC derivatives markets at this  
8 time. But it is something that we would continue  
9 to look at and as that work continues to be  
10 developed it could be a consideration for  
11 additional rulemaking on a particular reporting  
12 requirement, not reporting, sorry, this would be a  
13 recordkeeping requirement now.

14 COMMISSIONER CHILTON: Let me ask this  
15 then, and this is I guess a question for counsel.  
16 If we don't ask a question about whether or not,  
17 and I'm not disputing what you've suggested that  
18 high-frequency trading isn't as prevalent in the  
19 swaps market, I tend to agree, but the whole issue  
20 behind this legislation is that we don't know  
21 what's going on in some of these markets and so  
22 we're getting more information. The question is

1 if we don't ask such a question here specifically  
2 in this proposal, would we be precluded from  
3 inserting something if during the comment process  
4 we determine that maybe we did want to require  
5 reports that are separated by category? If we  
6 don't ask the question now, are we precluded from  
7 requiring it later if we determine a need?

8 CHAIRMAN GENSLER: Dan Berkovitz has  
9 come to the mike.

10 MR. BERKOVITZ: Commissioner, the  
11 question would be in the final rulemaking whether  
12 the final rule was a reasonable or logical  
13 outgrowth of the proposed rule so that it would  
14 depend on exactly how the proposed rule is worded  
15 in relation to the final rule.

16 COMMISSIONER CHILTON: It seems to me  
17 that we should preserve the option of doing  
18 something. Nobody is thinking that everything  
19 that we ask questions on we're going to do, but  
20 once swaps become traded on exchanges, it seems to  
21 me that high-frequency trading reporting might be  
22 something given the sorts of numbers I talked

1 about on the earlier proposals that we would want.  
2 I'm not sure we would, but it seems like a  
3 reasonable question. Mister Chairman, I'd like to  
4 add that question to preserve the Commission's  
5 options regardless of whether or not we end up  
6 doing anything.

7 MR. RADHAKRISHNAN: Let me point out  
8 something. Wouldn't that be covered by the  
9 covered by the proposed regulations for DCMs?  
10 There was some question on high- frequency trading  
11 with DCMs so maybe that would be covered. Bart,  
12 do you think they would be covered that way? I  
13 think the point is, and correct me if I'm wrong,  
14 you only get high-frequency trading when you have  
15 a platform. If you don't have a platform there is  
16 no such thing as high- frequency trading so that  
17 maybe it would be covered by the DCM rules.

18 COMMISSIONER CHILTON: It could be,  
19 Ananda. I'm not suggesting that we should  
20 actually do this, but given the responses we got  
21 earlier, it's clear to me we don't know enough and  
22 so I want to preserve the Commission's flexibility

1       rather than forestall options given what our  
2       General Counsel told me which was maybe perhaps if  
3       you wrote it a certain way. I don't know why we  
4       would tie one hand behind our backs to begin with.  
5       It's a simple question to preserve the option. If  
6       it's a duplicative question, Ananda, or it doesn't  
7       matter, we can toss it out with the bath water.  
8       Again, Mister Chairman, I'd like to ask the  
9       question.

10               CHAIRMAN GENSLER: I'm asking if there  
11       is any objection to unanimous consent to include a  
12       question in this rule as Commissioner Chilton has  
13       laid out. Not hearing any objection, we'll add  
14       the question.

15               COMMISSIONER CHILTON: Thank you, Mister  
16       Chairman. I don't have any other questions.

17               CHAIRMAN GENSLER: Commissioner O'Malia?

18               COMMISSIONER O'MALIA: Thank you.  
19       Sarah, I'd like to ask you a question regarding  
20       our existing recordkeeping rules. It's my  
21       understanding that under Rule 1.35, FCMs, IBs and  
22       members of contract markets do not an audit trail

1 for voice conversation requirement, yet this rule  
2 does. Is that something we're going to fix or is  
3 that under consideration for changing our existing  
4 rule?

5 MR. RADHAKRISHNAN: I think the preamble  
6 states that there is a DMO advisory that said that  
7 1.35 applies to records that are created or  
8 retained in electronic format including email,  
9 instant messages and other forms of communication.

10 COMMISSIONER O'MALIA: What about voice?

11 MR. RADHAKRISHNAN: The statute has a  
12 specific requirement that the Commission  
13 promulgate a regulation for voice communications  
14 for swap dealers and major swap participants. I  
15 don't know whether the CEA has a specific  
16 requirement for FCMs but I do know that the  
17 Enforcement Division was working on a proposed  
18 rule and I can find out where that rule is.

19 CHAIRMAN GENSLER: Could I help out a  
20 little bit? One of the things that's occurred,  
21 and here I am revealing something, we now have a  
22 thirty-first team. Everybody has heard about

1       these 30 teams. One thing that occurred to us  
2       some time ago is that the rules for futures  
3       commission merchants, the rules for introducing  
4       brokers, for commodity pool operations, for  
5       commodity trading advisers, other various  
6       intermediaries, may need to be conformed, it might  
7       be a lot of boring technical stuff, but conformed  
8       given the definition Act. In addition, there may  
9       be issues just like Commissioner O'Malia is  
10      raising. William Penner is heading that up. I  
11      don't know that it will be all in front of us in  
12      January, but all of what I'll call the  
13      intermediary conforming amendments, and  
14      particularly as Dodd-Frank included in the  
15      definition of introducing broker, commodity  
16      trading adviser, futures commission merchant and  
17      others, for the first time the word swap was  
18      inserted in each of these. William Penner is  
19      going through and I think this is a question that  
20      I would hope would be put into that team's  
21      efforts.

22                   MR. RADHAKRISHNAN: We actually base

1       this language on that draft that I mentioned.  
2       William has got that draft so it will probably be  
3       part of the package that will come to the  
4       Commission on these conforming amendments, and get  
5       ready for an avalanche because there are a lot of  
6       them when we do these conforming amendments.

7                   CHAIRMAN GENSLER:  Ananda, we've already  
8       had that.

9                   COMMISSIONER O'MALIA:  Proposed Rule  
10       23201 requires that records of each transaction be  
11       kept in a form and manner identifiable and  
12       searchable by transaction and counterparty.  These  
13       records include everything from cancelled orders,  
14       warehouse receipts, to phone calls and instant  
15       messages.  Correct?

16                   MS. JOSEPHSON:  Yes, both read together.

17                   COMMISSIONER O'MALIA:  From an interest  
18       in technology, how easy is that to do, to search  
19       by transaction and counterparty?  Is that  
20       something they easily code?  Is that more  
21       difficult than it sounds?

22                   MS. JOSEPHSON:  Our understanding is

1       that currently entities that have swaps on their  
2       books and derivatives generally, they have  
3       internal mechanisms for tracking those, that they  
4       have a unique identifier that's internal that they  
5       use to keep track of things and we're not  
6       prescribing that. What I will mention is that the  
7       rules do cross-reference to the extent the swaps  
8       have to be reported to a swap data repository,  
9       that they will then use the unique identifier that  
10      the data team is proposing. That might make  
11      things earlier in a way if the counterparty, the  
12      product and the transaction IDs that that team and  
13      the Commission has already voted on if those are  
14      in place. The rules work together in that way and  
15      that's why we coordinated with the data team and  
16      the SDR teams to make sure that they work  
17      together.

18                   COMMISSIONER O'MALIA: Now let me ask  
19      the big question. We're going to feed it into  
20      what machine here that will enable us to search  
21      this and use this efficiently?

22                   MS. JOSEPHSON: This is just

1 recordkeeping. This is not reporting. This is  
2 telling them what they need to maintain, that  
3 we're not requesting this. It is available to us  
4 for inspection and examination when we need it.

5 COMMISSIONER O'MALIA: So if we choose  
6 to inspect it and we desire it for only  
7 enforcement purposes, what will we use to search  
8 this stuff? Do we have technology in-house that  
9 is readily available?

10 MR. RADHAKRISHNAN: I'm not sure whether  
11 Enforcement has that. They may have at their  
12 disposal tools that allow us to do this. I'm not  
13 sure.

14 COMMISSIONER O'MALIA: I'll follow-up  
15 with them.

16 CHAIRMAN GENSLER: If there are no  
17 further questions, then Dave Stawik, all the roll.

18 MR. STAWIK: Commissioner O'Malia?

19 COMMISSIONER O'MALIA: Aye.

20 MR. STAWIK: Commissioner O'Malia, aye.  
21 Commissioner Chilton?

22 COMMISSIONER CHILTON: Aye.

1                   MR. STAWIK: Commissioner Chilton, aye.  
2 Commissioner Sommers?

3                   COMMISSIONER SOMMERS: Aye.

4                   MR. STAWIK: Commissioner Sommers, aye.  
5 Commissioner Dunn?

6                   COMMISSIONER DUNN: Aye.

7                   MR. STAWIK: Commissioner Dunn, aye.  
8 Mister Chairman?

9                   CHAIRMAN GENSLER: Aye.

10                  MR. STAWIK: Mister Chairman, aye.  
11 Mister Chairman, on this vote the ayes are five  
12 and nays are zero.

13                  CHAIRMAN GENSLER: Thank you, Sarah,  
14 Ananda and Dan for your cameo. Dan, please stay  
15 at the desk though for the next one. I thank you  
16 very much for all your efforts. Sarah and Ananda,  
17 we'll see you back here in 2 weeks and back again  
18 in January I guess.

19                                 (Recess)

20                  CHAIRMAN GENSLER: Next, Mark Fajfar and  
21 Dan Berkovitz from the Office of General Counsel  
22 will present an overview of staff's

1 recommendations on rules, further defining swap  
2 dealer, major swap participant, securities- based  
3 swap dealer, major securities-based swap  
4 participant and eligible contract participant.  
5 This is a rulemaking which is joint with the SEC.  
6 I don't know what Robert's Rule say, but if we  
7 vote it out it still has to go through the SEC and  
8 I believe, and I'm not trying to get in front of  
9 them, they've calendared it for Friday. I want to  
10 compliment staff before we get into this and  
11 compliment the Securities and Exchange Commission.  
12 I think that we're working both tirelessly to get  
13 these proposals out and to get the benefit of  
14 public comment on them. They probably even have a  
15 larger docket than we do if that's believable. I  
16 thank the staff because it was even 10 o'clock  
17 last night that they were getting some further  
18 edits from our friends at the Securities and  
19 Exchange Commission and I think the Commissioners  
20 for their patience with that because we  
21 distributed a couple of paragraphs this morning.  
22 There are 10 Commissioners and dozens and dozens

1 of staff working. I know that we wanted to do  
2 this in the middle of November but here we are  
3 now. It probably highlights that on the other  
4 rules like product definitions that no matter what  
5 date we think we're going to do them it might  
6 slip. Mark and Dan?

7 MR. FAJFAR: If we had done the rule on  
8 November 19, we could have used Harry Potter's  
9 sorting hat to decide who are swap dealers and  
10 MSPs.

11 CHAIRMAN GENSLER: Sorting hat to do  
12 what?

13 MR. FAJFAR: Decide who our swap dealers  
14 and MSPs are.

15 CHAIRMAN GENSLER: Now we're on December  
16 1.

17 MR. FAJFAR: I'd like to thank my  
18 colleagues on the Definitions Team including Terry  
19 Arbit, Julian Hammer, David Aaron and Rose Troya  
20 and my SEC colleagues including Josh Konz and his  
21 team for their contributions. I'd like to thank  
22 the Commissioners and their staff for their input

1 on the rules.

2 In developing this rule we reviewed more  
3 than 80 written comments in response to our  
4 advanced notice of proposed rulemaking. We met  
5 with market participants and other members of the  
6 public. We consulted extensively both with the  
7 SEC and the prudential regulators. We are very  
8 grateful for the input we've had so far and we  
9 look forward to continuing to meet with the public  
10 and our fellow regulators to develop and put the  
11 details on the final rules.

12 The Dodd-Frank Act defines swap dealer  
13 in terms of whether a person engages in certain  
14 activities, holding oneself as a dealer in swaps,  
15 making a market in swaps, regularly entering into  
16 swaps as an ordinary course of business or being  
17 commonly known in the trade as a dealer or market  
18 maker in swaps. The proposed rule follows the  
19 statutory definition closely.

20 Our interpretation of the proposed rule  
21 is guided by special aspects of the swap markets.  
22 Swaps are notional contracts. They're not bought

1 and sold. Because of this concept, use in the  
2 cash markets for securities and commodities cannot  
3 necessarily determine if a person is a swap  
4 dealer. Instead, we propose to identify swap  
5 dealers by their functional role in the swap  
6 markets. They tend to accommodate demand for  
7 swaps. They're available to enter into swaps in  
8 response to interest from others. They enter into  
9 swaps on their own standard terms or terms they  
10 arrange or customize on request. Also swap  
11 dealers tend to enter into swaps with more  
12 counterparties than do nondealers and nondealers  
13 tend to be a larger part of a swap dealer's  
14 counterparties.

15 In general, a person who meets the  
16 definition would be a swap dealer for all types,  
17 classes or categories of swaps and be subject to  
18 the swap dealer requirements for all of its swaps.  
19 This requirement would apply to the legal person  
20 who's designated as a swap dealer. However, there  
21 may be some companies especially physical  
22 commodity firms that conduct swap dealing through

1 a division. The proposed rule permits the  
2 Commission to issue a limited designation as a  
3 swap dealer with respect to only specified  
4 categories of swaps or activities on an  
5 appropriate showing by that person.

6 The statute includes a de minimis  
7 exception dealing activity that is so minor that  
8 it does not warrant registration. It requires  
9 that a person's dealing over the period 12 months  
10 be limited to swaps with an aggregate gross  
11 notional amount of no more than \$100 million of  
12 which no more than \$25 million could be with a  
13 special entity which is defined in the Act as  
14 certain governmental and other types of entities.  
15 Finally, the person could enter into no more than  
16 20 swaps as a dealer over the prior 12 months with  
17 no more than 15 counterparties.

18 There is also an exemption for swaps in  
19 connection with loans made by insured depository  
20 institutions. We propose this would apply to any  
21 swap related to the financial terms of the loan  
22 such as an interest rate or a currency swap, but

1       it would not apply to swaps related to the  
2       borrower's other business activities even if the  
3       loan agreement required the swap.

4                To wrap up the discussion of swap dealer  
5       I'll point out that the release also discusses  
6       other issues such as how the definition should be  
7       applied to aggregators of swap positions of other  
8       parties, to the physical commodity markets and to  
9       the generation or transmission of electricity.  
10       We'd like to hear from the public on those topics  
11       and all the others.

12               Turning now to the definition of major  
13       swap participant or MSP, this is intended to  
14       encompass firms that are not dealers but whose  
15       swap positions are so large they pose systemic  
16       risk. There are three parts to the statutory  
17       definition. First, it covers a person who has a  
18       substantial position in a major category of swaps  
19       excluding commercial hedging and ERISA plan  
20       positions. For this we're proposing four major  
21       categories of swaps, rate swaps, credit swaps,  
22       equity swaps and other commodity swaps. The

1 second part of the definition includes any person  
2 whose outstanding swaps creates substantial  
3 counterparty exposure that could have serious  
4 adverse effects on financial stability. Third,  
5 the definition covers and nonbank financial entity  
6 that is highly leveraged and has a substantial  
7 position in any of the major swap categories not  
8 including hedging or ERISA positions.

9 To define substantial position we  
10 propose two thresholds that use objective  
11 numerical criteria. One measures current  
12 uncollateralized exposure only and the other  
13 threshold combines both current exposure and  
14 potential future exposure. A position that  
15 exceeds either threshold would be a substantial  
16 position. The current exposure threshold would  
17 measure a person's total uncollateralized current  
18 exposure determined by marking its swap positions  
19 to market using industry standard practices. This  
20 calculation would deduct the value of posted  
21 collateral and would calculate exposure for each  
22 counterparty on a net basis. The numerical

1 threshold of current exposure would be \$1 billion  
2 in any major swap category expect that the  
3 threshold for the rate swap category would be \$3  
4 billion. The second proposed threshold for  
5 substantial position would account for both  
6 current exposure and potential future exposure.  
7 The calculation of potential future exposure is  
8 based significantly on bank capital standards. It  
9 discounts the total notional principal amount of a  
10 person's swaps by risk factors that are based on  
11 the type of swap and the duration of the position.  
12 The calculation also adjusts for netting  
13 agreements, clearing and margin posting. The  
14 second threshold would be \$2 billion in current  
15 exposure plus potential future exposure in any  
16 major swap category except again the threshold for  
17 the rate swap category would be \$6 billion. As I  
18 noted, the substantial position calculation  
19 excludes swaps that hedge commercial risk. The  
20 proposed definition of hedging would include any  
21 swap recognized as a hedge for accounting purposes  
22 or is bona fide hedging but would not be limited

1 to those categories. The proposal also covers  
2 swaps that hedge any business risk and it applies  
3 whether the entity is for profit or nonprofit, a  
4 financial firm or nonfinancial. However, swaps  
5 for the purpose of speculation, investing or  
6 trading would not be covered. For the substantial  
7 counterparty exposure part of the MSP definition,  
8 we propose calculations that are the same as the  
9 calculation of substantial position. Unlike the  
10 first test, however, hedging or ERISA plan  
11 positions would not be excluded and this test is  
12 not applied by swap category. The threshold would  
13 be current exposure of \$5 billion or a sum of  
14 current exposure and potential future exposure of  
15 \$8 billion across all of a person's swap  
16 positions. The third part of the definition for  
17 nonbank financial entities that are highly  
18 leveraged uses the same substantial position  
19 thresholds by major swap category as in the first  
20 part but does not allow for the exclusion of  
21 hedging or ERISA plan positions. To define highly  
22 leveraged, we are proposing two alternatives. One

1 would allow at a ratio of total liabilities to  
2 total equity in excess of 8 to 1, the other  
3 alternative would set the threshold at a ratio of  
4 15 to 1. We invite comment from the public on  
5 which of these is more appropriate.

6 To conclude again I'll point out that  
7 the release discusses a variety of other MSP  
8 issues including the application of a definition  
9 to manage investment accounts, registered  
10 investment companies, ERISA plans and sovereign  
11 wealth funds. Now that the public can review and  
12 consider our proposed rules in their entirety, we  
13 look forward to receiving their comments. Thanks  
14 for your attention and we welcome any questions  
15 you may have.

16 CHAIRMAN GENSLER: I will entertain a  
17 motion on the staff recommendation on the joint  
18 rule with the SEC.

19 COMMISSIONER DUNN: So moved.

20 COMMISSIONER SOMMERS: Second.

21 CHAIRMAN GENSLER: Thank you, Mark and  
22 everybody who's worked on this. I support the

1 joint proposed rule on entity definitions. I  
2 think it fulfills Congress' direction to further  
3 define these key terms, but it is just a proposal  
4 and it is going to be very helpful to get the  
5 public's comments on this proposal. The swap  
6 dealer definition I believe closely follows the  
7 criteria laid out by Congress. Those criteria as  
8 Mark said had four different aspects including  
9 whether an entity makes a market in swaps, holds  
10 itself out as a swap dealer, is commonly referred  
11 to as a swap dealer or regularly enters into swaps  
12 in the ordinary course of business. I think a key  
13 aspect that is in the proposal is whether a  
14 company makes itself available to people, receives  
15 demand from others in essence. I think that end  
16 users, and there have been hundreds of really  
17 well-thought out meetings I've participated in, I  
18 don't think it's our intent and we will hear from  
19 people, but it's not our intent to capture end  
20 users in the swap dealer definition and I think  
21 that that was a helpful add to this proposal that  
22 holding yourself out and accommodating other

1 people's demand which is in contrast of going to  
2 seek and hedging yourself. We'll certainly get  
3 comments on that and those comments will be  
4 helpful.

5 I think that the major swap participant  
6 definition relies on Congress' three-prong test  
7 and the category has been meant to be very clearly  
8 limited only to those entities that have very  
9 large risk, enough pose threat to the U.S.  
10 financial system, and it's for those parties that  
11 aren't swap dealer. This was meant to be a very  
12 small category that you're not a swap dealer and  
13 yet you might have such significant positions.  
14 It's a very complicated thing Congress gave us  
15 because there are three prongs. The first prong  
16 is only if you're not an ERISA plan and not  
17 hedging commercial risk and of course I've lightly  
18 internally called that the speculator's prong, but  
19 the first prong if you're speculating in these  
20 markets and have significant exposure, then Mark  
21 laid out the numbers. The second prong is all of  
22 your counterparty risk and I think staff did an

1       excellent job. This is not a rule that's directly  
2       tied to notional amounts, it's tied to exposures,  
3       current exposures after collateral and I think  
4       Congress dictated that but a lot of end users and  
5       others have come in and said I hope you're only  
6       going to be looking at the sort of noncleared  
7       swaps and after collateral. We didn't do that  
8       quite but I think this important in that it does  
9       say that it's net of collateral because cleared  
10       swaps postmargin it's very different. The number  
11       is large. It's \$5 billion of current exposure or  
12       \$8 billion combined of current and potential  
13       future exposure. I'll share a little bit of a  
14       story. Then years or 12 years ago when long-term  
15       capital was failing I had a \$1.3 trillion  
16       derivatives book but I'll never forget that Sunday  
17       that I went up there personally and their current  
18       exposures as I remember them but the spreadsheets  
19       weren't kept perfectly, were in that \$4 billion  
20       range and I can tell you having lived it, that was  
21       a systemic issue. As for the \$5 billion and \$8  
22       billion, I don't how people will comment on

1 publicly. It will be very helpful to hear. But  
2 they're very large numbers and I think in a major  
3 swap participant definition there will be come,  
4 there will probably a handful or something, but  
5 it's meant to be only those people who aren't swap  
6 dealers and are very large. I support the  
7 proposal but very much look forward to public  
8 comments to help us get this appropriately done so  
9 that swap dealers are regulated as swap dealers  
10 but end users don't somehow get caught up in being  
11 a swap dealer and only the largest nonswap dealers  
12 would be ending up being major swap participants.  
13 I don't have any questions. Commissioner Dunn?

14 COMMISSIONER DUNN: Thank you, Mister  
15 Chairman. Mister Chairman, I'm going to support  
16 this proposed rule simply because I think we need  
17 to get something out on the table. We've gone way  
18 too long for folks to try to figure out where do I  
19 stand in all this, am I in or am I out? This is  
20 our first cut at giving some clarity of where they  
21 stand, and I appreciate all the hard work that  
22 staff of both the CFTC and SEC did working through

1 that, Mister Chairman, your staff and your  
2 personal intervention in moving this forward so  
3 that we have at least something on the table that  
4 people can begin to comment on. This is unique  
5 since the SEC is going to be taking up a similar  
6 provision. It's like the House and the Senate  
7 working on a bill and we may have to have a  
8 conference later on to ensure that we come  
9 together with these definitions.

10 CHAIRMAN GENSLER: Are we the House or  
11 the Senate, Commissioner Dunn?

12 COMMISSIONER DUNN: I've always worked  
13 for the upper house, Mister Chairman. With this  
14 rule and the subsequent rule on product unity,  
15 could you elaborate a bit, Mister Chairman, on  
16 what happens if we cannot come to a conclusion and  
17 the role that FSOC may have in this?

18 CHAIRMAN GENSLER: You're absolutely  
19 right. There is the role of the Financial  
20 Stability Oversight Council if we can't. I don't  
21 think that's an acceptable outcome. I think the  
22 Securities and Exchange Commission and the CFTC

1 very much need to do that here, do that on product  
2 definitions and also interestingly there is a rule  
3 that we'll take up in January that's not related  
4 to derivatives but it's related to hedge fund  
5 disclosure and there's a piece of that that's a  
6 joint rule. Maybe General Counsel Berkovitz wants  
7 to give the exact role of the Financial Stability  
8 Oversight Council if we for some reason we  
9 couldn't come to an agreement.

10 MR. BERKOVITZ: That's right. If the  
11 two agencies cannot agree, it would be determined  
12 by the Financial Stability Oversight Council.  
13 I'll look up the exact timeframe or the exact  
14 wording.

15 COMMISSIONER DUNN: The clarification of  
16 where this may end up if we can't, but I think  
17 again it is probably is important as anything that  
18 we've done that we get comments on these  
19 definitions.

20 CHAIRMAN GENSLER: I will say this.  
21 Though this 3 or 4 weeks later than we calendared  
22 it, I think SEC and CFTC staff and the

1 Commissioners, I know each of you talked to their  
2 Commissioners as I do sometimes too, that it's  
3 been a very collaborative process and it's been  
4 collaborative working through the May 6 issues.  
5 We've had the Joint Advisory Committee, we've had  
6 four or five roundtables together, and I'm sure  
7 we've probably approaching 200-plus staff meetings  
8 between the SEC and CFTC now. We share all the  
9 documents with them even the ones that aren't  
10 joint. I think it's been excellent. There are  
11 times where we disagree and you can probably if  
12 you're very clever look through this document and  
13 figure out through questions and footnotes where  
14 some of those disagreements are. But I think it's  
15 been working very positively so that again my  
16 compliments to SEC and CFTC staff.

17 MR. BERKOVITZ: As a point of  
18 clarification on the role of the council,  
19 Dodd-Frank provides that in the event that the  
20 CFTC and the SEC fail to jointly prescribe rules  
21 in a timely manner, then at the request of either  
22 Commission the Financial Stability Oversight

1 Council shall resolve the dispute so that either  
2 Commission would have to request the FSOC to  
3 resolve the dispute. I would also add what the  
4 Chairman has just stated that we have had many,  
5 many discussions but nothing has elevated to what  
6 I would call the level of a dispute between the  
7 two agencies and the fact that we're here today  
8 and they're going to be where they are I think is  
9 a testament to that.

10 CHAIRMAN GENSLER: Can we kick portfolio  
11 margining upstairs too?

12 COMMISSIONER O'MALIA: Put it on the  
13 list.

14 CHAIRMAN GENSLER: Commissioner Sommers?

15 COMMISSIONER SOMMERS: Thank you, Mister  
16 Chairman. I'll start with questions about the  
17 limited registration that I referred to in my  
18 opening statement. Even though the statute  
19 provides for limited registration for dealers, we  
20 have decided that a person who satisfies the  
21 definition of swap dealer or security-based swap  
22 dealer would be a dealer for all types. And we go

1 on to say that because we think it would be  
2 difficult to separate their dealing activities  
3 from other activities, could you elaborate on why  
4 that's difficult?

5 MR. FAJFAR: First of all, we're  
6 starting from the premise that there are very many  
7 different types of swap dealers active in very  
8 many different types of markets. For some swap  
9 dealers it might not be difficult, but we think  
10 that most companies view their swap activity as a  
11 whole, there hasn't been a designation of swap  
12 dealer before the statute and so they view their  
13 activities in swaps as a whole so that they don't  
14 distinguish for example separate books of records  
15 or separate compliance practices for swaps where  
16 they're accommodating demand and responding to  
17 demand from others versus putting on positions at  
18 their own initiative. That's the main reason.

19 COMMISSIONER SOMMERS: If there are  
20 dealers who can easily separate and they know  
21 exactly what types or classes of swaps that they  
22 are a dealer for, will we be able to provide for

1       them a limited registration for just those  
2       categories?

3                   MR. BERKOVITZ:  Yes, Commissioner, the  
4       proposed rule provides that the dealer in that  
5       category may apply for limited designation and the  
6       rule states that the Commission shall act upon  
7       that application and that would be at the time of  
8       the initial designation or subsequently  
9       afterwards.

10                   COMMISSIONER SOMMERS:  I guess I should  
11       clarify.  Instead of being categorized as a dealer  
12       first for everything, can they just apply only in  
13       a limited designation?

14                   MR. BERKOVITZ:  Yes.  At the time  
15       they're coming in with their registration, they  
16       would say we want to be a limited designation so  
17       that that limited designation could become  
18       effective upon registration.

19                   COMMISSIONER SOMMERS:  I guess it was my  
20       understanding that the registration rule that we  
21       did didn't provide for that.

22                   MR. BERKOVITZ:  That's correct, but in



1                   MR. BERKOVITZ: Yes. It's 141 for the  
2 swap dealer. Excuse me.

3                   COMMISSIONER SOMMERS: So that they will  
4 not be designated as a swap dealer in all classes  
5 if they apply for a limited designation?

6                   MR. BERKOVITZ: The Commission shall  
7 make a determination upon such application so that  
8 if the Commission were to make the determination  
9 of limited designation, there would not be a time.

10                  COMMISSIONER SOMMERS: Where they're  
11 considered a dealer for everything.

12                  MR. BERKOVITZ: Correct.

13                  CHAIRMAN GENSLER: If I can help because  
14 this is one place where I think Commissioner  
15 Sommers and I agree. If we get through all this  
16 and we have final rules, that somebody could come  
17 in and say I'm only a swap dealer for interest  
18 rate swaps, I do an occasional oil swap but we  
19 don't deal in that, or on the other hand, I'm a  
20 dealer in oil swaps but I occasionally do interest  
21 rate swaps, that we have the clear flexibility in  
22 statute to designate them a swap dealer in one

1 category and not the other and I'm hoping that we  
2 maintain that flexibility and that the limited  
3 dealer designation is something easy for us to  
4 facilitate, easy because it's what Congress  
5 directed us to do.

6 MR. BERKOVITZ: That's correct. We have  
7 the statutory authority and the rule here if it  
8 were adopted would provide for us to exercise that  
9 authority upon application for registration and we  
10 would so designate a person as a limited manner so  
11 they would not be a swap dealer at all until they  
12 received either the limited designation or the  
13 full designation.

14 COMMISSIONER SOMMERS: I guess I would  
15 suggest that's not clear. It says here that  
16 they're subject to all regulatory requirements  
17 applicable to dealers for all swaps into which  
18 they enter.

19 MR. BERKOVITZ: That's correct, but if  
20 they apply and said they would like a limited  
21 designation, if they come in and say here's why we  
22 think we should be limited, the rule says the

1 Commission shall determine whether indeed to do  
2 so. So if they don't come in apply, the  
3 presumption is they're for everything, but if they  
4 come in apply and we agree, yes, indeed this  
5 should be limited, then they will become a  
6 limited-designation dealer.

7 COMMISSIONER SOMMERS: My next question  
8 is with regard to the dealer/trader distinction  
9 that the SEC will use that we have chosen not to  
10 use. I do understand that there may be criteria  
11 in that distinction that may not be applicable to  
12 transactions that are not securities. However, is  
13 it possible for us to add into our definition of a  
14 dealer the concept that they have regular  
15 clientele without adopting everything that we  
16 don't believe is applicable? Again I would  
17 suggest that if you don't have clients, you're  
18 probably not a dealer.

19 MR. FAJFAR: I think that this is  
20 something that we would be looking to address  
21 during the comment period in the development of  
22 the final rules. I'd like to make clear that

1       there was not a disagreement with the SEC about  
2       how the distinction applies, and we had a very  
3       useful working discussion with them about the  
4       different rules that we would apply and that they  
5       chose to apply some of their precedents because of  
6       the view of how the security-based swap market  
7       works. Again because of the diversity of the swap  
8       market and all the differences between the  
9       different aspects, we tried to start for this  
10      proposal as I think Chairman Dunn was saying with  
11      something that applies across the board in an even  
12      way to all parties in the swap market and they can  
13      look at it and identify the issues that arise for  
14      them. And if it were to turn out that as a means  
15      of defining who accommodates demand and who  
16      facilities entering into swaps, it may be that the  
17      role of clients or counterparties would be one of  
18      the factors that would be developed in the final  
19      rule. But it's difficult to say now because there  
20      are so many different ways that people enter into  
21      swaps and it could be different for some people.

22                   COMMISSIONER SOMMERS: Let me make sure

1 I understood that. There could be people who  
2 don't have clients who are still dealer? I guess  
3 that's what I heard.

4 MR. FAJFAR: You'd have to think about  
5 what the meaning of a regular client base is and  
6 how they enter into swaps.

7 COMMISSIONER SOMMERS: What if you don't  
8 have any clients ever?

9 MR. FAJFAR: I think we'd have to see  
10 how the different factors would apply to the  
11 different ways that people enter into swaps.

12 MR. BERKOVITZ: One of the factors is  
13 whether they hold themselves out for a dealer,  
14 whether they accommodate demand, so it may be a  
15 factor in determining that whether they have a  
16 regular clientele or not, but somebody may hold  
17 themselves out and not have a regular base or make  
18 a market without having a regular base of clients  
19 so that it's a factor but necessarily  
20 determinative either way.

21 COMMISSIONER SOMMERS: In this same vein  
22 I have questions about how we define or how we

1 anticipate defining market maker because that is  
2 one of the prongs for definition of being a dealer  
3 and I'm not sure that it's real clear, and if you  
4 have anything you want to elaborate on about who  
5 exactly is a market maker and what do they have to  
6 satisfy in order to be considered in to be a  
7 market maker.

8 MR. FAJFAR: Through the process of  
9 developing the rule proposal and looking at the  
10 comment letters, obviously the preamble only says  
11 a little bit about what a market maker would be  
12 and that's what we were able to glean from the  
13 meetings we've had and the comments. We're  
14 certainly open to more input on that, but at this  
15 time from the information that we have it looks  
16 like the statutory definition of a market maker,  
17 the use of that word and what a market maker in  
18 swaps is, is what we have to present at this time  
19 and we're opening up to comment on that.

20 COMMISSIONER SOMMERS: I understand  
21 that, but do you anticipate putting more to that  
22 rule so that it's very clear?

1           MR. FAJFAR: I think that in general in  
2 these questions, we say right up front, it's on  
3 page 6 of this draft and there's a footnote  
4 addressing it, that we expect that the market for  
5 swaps is going to evolve and change including  
6 through the influence of the Dodd-Frank Act and we  
7 want to have the definitions in a way sufficiently  
8 flexible to address how the market changes and how  
9 people go about making a market in swaps for  
10 example. And we're specifically asking for  
11 comment on how the rules should be both flexible  
12 enough and determinative enough to give guidance  
13 on topics such as what it means to be a market  
14 marker for swaps.

15           COMMISSIONER SOMMERS: Thank you.

16           CHAIRMAN GENSLER: May I follow-up on  
17 Commissioner Sommers's question? It occurs to me  
18 that one of the categories that currently is not  
19 participating in any size in the swap market or  
20 high-frequency traders but as this moves into  
21 trading platforms and as Commissioner Chilton has  
22 raised a number of times, high-frequency traders,

1 if a high-frequency trader as we know them today  
2 made bids and offers on a swap execution facility  
3 and were active, did thousands of trades a year or  
4 tens of thousands because they're high frequency  
5 and they left resting orders and resting bids and  
6 provided liquidity to the marketplace, would they  
7 be under this definition of market makers and swap  
8 dealers?

9 MR. BERKOVITZ: We haven't squarely  
10 addressed that but I think that certainly could be  
11 possible under the four-prong test. The  
12 functional definition talks about making a market  
13 or accommodating demand. Certainly making the  
14 market or accommodating demand could be in a  
15 number of ways. One would be by posting on the  
16 website saying we're available for swaps, another  
17 could be putting in a number of resting bids or  
18 offers into the market.

19 CHAIRMAN GENSLER: Certainly the market  
20 will evolve, but I think that it would be good to  
21 hear from the public. It does strike me that  
22 Congress said making markets. How many times have

1 I met with a high-frequency trader and said we're  
2 making markets to provide liquidity? They may not  
3 be doing it yet, but I think that it may well be  
4 that Congress decided this for us, but we'll get  
5 public comment. It sounds like we haven't  
6 squarely said that here but we'll get public  
7 comment and this may be related to Commissioner  
8 Sommers's question at least. Commissioner  
9 Chilton?

10 COMMISSIONER CHILTON: No, I'm good.  
11 Thank you, sir.

12 CHAIRMAN GENSLER: Commissioner O'Malia?

13 COMMISSIONER O'MALIA: Thank you. In my  
14 little travels, one of the slides that they had at  
15 this PJM conference was they pulled up our  
16 commitment of trader's reports for a bunch of PJM  
17 trading contracts. I noticed this in a lot of  
18 these contracts because as end users they have our  
19 standard definitions of producer/merchant, swap  
20 dealer, manage money and then the  
21 producer/merchant plus swap combination to total  
22 it. In here I was struck by the high totals or

1 producer/merchant and relatively low totals of  
2 swap dealer. In the PJM peak contract for example  
3 there's 66-percent producer and 7-percent swap  
4 dealer. And since I think people are relatively  
5 comfortable with the way we bin these things and  
6 we use a predominance test, could you explain to  
7 me how this rulemaking might change the way these  
8 people are categorized? Are we likely to see more  
9 producer/merchants in a swap dealer category as a  
10 result of this rulemaking?

11 MR. FAJFAR: First of all I'd say that  
12 we met extensively with people involved in the  
13 generation and transmission of electricity and one  
14 of the things we learned on those meetings as we  
15 know is that that market is very, very complex and  
16 there is a lot of usage of what they call swaps  
17 and other types of derivative instruments, even  
18 managing next-day delivery or delivery this  
19 afternoon and set this morning, so the approach  
20 that we took in the release is to have a specific  
21 paragraph pointing out that the electricity market  
22 is very different. It's one of the things that I

1 was referring to in the variety of different  
2 markets where people use swaps. We are  
3 specifically interested in comment on how you  
4 apply a regulatory and statutory definition of  
5 swap dealer to a market where people are for  
6 example managing load on electricity lines. We  
7 couldn't predict right now how this definition  
8 will affect that market or how that market might  
9 evolve, but we are definitely very sensitive to  
10 that and want to hear specifically on that issue  
11 and continue to work with them.

12 COMMISSIONER O'MALIA: I appreciate your  
13 concern about that, but do you think it's going to  
14 change the way we bin these categories or are  
15 producers going to be in the swap dealer category  
16 in this market based on the extensive  
17 conversations you've had? I'll pulled up all the  
18 meetings we've had with a lot of energy companies  
19 and based on your conversations with them, is it  
20 going to be as cut and dry as our large-trader  
21 reports, our commitment of trader reports are?

22 MR. FAJFAR: I don't think it will be

1 cut and dry, no. At this point we haven't  
2 developed a prediction where we could say what  
3 we'll have.

4 COMMISSIONER O'MALIA: Subparagraph C of  
5 the swap dealer definition excludes from the  
6 definition "A person that enters into swaps for  
7 such person's own accounts either individually or  
8 in a fiduciary capacity but not as a regular  
9 course of business. This language comes from the  
10 1934 Exchange Act. And has not been subject to  
11 extensive judicial interpretation and the SEC uses  
12 a variety of factors to determine whether these  
13 entities are dealers. That being said, at least  
14 one court in New York I believe has determined  
15 that making money through buying and selling  
16 securities is not conduct which in and of itself  
17 makes someone a dealer. My question is what does  
18 it mean for a person to enter into swaps as a  
19 regular course of business?

20 MR. BERKOVITZ: We've interpreted the  
21 third prong of the swap dealer test also in  
22 conjunction with the exclusion from the definition

1 of swap dealer which is very similar language.  
2 What the guidance in the preamble says is that in  
3 looking to whether they're entering into swaps as  
4 a regular course of business you have to look at  
5 whether they're doing the functions that we've  
6 talked about in connection with the other prongs,  
7 whether they're accommodating demand or whether  
8 they're entering into swaps in response to  
9 requests from other parties so that it really  
10 relates to the activities that are described in  
11 the other prongs. This is also an issue that we  
12 met with and discussed with a lot of the market  
13 participants and so we're hoping we're providing  
14 that clarity in the we've drafted it in this rule.

15 COMMISSIONER O'MALIA: But we're not  
16 falling back on some of these litigated terms so  
17 to speak in what is a regular course of business  
18 and the court found that buying and selling of  
19 securities does not make them a dealer  
20 necessarily. Would we use any of those  
21 definitions? You're going back to the activity I  
22 guess is what you're saying.

1                   MR. BERKOVITZ: We're looking at it  
2 holistically in terms of the third prong with the  
3 exclusion in the Dodd- Frank and relating it to  
4 the other types of dealing activities that are  
5 described. That's the business that we're focused  
6 on.

7                   COMMISSIONER O'MALIA: Maybe I missed  
8 it, but how is a market supposed to interpret the  
9 term accommodates demand? Do you want to explain  
10 that, Mark?

11                  MR. FAJFAR: I think we can start from  
12 the premise that there is what you could call a  
13 demand for swaps. There's a need for swaps to  
14 hedge risk, there's a need for swaps to speculate.  
15 People need swaps. And when they want to enter  
16 into a swap they need to find a counterparty and  
17 it might be a one-off situation where they know a  
18 counterparty is available to them, but on the  
19 other hand they might go to a party who maybe goes  
20 so far as to advertise or is otherwise holding  
21 itself out as a dealer and is saying I'm ready to  
22 enter into swaps with people to take the other

1 side of that swap. When you do that you're  
2 accommodating demand, you're fulfilling the  
3 demand, you're providing what the demand is asking  
4 for and we're starting with the premise that  
5 that's a swap dealer.

6 COMMISSIONER O'MALIA: I think one of  
7 the other questions that was answered, not  
8 answered but at least asked twice was this  
9 execution on a trading platform and if you  
10 accommodate demand by standing on the other side  
11 of that. I'm very interested to see how that's  
12 going to play out. It's clear in the statute that  
13 Congress intended for an entity with a de minimis  
14 amount of swap-dealing activity to be exempt from  
15 the swap dealer definition, but this exemption  
16 sets thresholds on the overall swap activity and  
17 not the swap dealing. Is that correct or is it  
18 the other way around?

19 MR. FAJFAR: No, it is for the dealing  
20 activity.

21 COMMISSIONER O'MALIA: For the dealing  
22 activity. That is definitely the subcategory of

1 the overall activity?

2 MR. FAJFAR: Right. The rule and the  
3 preamble both limit to the person's dealing  
4 activity.

5 COMMISSIONER O'MALIA: I know you  
6 mentioned this or somebody mentioned this, but I'd  
7 like a further explanation. Why doesn't the de  
8 minimis exemption use a net notional calculation  
9 or net uncollateralized risk similar to the MSP  
10 rule?

11 MR. FAJFAR: First of all, with the  
12 collateral if you said that you can enter into  
13 swaps as long as they're collateralized, that  
14 wouldn't measure your activity, that would be a  
15 measure if anything would be a measure of risk so  
16 that you could enter as the preamble says  
17 virtually unlimited numbers of quantity of swaps  
18 as long as you're collecting collateral. Then the  
19 same principle, if it goes with a net basis  
20 depending on how the netting applies, long versus  
21 short, you could enter into swaps on one side of  
22 the market and then bring down that total by

1 entering into swaps on the other side of the  
2 market and again you could have extensive swap  
3 activity and remain below a net level. That's why  
4 we look at the gross level for the de minimis test  
5 only.

6 COMMISSIONER O'MALIA: Thank you. How  
7 do we treat voice brokers in this dealer  
8 definition? Two commercials will bring together  
9 on either a platform or through a telephone call,  
10 are they dealers?

11 MR. FAJFAR: The first answer is that  
12 the way the two people connect or they enter into  
13 the swap, the manner that they do that, is not a  
14 determinative factor in whether or not they're a  
15 dealer. It's rather we're trying to look at their  
16 overall functional rule in relation to their  
17 counterparties and what role they're playing so  
18 that in a simple case if you had two people who  
19 deal with each other very rarely perhaps on the  
20 basis of some other connection they have, then  
21 that's not a dealing activity.

22 COMMISSIONER O'MALIA: To give the end

1 users the confidence that they will not get swept  
2 up in this, what page should they read in this  
3 rulemaking to give them the confidence that there  
4 is a safe harbor for them?

5 MR. FAJFAR: In terms of safe harbors,  
6 that would have to be determined by the  
7 Commission. We don't propose any safe harbors at  
8 this time. There is a paragraph where we say in  
9 conclusion what a swap dealer is in the discussion  
10 of the application of the test to swap dealers,  
11 and what we were trying to do is lay out a  
12 description of activities that would cause you to  
13 be a swap dealer with the presumption that you  
14 don't engage in those activities you're not a swap  
15 dealer.

16 CHAIRMAN GENSLER: What page is that?

17 MR. FAJFAR: It's on pages 12 to 14.

18 COMMISSIONER O'MALIA: Mark, I  
19 appreciate everything you'd done. This is not an  
20 easy definition. It's not the clearest statutory  
21 direction and I appreciate all the hard work  
22 you've put into this. I do think there is more

1 work to be done an obviously the comments  
2 hopefully will provide a lot of assistance in  
3 where we draw these lines and certainly hopefully  
4 narrow this so that we actually capture the dealer  
5 activities and protect end users. Thank you.

6 CHAIRMAN GENSLER: I think staff and I  
7 thank the Commissioners. I think that this  
8 proposal does strike the right balance, but again  
9 it's a proposal that's trying as I think we're all  
10 trying, that end users rather they're hedging or  
11 even speculating, but that they're not swept into  
12 to be swap dealers, but if you read the statutory  
13 definition and add to it what the SEC and the CFTC  
14 are jointly saying about accommodating demand and  
15 Commissioner Sommers asked the question what does  
16 that mean, but accommodating demand where somebody  
17 else is coming to you and you say I'll fill their  
18 order or something, facilitating the markets, that  
19 that was helpful clarification at least for me  
20 that the proposals might come forward. I also  
21 think very importantly in the major swap  
22 participant definition in what was called prong

1       one, prong is what I call the speculator's prong,  
2       but the noncommercial hedging, the rule does lay  
3       out that if you're hedging an asset, if you're  
4       hedging a liability, if you're hedging an input,  
5       if you're hedging a service, if you're hedging a  
6       future input or a future service, that's hedging  
7       or mitigating commercial risk as long as it's not  
8       "speculation," that the position itself, that the  
9       swap isn't, I think it's speculating or trading or  
10      vesting so that you can be hedging assets,  
11      liabilities, inputs, services or future inputs and  
12      services. Did I get the right list?

13                 MR. FAJFAR: Yes.

14                 CHAIRMAN GENSLER: Thanks. So it's not  
15      just relying on some narrow FASB definition even  
16      though we also said if you're relying on FASB,  
17      that's a commercial hedging. We didn't just rely  
18      on a narrow bona fide hedger definition even  
19      though we said that that would work too. So I  
20      think that we did it, but we'll see when we get  
21      comments. I do think some companies will end up  
22      being major swap participants, but Congress passed

1 the statute and I don't think we were supposed to  
2 write something that nobody was a major swap  
3 participant. We don't know for sure, but I should  
4 ask how many people do we think might be major  
5 swap participants under this rule and not major  
6 securities-based swap participants, but major swap  
7 participants?

8 MR. BERKOVITZ: We haven't done a  
9 thorough survey on this, but we're estimating  
10 based on the our interviews maybe a handful, at  
11 most two handfuls, somewhere in the handful range.

12 CHAIRMAN GENSLER: And that from the  
13 General Counsel of the CFTC.

14 MR. BERKOVITZ: I'm hedging, Mister  
15 Chairman.

16 CHAIRMAN GENSLER: What school did you  
17 go to? Mr. Stawik, do you want to call the roll?

18 MR. STAWIK: Commissioner O'Malia?

19 COMMISSIONER O'MALIA: No.

20 MR. STAWIK: Commissioner O'Malia, no.  
21 Commissioner Chilton?

22 COMMISSIONER CHILTON: Aye.

1                   MR. STAWIK: Commissioner Chilton, aye.  
2 Commissioner Sommers?

3                   COMMISSIONER SOMMERS: No.

4                   MR. STAWIK: Commissioner Sommers, no.  
5 Commissioner Dunn?

6                   COMMISSIONER DUNN: Aye.

7                   MR. STAWIK: Commissioner Dunn, aye.  
8 Mister Chairman?

9                   CHAIRMAN GENSLER: Aye.

10                  MR. STAWIK: Mister Chairman, on this  
11 question the ayes are three, the no's are two.

12                  CHAIRMAN GENSLER: I thank you, Mark and  
13 Dan and I thank the SEC again. We will not send  
14 this to the Federal Register until after Friday  
15 naturally depending on what the SEC does I guess.  
16 We'll have to see there. I'm supposed to though  
17 at this point ask for unanimous consent to allow  
18 staff to make technical corrections to the  
19 document voted on today prior to send it to the  
20 Federal Register.

21                  COMMISSIONER DUNN: Mister Chairman, a  
22 question on that. If the SEC makes some minor

1 changes that is technical and clarifying in  
2 nature, then it would allow the staff then to make  
3 the decision of sending it forward?

4 CHAIRMAN GENSLER: I think it would.  
5 The unanimous consent suggestion is that there  
6 would be changes. These are really meant to be  
7 technical corrections. This is supposed to be  
8 very limited.

9 COMMISSIONER SOMMERS: On that subject,  
10 does that mean that if the SEC does not adopt this  
11 identical rule that we will have to pass it again?

12 CHAIRMAN GENSLER: Dan, will you help  
13 us? It's a joint rule.

14 MR. BERKOVITZ: Both agencies have to  
15 approve the identical text for it to be published  
16 in the Federal Register, yes.

17 CHAIRMAN GENSLER: That makes sense to  
18 me so that we're not sending anything until after  
19 Friday and subject to Friday. We're the upper  
20 house, but we have to wait for the other house I  
21 guess or we're the lower house. I don't know.  
22 Whatever it is. Not hearing objection to the

1 unanimous consent, that's passed. I'll take a  
2 motion to adjourn. Is there any other Commission  
3 business? I'll take a motion to adjourn the  
4 meeting.

5 COMMISSIONER DUNN: So moved.

6 COMMISSIONER SOMMERS: Second.

7 CHAIRMAN GENSLER: All in favor?

8 (Chorus of ayes.)

9 CHAIRMAN GENSLER: We don't need a  
10 recorded vote on that do we? No. Thanks.

11 (Whereupon, at 1:40 p.m., the  
12 PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Stephen K. Garland, 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: May 31, 2014

