COMMODITY FUTURES TRADING COMMISSION

PUBLIC ROUNDTABLE ON FUTURIZATION OF SWAPS

Thursday, January 31, 2013

Commodity Futures Trading Commission

1155 21st Street, N.W.

Washington, D.C.

A P P E A R A N C E S

PANEL 1

CFTC MEMBERS:

AARON BRODSKY

FRANK FISANICH

EVE GUTMAN

ABIGAIL KNAUFF

NANCY MARKOWITZ

SCOTT MIXON

RICHARD SHILTS

ANANDA RADHAKRISHNAN

DAVID VAN WAGNER

PANELISTS:

PAUL CAMPBELL

BRYAN DURKIN

TOM FARLEY

CHRIS FERRERI

GEORGE HARRINGTON

CLIFF LEWIS

WALT LUKKEN

JEFFREY MARON

LEE OLESKY

A P P E A R A N C E S (Continued)

JOHN PARSONS

WILL RHODE

DEXTER SENFT

DON WILSON

PANEL 2

CFTC MEMBERS:

ANANDA RADHAKRISHNAN

TRACEY WINGATE

PANELISTS:

NEAL BRADY

JAMES CAWLEY

TOM FARLEY

JACK HATTEM

DANIEL MAGUIRE

DAVID OLSEN

SEAN OWENS

KIM TAYLOR

DON WILSON

LUKE ZUBROD

A P P E A R A N C E S (Continued)

PANEL 3

CFTC MEMBERS:

AARON BRODSKY

EVE GUTMAN

ABIGAIL KNAUFF

NANCY MARKOWITZ

GEORGE PULLEN

MICHAEL PENICK

RICHARD SHILTS

SAYEE SRINIVISAN

DAVID VAN WAGNER

NHAN NGUYEN

PANEL MEMBERS:

NEAL BRADY

TOM CALLAHAN

JAMES CAWLEY

BRYAN DURKIN

WILLIAM EMMITT

TOM FARLEY

SUNIL HIRANI

JERRY JESKE

A P P E A R A N C E S (Continued)

ROBERT LEE

WAYNE PRESTONE

BILL THUM

DON WILSON

PANEL 4

CFTC MEMBERS:

AARON BRODSKY

EVE GUTMAN

ABIGAIL KNAUFF

NANCY MARKOWITZ

GEORGE PULLEN

RICHARD SHILTS

DAVID VAN WAGNER

FRANIK FISANICH

SCOTT MIXON

MICHAEL PENICK

PANEL MEMBERS:

JIM ALLISON

PAUL CAMPBELL

LAEL CAMPBELL

THOMAS DEAS

A P P E A R A N C E S (Continued)

LANCE KOTSCHWAR

DAVID FRENK

SALLY INGBERG

CHARLES REYL

LUKE ZUBROD

C O N T E N T S

P R O C E E D I N G S

MR. SHILTS: Good morning, everyone. My name is Rick Shilts. I'm the Director of the Division of Market Oversight here at the CFTC, and with me today is our co- moderator, Ananda Radhakrishnan, the Director of our Division of Clearing and Risk.

I'm pleased today to open this public roundtable to provide industry participants and others an opportunity to present their views relating to the listing for trading and the clearing of various swap-like instruments, futures, and options contracts, unregulated designated contract markets, or DCMs. Many have referred to this practice as the futurization of the swaps marketplace, hence the name of the roundtable today. We're looking forward to a very productive discussion.

Before we begin those discussions today, I have the pleasure of introducing Chairman Gensler, who has agreed to offer some opening remarks for us today.

Chairman Gensler.

CHAIRMAN GENSLER: Thank you, and thank you for all attending. Welcome to the Commodity Futures

Trading Commission. I see Commissioner Wetjen. I saw Commissioner O'Malia. I will well imagine that Commissioner Chilton is listening by phone if he's not physically here. I know I saw Commissioner Sommers yesterday. So she may be attending as well, and I thank all of my fellow commissioners.

But I mostly want to thank Rick and Ananda and their teams: Scott Mixon, who you'll get to know, who is now our Acting Chief Economist. I want to welcome him also to the CFTC because he has only joined us about a -- is it about six weeks now?

MR. MIXON: Two months.

CHAIRMAN GENSLER: And I hope you all get to know Scott very well as he helps us guide through this phase of our rule writing and implementation.

This is the CFTC's 21st public roundtable since the passage of Dodd-Frank, and next week we'll actually be holding the 22nd, and now that I tell you the topic, it might be as well attended because it's about customer protection. It's actually the third one that we'll have on customer protection.

These roundtables have helped us

tremendously. This roundtable is occurring at a historic time in the markets. The marketplace is increasingly shifting to implementation of the common sense rules of the road for this swaps market. I saw Ken Raisler when I walked in. He said it's a very interesting time and evolution in the markets, and I suspect in his practice as well.

For the first time, the public will be benefitting from the greater access to the markets and the risk reduction that comes with central clearing. Required clearing of interest rate and credit index swaps begins for financial entities this coming March, March 11th to be more precise. I see Don Wilson is writing down the exact date.

For the first time as well the public is benefitting from seeing the price and volume of each swap transaction. This post-trade transparency builds upon what has worked for decades in the futures and securities markets. The new swaps market information is available free of charge on a Website like a modern day ticker tape, and for those of you familiar with it, not that dissimilar from what FINRA has in the corporate bond market called TRACE.

For the first time as well the public will benefit from specific oversight of registered swap dealers. As of the end of this week, there will be 71 provisionally registered swap dealers. It has inched up a little bit from the end of December, and we would anticipate that that will continue to do so over the course of this year.

They are subject to standards for sales practices, recordkeeping and business conduct to help lower risks to the economy and protect the public from fraud and manipulation. So three first, for the first time central clearing for interest rate and credit index swaps; we have post-trade transparency like a modern day ticket tape; and also the oversight of provisionally registered swap dealers.

An early crisis led to similar common sense rules of the road for futures and securities markets, and I believe that these critical reforms in the 1930s have been a foundation of our strong capital markets and many decades of economic growth.

In the 1980s, the swaps markets emerged, and until now it lacked the benefit of such rules to promote transparency, lower risk through central clearing, and promote integrity by overseeing the intermediaries.

We know what followed: the 2008 financial crisis, which eight million American jobs were lost. In contrast, the futures markets supported by earlier reforms weathered the financial crisis. President Obama and Congress responded and crafted a swaps provision of

Dodd-Frank by borrowing from what had worked best in the futures markets for decades: clearing, transparency, oversight of intermediaries.

Given that we have largely completed the swaps market rule writing with 80 percent behind us, today is a good opportunity to hear from market participants on where we are and where we ought to go from here. As we have asked throughout this process, we'd like to hear from market participants today on what provisions for swaps should mirror those for futures, and when is it appropriate for there to be differences.

We've been asking this question, along the way have benefitted from it, but today is a good day to sort of pause and look at where we are and where we ought to go.

Congress recognized though that there are some differences between swaps and futures, and I want to mention one that's critical to farmers, ranchers, merchants, and other end users. That is the ability to continue to hedge their risk, lock in a price or a rate in the customized swaps market. Customized swaps sometimes are not standard enough to be cleared, and of course, also end users working through the policy development with Congress even in standardized swaps need to maintain the option and choice as to whether to use that central clearing mechanism.

Now that the entire derivatives marketplace, both futures and swaps, have come under comprehensive oversight, I think it's the natural order of things for some realignment to take place. The notional open interest in the futures market, about $30 trillion notionally open interest. There are various estimates for the notional size of the U.S. swaps market, but

I'll go with the conservative number of about 250 trillion notional open interest.

So though the futures market trades far more actively in terms of open interest, just one-ninth of the combined open interest of the derivatives marketplace is futures. Think about that. Approximately eight-ninths of the derivatives marketplace, what we had called swaps, and until recently was unregulated; now we bring regulation to both sides. Is it not just natural that there might be some realignment, relabeling now that the whole nine-ninths is under oversight?

This roundtable also, I think, provides an opportunity to hear from market participants on recent actions of the two largest exchanges. Bryan, you're not on the end for any reason, but I think everybody is going to be asking -- and where's Tom? Oh, on the end with you -- but the two largest exchanges last fall, as you know, Intercontinental Exchange converted power and natural gas related swaps into futures contracts, and in addition, the CME groups, Clearport Products which were cleared as futures, including those which were executed bilaterally as swaps, are now being offered for trading on Globex or on the trading floor.

I think I got that about right, Bryan and Tom?

Okay. CME also adopted new block trading rules for its Clearport energy contracts as well as began trading a futures contract where the underlying product is an interest rate swaps contract. So, again, a good time to have a roundtable.

It's important to note that whether one calls a product a standardized swap or a future, both markets now benefit from central clearing, and this feature markets since the late 19th century helps lower risk for the public, but it also fosters access for farmers, ranchers, merchants and other participants and allows them the benefit of greater competition in the markets, and people can come into a clear product and trade on a platform anonymously.

In March swap dealers in the largest hedge funds will be required for the first time to clear a certain interest rate in credit index swaps, but when I say "certain interest rate" swaps and credit index

www.CapitalReportingCompany.com © 2013

swaps, it's really probably well over half of that marketplace when you measure it in notional values.

Compliance will be phased in for other market participants throughout the year. In addition, transparency, longstanding hallmark of the futures market for both pre-trade and post-trade is coming to the swaps market. Now for the first time the swaps market is benefitting from that post-trade transparency. That began on December 31st when the then 66 registered swap dealers began real time reporting for interest rate and credit index swap transactions.

Building on this, swap dealers will begin reporting equity, foreign exchange, and other commodity assets at the end of February, and other market participants will begin report April 10th. The time delays are still between 30 minutes long and sometimes up to two days for end user to end user transactions, but generally if it's a swap dealer, it's on a platform that will come down to 15 minutes this October for interest rates and credit index swaps and for the other asset classes the following January. That 15 minute delay is something very similar to TRACE, if you just want to know its background and where we may have been looking.

The futures marketplace has a time delay for blocks for about five minutes. So after we complete the block rule for swaps, trades smaller than a block will be reported as soon as technologically practicable. Those are the words that Congress has in its statute.

Oversight of intermediaries and protection of customer funds have also been an integral part of the futures marketplace for decades. Futures commission merchants introducing brokers and commodity pool operators have been registered with the CFTC and with the NFA for a long time.

Dodd-Frank extended this oversight to these same intermediaries to include their swaps activity and to promote market integrity, and lower risk to taxpayers also brought oversight to a new class of intermediaries:

swap dealers. The initial group of provisionally- registered swap dealers includes the largest domestic and international financial institutions dealing in swaps with U.S. persons. It includes the 16 institutions commonly referred to as the G16 dealers.

So you see there's been a lot of change in the last few weeks. Reforms that CFTC has finalized to enhance protection of customer funds, as well as those proposed and that will be discussed at next week's roundtable, are consistent in that they cover both futures and swaps.

Looking ahead to further enhanced liquidity and price competition, the CFTC must finish the pre-trade transparency rules for swap execution facilities, as well as the block rules for swaps.

I don't know if you've got the right card there, by the way, Chris, because it says Julian.

MR. FERRERI: I'll speak with a British accent.

CHAIRMAN GENSLER: What's that? You'll speak with a British accent?

But I think that Chris said to me as I was coming in, he said, "Let there be SEFs." I think it's critical that we complete these rules. The Commission is close to that, and hopefully we can do that in February, but I think it's critical to lower the uncertainty and allow these platforms the opportunity to compete and provide the service to the public that Congress mandated and expected.

I think it's also critical that we preserve the pre-trade transparency that has been a core of the futures marketplace, and in that context I'm looking forward to hearing from panelists today about recent actions by the exchanges to lower their minimum block sizes for certain energy futures. As we move forward with transparency in one market, it's natural that some will be relabeled and come over to futures. We wouldn't want to lose what's been a core function of the futures market, both pre-trade and post-trade transparency.

I know there's an awful lot to cover. I'm going to apologize in advance because I need to leave here shortly for a Financial Stability Oversight Council meeting, but after that I'll come back and sort of listen. I don't know, Rick, if you're going to allow Scott, Mark, others to, but I just wanted to say a few thoughts on futures, swaps, and this panel.

I don't know. Rick, it's up to you, but I'm sure.

MR. SHILTS: Yes, I understand also that Commissioner Chilton would like to make some comments.

Bart, are you on the phone?

COMMISSIONER CHILTON: Are you reading the five- by-five?

MR. SHILTS: Yeah, go ahead. Commissioner? You can go ahead and make your comments now, your opening remarks.

CHAIRMAN GENSLER: Bart, can you hear us?

(No response.)

MR. SHILTS: Yes, we can't hear you. So maybe we'll move on.

Commissioner O'Malia also has some opening remarks. Commissioner.

COMMISSIONER O'MALIA: Well, thank you, Rick and all the staff for organizing this. I greatly appreciate your assistance, and specifically to the Chairman for allowing this to happen.

I requested this back in November when we were beginning to look at this, and so he has put together and brought the staff together to put a really good set of panels together, and I'm pleased to see everybody here. I know it's a big panel for the first one, and I encourage you to get your thoughts out concisely so we can talk about these issues going forward. Don't wait to be asked. Offer your insights early and often if you will because we just have so many people here today.

Some of the issues that I'm really focused on is this margin issue, and I'm glad the clearing houses are here and we can talk about risk because that's what this is about. Margin should be about risk, and we should understand that relationship. So I hope we'll get into that.

I'm very interested to hear from the end users. I think the Chairman made his point. What happens if we change the lot rules in the future space to raise those up? They've moved over to the futures. Where will they go? How will they trade? I'd like to hear from the end users on that last panel.

Understanding the relationship on blocks is very important. So I think on the block panel we will capture that. So I'm very pleased with the panels we have and certainly the panelists, a great turnout and a great audience here.

There are some more seats up here if you can make your way. It's going to be a long day if you have to stand, so please come forward.

And I'd just like to make one other comment. I believe Mr. Wasendorf is being sentenced today. That is great news. The other good piece of good news is in the last month two SROs, CME and NFA, have done a terrific job and have lived up to the commitment they made to the Technology Advisory Committee back in July when we had an emergency technology meeting, is to automate the surveillance of customer accounts, and we are beginning to receive -- we have over 50 percent of the individual customer accounts being screened through an automated, pushed out from the depository banks to be matched up with the FCM data, and within one percent tolerance we're going to be able to see where the money is, and that's critically important to protect customers going forward.

So I think that's an absolutely terrific development over the past month, and I hope that we'll get 100 percent coverage in the very near future to make sure that customers are protected. So there's a lot going on.

I also understand MF Global trustees are also coming to some agreement today as well. So it's a big day for this industry, this panel, and the two bankruptcy issues.

So I greatly appreciate everybody's participation today, greatly appreciate the staff hosting this event, and I look forward to everyone's comments.

Thank you.

MR. SHILTS: Thank you, Commissioner, and I think we'll try again and see if Commissioner Chilton is available.

COMMISSIONER CHILTON: Yeah, can you hear me, Rick?

MR. SHILTS: Yes, we can now. Go ahead.

COMMISSIONER CHILTON: Sorry about that. It's always the difficulty on the blower, you know. I hit the mute button and it disconnects. So I'm sorry, but I did hear everything the Chairman said.

I just wanted to make a quick point. You know, we've been hearing a lot about this and not all bad that some of these swaps are becoming futures. I mean, you know, swaps were part of the problem, and so it doesn't bother me that we see some of this futurization, and the question is: does it become excessive? And to deal with that, the best thing we can do is what the Chairman talked about at the end of his remarks, is get on with the SEF rule.

I mean, you SEF guys have been ready-go for a long time. It's actually one of the good things that have come out of the delay in the SEF rule, is that you guys are ready to go now, and so we just need to get on with it, and I hope we do so in the next couple of weeks, and I just encourage us to bring it up even if we're not agreed on it all ahead of time. Let's go ahead and bring it up and talk about it and vote on it and amend it if we need to.

There is one other concern though that I do have, and that is with the swapification, the swapification of the futures industry, and I think this is potentially a silent creeper in that, you know, we don't want to take sort of relaxed rules that have been in the swaps space and transfer them to the futures industry, and the futures industry has operated really well. That was the problem with the mess in 2008.

So whether or not it's block trades or whether or not it's something else that occurs, either may be occurring or has the potential to occur, in the futures space I want to make sure that regardless of the history of these contracts, whether or not they're swaps, that we don't transfer sort of the regulatory oversight into a less regulated futures industry.

So I'm going to have an open mind about all of this. I'm just going to listen after this, Rick. I may just call back in on the listen only line, but I look forward to being enlightened, and thank you for your patience with the telecommunications, and thanks to you all for being here.

MR. SHILTS: Okay. Thank you very much, Commissioner Chilton.

As has been mentioned, the actual and potential migration of swaps to the futures markets is evidenced by several recent events both in the energy space as well as interest rate and credit areas. We're very interested in hearing panelists' comments about the potential impact of these events on the derivatives marketplace and the public interest. We're especially interested in learning about the issues and the challenges the Commission should be attending to.

We'd also like to know if there are any issues or changes which should be addressed regarding the consistency between the swaps and futures regulations, whether in one of the remaining Dodd-Frank implementing rules that the Commission will be finalizing, or to modifications to the already implemented regulatory provisions.

And now before we begin, I'd like to invite my colleague Ananda to give us some opening remarks.

MR. RADHAKRISHNAN: Thanks, Rick.

And thank you to all of the participants. I think we will benefit tremendously from the thoughts and the discussion. We appreciate you giving your time to come to the Commission today.

And I'm also appreciative of the fact there are so many people here to pay attention to this conference.

I want to make a couple points which I hope there will be a discussion about. One is all futures contracts have to be cleared, and as a guy with a slight clearing bias, I think that that is a good thing. The statute provides that all futures contracts have to be cleared by registered DCOs, and there are no exceptions.

In the swaps world, the Commission first has to make a determination as to whether certain classes of swaps have to be cleared, and as you heard the Chairman, the Commission has already made the determination with respect to certain interest rate swaps and certain credit default swaps.

Number two, even after the Commission makes the determination, not all swaps that can be cleared have to be cleared, and as Commissioner O'Malia alluded to, you have the so-called end user exception.

So the question which I'd like discussion on is:

is it a bad thing for all clearable derivatives to become futures?

And I'm not demonstrating a bias. I'm just asking: is that a bad thing? Because, you know, if that happens, there will be certainty of clearing because everything has to be cleared.

Does the government have a role to play in this? Should we care about whether all clearable derivatives become futures contracts? And if so, why? And if not, why not?

Now, the other issue of course, we've heard Commissioner O'Malia mention that in the swaps arena end users can participate in the swaps market and they don't have to clear and, therefore, there might be lower cost to them; they have opportunities to hedge.

So is it essential that there be some swaps that end users can transact without having to clear so that they can take advantage of supposed lower costs. So I hope there will be some discussion on that.

And again, thank you very much and I'll pass it on to Rick.

MR. SHILTS: Thanks, Ananda.

I need to go through some housekeeping remarks, but first I'd like to, again, thank everyone for coming. It's a really crowded event today, but I'd especially like to thank the staff of the Commission who've put this on, especially our DMO attorneys, Eve Gutman and Abigail Knauff, who largely put this together and made most of the arrangements.

For the record, I'd like to note that all the statements and opinions that are expressed today and questions asked by staff are those of the staff alone and do not necessarily represent the views of the Commission or any particular Commissioner.

Also, in order to ensure that we're able to hear the opinions of the participants and all of the panelists today, I encourage you to limit your remarks to the time allotted, and please note that the meeting is being recorded. A transcript will be made. The microphones are in front of you. Press the button and you'll see the red light. That means you can speak;

then you should speak directly into the mic, and then when you're done, please press the button and turn it off.

We've been asked that you refrain from putting any BlackBerries or other devices on the table as they can cause interference with our system.

As you can see, we have coffee, tea, and water in the back, and the restrooms are behind the conference center down the steps in the back.

I'd like now to quickly go through the agenda. As you know, we have four panels. The first one is entitled "General Industry Views and Concerns Regarding the Futurization of Swaps in Different Asset Classes." It will run for an hour and 15 minutes, and then we'll take a five-minute break.

The second panel is entitled "Clearing and Different Margin Requirements for Swaps and Futures." That will end at noon, and then we'll take a one-hour lunch break.

After lunch, we'll start the third panel, entitled "Transaction-Related Matters Including Appropriate Block Rules for Swaps and Futures." That will go for an hour and 15 minutes.

And then our last panel of the day will cover "The Effect of the Conversation of Swaps to Futures on End-Users," and that will end it, and then we'll end the panel discussion today around 3:15 this afternoon.

So now I'd like to get started with the first panel, which we'll focus on industry views and concerns. The panelists are invited to identify any issues or challenges that the market participants want to raise related to conversation of swaps to futures in the energy asset class as well as any of the other asset classes.

We'd like to you to share your views and whether there are any issues or challenges or changes that we should be considering regarding the consistency between swaps and futures regulations, either in the existing Dodd-Frank rulemakings or by adjusting other regulations.

But before we begin the discussion, I'd like to go around the table and have everyone introduce themselves. So I think I can start here. I'm Rick Shilts, the Director of Market Oversight at the CFTC.

MR. RADHAKRISHNAN: Ananda Radhakrishnan, Director of the Division of Clearing and Risk, CFTC.

MR. VAN WAGNER: David Van Wagner, Chief Counsel, Division of Market Oversight.

MR. FISANICH: Frank Fisanich, Chief Counsel of the Division of Swap Dealer and Intermediary Oversight.

MR. MIXON: Scott Mixon, Acting Chief Economist.

MR. SHILTS: We can finish up here.

MS. MARKOWITZ: I'm Nancy Markowitz, Deputy Director of Exchange and Data Repository.

MR. BRODSKY: Aaron Brodsky, Exchange and Data Repository.

MS. GUTMAN: Eve Gutman, Exchange and Data Repository.

MS. KNAUFF: Abigail Knauff, Exchange and Data Repository.

MR. SHILTS: Okay. Now let's start, Bryan.

MR. DURKIN: Hi. Bryan Durkin, COO, CME Group.

MR. FARLEY: Tom Farley, SVP Financial Markets, Intercontinental Exchange.

MR. HARRINGTON: George Harrington, head of Fixed Income Trading, Bloomberg.

MR. OLESKY: Lee Olesky, CEO, Tradeweb.

MR. MARON: Jeffrey Maron, Managing Director, MarkitSERV.

MR. RHODE: Will Rhode, Director of Fixed Income Research at Tabb Group.

MR. LEWIS: Cliff Lewis, EVP at State Street Bank.

MR. WILSON: Don Wilson, CEO of DRW Trading and also Chairman of FIA PTG.

MR. LUKKEN: Walt Lukken, President of FIA.

MR. SENFT: Dexter Senft, of Morgan Stanley, representing ISDA.

MR. FERRERI: Chris Ferreri, representing the Wholesale Markets Brokers Association.

MR. CAMPBELL: Paul Campbell, I lead Deloitte's Energy and Regulatory Risk Practice.

MR. PARSONS: John Parsons, MIT Sloan School of Management.

MR. SHILTS: Okay. Thanks to all.

And just to quickly review the format, we'd asked each panelist to provide their remarks and to limit them to four minutes or less. Once we hear all of the panelists' prepared remarks, then we'll start an open discussion. So we ask you to please hold your remarks to the four minutes because, as you know, it's a very large panel, so we want to give everybody an opportunity to speak and a chance to ask questions.

So with that, let's begin. I think maybe, Bryan, do you want to start?

MR. DURKIN: Well, thank you very much.

As representative of the CME Group, we appreciate the opportunity to be with this distinguished panel today to talk about the innovation that continues to exist as these markets evolve. The CME Group, we pride ourselves on being a very open institution with respect to the products and services that we offer as a derivatives exchange and also offering our clearing services to the OTC markets.

We are very, very much about open access and providing the facilities, products, and capabilities, deep liquid markets, to manage the risk management needs of the marketplace that comes to our company.

At the end of the day, one of the things that we, you know, want to make very clear is, you know, this panel today, the foundation and the principles of the issues have really been premised on longstanding, very well run markets, and those are futures markets. We have had, you know, a long, undisputed history in the context of providing deep, liquid marketplaces in which, you know, we can provide risk management needs from a central common party clearing perspective. We operate markets that clear 11 million contracts a day and have 75 million open interest and we do that with great pride.

At the end of the day, as we start talking about some of the issues of topic today in the context of the differences between futures and swaps, there are differences and those differences have been distinctly identified in the context of the rulemaking. And we feel that as markets evolve, you continue to innovate and you provide instruments and services to come along with that evolution.

A number of panelists around this table, I think, have over time made some commentary in the context that one size does not appropriately fit all, and I think that that's part of what we're talking about here today, and I wanted to make sure that as we talk about the term, you know, "futurization of products" we keep in mind that there are very distinct differences between a futures contract which has a tendency to be very standardized and a swap contract which has a tendency to be very customized.

There's a difference on risk elements associated with those products, and as such the rules in terms of maintaining and monitoring those products are not necessarily going to be the same, nor should they be.

And so we look forward to sharing more of our philosophy on those topics as each of the panelists speak.

MR. SHILTS: Tom.

MR. FARLEY: Thanks. Thanks for having me here today on behalf of ICE.

I'd like to spend my four minutes giving a little bit of the history of the energy markets. Twelve years ago, the OTC energy markets were opaque. They were phone traded. There was very little, if any, clearing, and during the intervening 12 years in large part because of ICE's efforts, those markets have become transparent. They've become cleared, and the contract terms have largely become standardized.

You might have even said that those contracts during that 12-year period have come to look a lot like futures contracts. A slight regulatory breeze may have blow those contracts from swaps land to futures land, and Dodd-Frank as it turns out was little more than a slight breeze. I'll let each of you finish that metaphor privately.

So in October, we converted all of our swaps contracts to futures, and it's important to share that our customers loved that decision. In fact, we're a company with dozens of thousands of customers, and of the responses we received, 100 percent, not 95 percent, not 98 percent, 100 percent were supportive of our decision because our customers agreed with us that this was the natural evolution of these markets from purely

OTC to ECM, to SPDC if you're familiar, to fully regulated, fully regulated futures.

So what is it that they were choosing on the day we went from swaps to futures? Because it was more than just a naming convention, crossing out the word "swaps" and putting in the name "futures." I've seen it reported in the press. I've even seen it said in Congress that somehow these customers were choosing a lesser regulated market.

Here's what they were choosing on the day we converted to futures. Every one of those contracts instantaneously market-wide -- every one of those trades, pardon me, market-wide needs to be reported. Every one of those contracts, as Ananda pointed out, has to be cleared. Every one of those contracts has pre-trade price transparency. Every one of those contracts has a position limit regime.

None of those characteristics was true of the swaps market, is true of the swaps market, or will be true of the swaps market under Dodd-Frank.

And so I get very passionate about this, as you may be able to tell, and it reminds me that the arc of ICE's history is about more than ECMs and SPDCs. There's an arc of loopholes. Those of you who have been around a long time can probably guess what I'm referring to, but a decade ago, there was this thing called "ENRON Online." It was conflicted. They were both the owner, but a customer.

The customer said, "Hey, ICE, here's an opportunity to build an exchange that's not conflicted, that's more transparent." So we did that, and we were successful because customers really liked it.

And then people said, "Well, wait a minute. ICE must have found an ENRON loophole."

And so then we as managers, using what we thought was a dose of wisdom at the time, we moved to fully regulated UK futures. Customers loved it. We were successful because our customers really liked it. So, of course, we hear ICE has abated U.S. regulation. There's a London loophole.

And so now I'm hoping this is the conclusion of the loophole story because oddly, ironically, we have decided to move our contracts to the gold standard, the global gold standard of regulation, U.S.

futures, the standard bearer, if you will, and I'm here in part to defend a futures loophole, which is beyond affiliated.

I just want to conclude with a couple of remarks. I'm a provider of products and services, as are my colleagues, for instance, to my immediate right and left. I'm not a customer. I'm, indeed, self-interested, and my comments should be viewed through that lens, as should many of my colleagues' here on this panel.

I urge you to consider what the customers are saying and what's good public policy, and the title of this panel is "General Observations." I'll just leave you with a few.

My first general observation, which is the observation of ICE, is what's happening in the energy market is very good for public policy. It has been very good for customers and, quite frankly, is the logical evolution of these markets and was expected by intent market observers.

And the second general observation is I just want to repeat that we should seek to differentiate comments born out of self-interest borne out of self-interest or for commercial one-upmanship, and we should focus on the customer.

Thanks.

MR. SHILTS: Thanks. George?

MR. HARRINGTON: Good morning. Again, my name is George Harrington, and I'm the global head of fixed income trading at Bloomberg based in New York.

I want to thank the Commission for giving me this opportunity to present our thoughts and the concerns of our clients on these important issues.

Bloomberg is a provider of market data, analytics, trade execution to more than 310,000 subscribers globally. Since 2005, Bloomberg has hosted electronic trading in the derivatives market through 24 dealers to more than 1,000 end-user customers. In the credit default swap, interest rate swap, commodity, and FX spot markets, Bloomberg is the provider of electronic trading platforms and connectivity to the central clearing houses represented here today.

Since 2006, through our broker-dealer Bloomberg Trade Book, we operate a multi-FCM global futures ISV. Our interest in this debate is to assure that our customers on both the buy-side and sell-side have unfettered access to data and trading services across the broadest range of investment options.

Efforts to move segments of the swaps market to futures is not a new idea, and is not a construct from the Dodd-Frank legislation. Over the past decade, there have been multiple attempts by exchanges to launch futures contracts based on swaps, none of which have developed significant liquidity to become viable.

The requirement of Dodd-Frank that OTC derivatives be centrally cleared may, in fact, lead to viable swap futures product. However, that should not be a result of disparate minimum liquidation times set forth in CFTC Rule 39.13. When trying to understand the reasoning behind having a one-day minimum liquidation time for futures and options, and a five-day minimum liquidation time for centrally-cleared swaps, we can find no economic argument.

The most obvious reason, a difference in the implied risk of the products, is not a factor that we have seen quantified. Of even more concern, there's no mention of differences in the liquidity of the instruments. There is no question today, as the Chairman just pointed out, there is significantly more liquidity in cleared swap products than in cleared swap futures. In that light the establishment of a margin regime that favors futures over swaps runs the risk of increasing systemic risk.

Forced futurization, which the CFTC derives with this rule, risk undermining the central goals of

Dodd-Frank. For the topics we're discussing today, the United States Congress had three main objectives:

Number one, greater pre-trade price transparency in the market; Number two, reduced systemic risk to central clearing; and Number three, public dissemination of pricing to swap data repositories.

To accomplish the first objective, the concept of a swap execution facility was envisioned by Congress. When the swap execution facilities rules are finalized by this Commission, we expect they will require electronic trading of swaps through the display of executable quotes or request for quote system. This represents a dramatic change in the current form of the OTC market where the great majority of deals are negotiated over the phone on a bilateral basis.

Represented in this room today are at least five firms that intend to launch SEFs, assuring a competitive start to the market. A margin regime that dramatically favors futures over swaps lowers the value of the stuff to the point of potentially making it unviable from a business standpoint.

The objective of central clearing is nearly universally agreed to be safer for the market. Movement onto the futures market, either natural or forced by the government, will not have an impact on central clearings since both swaps and futures will have the same requirement to clear, but with different margin regimes.

To the point I made earlier, a lower margin requirement for a lower liquidity instrument actually increases systemic risk in these clearing houses.

The objective of swap data repositories were envisioned as public dissemination tools for all swap activity. The public good to be served by these utilities was to avoid opaqueness in pricing that was at the heart of the AIG situation in the 2008-2009 financial crisis. Forced futurization has a far lower transparency than was envisioned by Congress. The SDR rules call for price dissemination as soon as is technologically possible for swap trades executed via a SEF and after a reasonable delay and after a reasonable delay for block exempt trades.

Futures exchange require price disclosure by the day basis. This is obviously a worse outcome.

One last point we would like to make is on the risk of moving swap trading offshore by creating an uncompetitive regulatory environment. Global organizations with specific investment needs will continue to utilize the swap market. If the cost of executing these transactions is priced prohibitively high by the Commission, they will likely look around to achieve these financing needs.

In summary, we believe the push towards central clearing is very positive for the market, but forced futurization is a negative and can prove extremely costly to the American consumer.

Again, we thank the Commission for the opportunity to be here today and are happy to answer any questions that you have to the best of our ability.

Thank you.

MR. SHILTS: Okay. Thanks.

Lee.

MR. OLESKY: Thank you.

Tradeweb appreciates the opportunity to be here and participate in today's roundtable. We've been supportive of Dodd-Frank and its policy objectives, pre- trade transparency, market efficiency, and reduction of systemic risk. It has been hallmarks, in fact, of Tradeweb's business since 1998 when we did our first trade in U.S. Treasuries.

We're here to provide our perspective and raise our concerns on the issues surrounding the different regulatory regimes for swaps and futures. Fundamentally, we are concerned that as currently constructed and contemplated, the regulatory structure and rulemaking for swap futures creates an uneven playing field for market participants that wish to trade swaps and allows economically equivalent products to be traded subject to different system rules.

The clearest example of this, the difference between the block rules for swaps and futures. That creates two entirely different paradigms in terms of transparency and mode of execution.

As currently proposed, the CFTC has set minimum block levels and public reporting times for swaps but not for futures. These differences have more consequences for how these products will be traded and recorded and highlight how the move to futurization may actually lead to less transparency for a very similar risk instrument.

In the absence of similar block rules, an economically-equivalent swap and future will be traded entirely differently. The future can continue to be traded bilaterally, off exchange, where the swap it will be required to be traded by an RFQ to a minimum of five as the SEF rules have been proposed.

There's really no logical reason for this discrepancy. One is bilateral and one is out to five. In addition, the time in which those trades will be reported to the public will be different. Swap future will actually be less transparent than its swap equivalent, both pre and post-trade.

In short, there should be no difference in the transparency, execution and reporting for the same risk instrument, and we urge the CFTC to address this difference as soon as possible.

Further, with more onerous obligations on market participants as it relates to margin, as George just raised, the business conduct rules, cross-border rules, reporting, trading swaps may become less attractive to market participants.

Two additional factors are also at play. One is the delay in the SEF rules. Market participants have begun to consider moving away from the swap market really as a result of some of the uncertainty on timing with respect to the SEF rules, in part.

Furthermore, the prescriptive nature of the proposed SEF rules will push market participants further away from certain segments of the swap market.

In the absence of a level playing field, market participants will not have the flexibility to choose which products to suit their hedging and risk needs. Instead, they will be choosing one product over the other because of an imbedded regulatory advantage. We do not believe that that's what Congress intended when it passed Dodd-Frank, and we fear that the current construct undermines the goals and policy objectives of Dodd-Frank.

Market participants are prepared to trade swaps in a regulated environment with real time reporting, clearing, and mandatory execution, but they need flexibility and choice in how they trade in order to manage their risk and transaction costs, and they want a fair and consistent regulatory regime when it comes to transparency and execution.

We believe that if the rules provide for a level playing field, it would foster greater and consistent transparency in the marketplace, and it will also foster competition and innovation among market participants and the various venues that are represented today at this roundtable.

We encourage the Commission to consider how their rules concerning swaps and swap futures will impact market participants' choice of product and the overall impact on the swaps market.

Thanks very much.

MR. SHILTS: Okay. Thank you.

Jeffrey.

MR. MARON: MarkitSERV thanks the Commission for this opportunity to participate in the roundtable. More importantly, thanks to the Commission for having the roundtable and listening to the voices and the various views that are available around the table.

MarkitSERV is a neutral industry middleware provider offering services and connectivity across the entire community, confirmation services, affirmation services, and other. We connect over 2,500 firms covering over 26,000 different underlying funds. We speak to over 60 different brokers from 20 different clearing houses, and as such, we have a variety of voices from among our customers. What we'd like do today is present the views that we are hearing and the concerns that they raise and some of the recommendations I will put forward.

We recognize that market participants trading in derivative instruments may at times find that a swap more appropriately choosing their hedging route investment strategy while at other times the futures contract may be the more appropriate choice. Generally speaking, in the circumstances where an OTC-derivative product has reached a sufficiently high level of standardization and liquidity, there may be a simple basis for creating a standardized futures contract designed to replicate that OTC product.

Once futures contracts have been launched for a specific product, they may often be used alongside swaps as an alternative when market participants decide between swaps and futures depending on the uses, users, and product specifications.

The recent process of futurization has been marked by a larger scale of migration products commonly traded as swaps to the futures markets. We believe that such overnight futurization, unlike historical market- driven product evolution, has been significantly distorted by regulation. Accordingly, we believe that this market shifts should be carefully monitored by the Commission since it may harm market functioning if market participants are no longer able to find the choice, flexibility, and the liquidity that they require from the swaps markets.

This would in particular damage end-user derivatives that require the custom terms that only swaps provide as they look to hedge the risks that arise from their core businesses. Further, such developments might harm competition if the execution of derivatives shifts from a competitive marketplace with many execution venues offering flexible products that can be cleared in any of several different DCOs to one that is dominated from a few standardized products that each trade on a single, vertically-integrated exchange and clearing platform.

So just comments and recommendations, we therefore encourage the Commission to carefully monitor future developments, analyze their drivers, and evaluate actions they might need to take to prevent damage to the efficient functioning of the derivatives markets overall. Specifically, we believe that the Commission should mitigate the risks of excessive harmful futurization, regulatory arbitrage by first finalizing the rules and issuing guidance to ensure that economically-equivalent products are treated equally, regardless of whether they're called futures or swaps.

As mentioned, there are issues that differ between reporting rules, margin requirements, tied arrangements between execution and clearing, and block rules. Until we see certainty on all of these, there are differences between them. So recommendations to harmonize the rules applicable to futures and swaps or economically equivalent contracts.

Number two, ensuring the regulations applicable to swaps markets are not overly burdensome. Particularly this impacts end users of derivatives. As mentioned by the Chairman and by the Commissioners, it's important that end users continue to have a forum in which they are able to customize transactions to meet their individual needs and hedge. The worst case outcome for all of this would be for them not to hedge their risks and to take those burdens forward without an appropriate forum. SEFs should have the right level of flexibility to executive these contracts.

And, finally, number three, taking sufficient time for the finalization of remaining rules to ensure that swaps markets are not unintentionally disadvantaged. As mentioned by Commissioner O'Malia yesterday, we should make sure we do the rules right, not do them quickly, to paraphrase him, but it's important that we do, do them quickly and do them in an appropriate timetable.

What's also important is for the market to have the opportunity to organically come up with its own solutions to various problems that have come up rather than having to force it into a narrow timeframe, such as certainty of clearing.

We thank you again for the opportunity to present the information to you today. Much more information is available in the formal comments that we submitted.

MR. SHILTS: All right. Thank you very much.

William?

MR. RHODE: Good morning, members of the Commission and staff. Once again, my name is Will Rhode. I am the Director of Fixed Income Research at

Tabb Group. We're an independent research and advisory firm focused exclusively on the capital markets. I would like to thank the Commission for the opportunity to participate in today's important discussion on this matter of public policy.

Swap futures acts as a wrapper to insulate swap users from some of the more punitive elements of Dodd- Frank reform. On the one hand, they may be viewed as a healthy innovative response by the financial services industry to regulatory change. Given that Congress looked to the futures market as a guide for swaps reform, it could be argued that swap futures are consistent with regulatory intent. In many ways, they appear to be a logical progression. On the other hand, swap futures can be viewed as regulatory avoidance. To borrow from Myron Scholes, one of the reasons we have financial innovation is to get around rules and regulations.

Swap futures obviate six specific elements of the reform process: dealer registration, margin treatment, block thresholds, clearing competition, execution competition, open reporting. Thus, swap futures appear to destabilize three pillars of the 2009 G20 commitment to reform the swaps market. First, by removing the need for heavy use as swaps to registered dealers and lowering block threshold so that bilateral off-exchange trading may be facilitated, swap futures appear to undermine the G20's transparency goals. Second, the amounts of posted margin for futures is lower than for swaps. This creates concerns that swap futures will lead to more, not less, systemic risk. And, third, the vertical nature of futures clearing and licensing rights appear contrary to the open-choice clearing and execution structure designated by the Commission in the Dodd-Frank rulemaking process.

To shed light on the issues and the challenges regarding consistency between swaps and futures regulations, we would like to refer the Commission to a written analysis of three swap future initiatives that we have submitted. In the analysis, we focus on the IntercontinentalExchange's energy swap futures, Eris Exchange's interest rate swap future, and the CME Group's deliverable swap future, but these are by no means the only examples nor will they be the last.

Innovation in financial services must be fostered even as the regulatory process unfolds. At some point, rules will need to be finalized in order to allow the seeds of new markets to germinate and grow. The question is whether some level of protection should be afforded to the new horizontal market structure that the Commission has designed so that it may emerge and flourish, or if the Commission will consider swap futures as a viable alternative to the traditional dominance of banks in the OTC swaps market. Both avenues open up the swaps market to new competitive elements which should be considered a success of the Dodd-Frank rule-writing process. The only question that now remains is how best to balance the playing field between these new dynamics so that other tenets of the reform process are just as successfully observed and deployed.

The overwhelming message from the market is that swap futures are more efficient, cheaper to use, easier to deploy, and have less regulatory heartache than swaps. They also fulfill many of the major G20 requirements for the treatment of swaps. While we believe swap futures will be successful, we do not believe they will take over the swaps market. That said, we do observe some disharmony in the regulatory treatment of swap futures versus swaps that could advantage the former.

Beyond the details, Tabb Group believes there is really only one question the Commission has to consider when it comes to the future of swaps and the role of swap futures. Has the swaps market become overregulated, or is the problem that the futures market is underregulated? We believe the answer to this question will ultimately guide the Commission when considering changes to one of the remaining Dodd-Frank rulemakings or through modifications to already implemented regulatory provisions.

I would like to thank the Commission for allowing me to present Tabb Group's research and my personal thoughts on swap futures.

MR. SHILTS: All right. Thank you.

Cliff?

MR. LEWIS: Thanks. I'm going to speak really from the perspective of our clients. State Street is a custodian and an asset manager, the second largest asset manager in the world. I'm going to talk about the pension funds, insurance companies, really financial asset managers when we talk about buy-sides and just answer Ananda's question up front. They would love it if it all went futures; that would be the preferred outcome.

And I think I'm going to give an uncharacteristic statement to the Commission: I think the way you've approached this is spot on. I think you ought to hold a parade and declare victory because I think actually moving much of this to the futures market is going to be a huge improvement in buy-side financial market management, not just from a risk perspective but from an efficiency perspective. And I'm saying that despite the fact that I'm spending a lot of money, a lot of the shareholders' money, on creating a SEF. We believe that the market will evolve, that clients will have different requirements, we're spending a lot of money to have a SEF, we're spending a lot of money to help our clients understand how to use standardized futures products. So we basically -- pardon my expression -- are hedging our bets a little bit in terms of how this evolves.

I think intellectually the criticism of the futures model implicit in some of these statements is not borne out by any of the historical record either recent or over the past 100 years. In effect, it comes down to arguing that the clearinghouses are setting margin regimes inappropriately. I don't think that's the case. I think that the standards that the CFTC has created work well. I think, if anything, the clearinghouses have gotten dramatically better, even though, as was noted by the Chairman, they weathered the crisis very well.

I think the tradeoffs simply put between the way you treat a CLOB with price reporting requirements that permit transaction cost analysis versus an RFQ is the appropriate distinction.

I think the blocks issue is a red herring. I think the issue really from a fiduciary perspective on the buy-side is you have a legal obligation to get the best price. If you're using blocks to get less than the best price, you're going to go to jail. From a buy-side perspective, it's as simple as that. There are plenty of people who want to make money as whistleblowers in this world, too, so I don't think there is a lot of concern that people are going to drive a truck through that. I think the real issue isn't really expressed. I think the real issue here is the way that dealers make money in the current regime rather than the advantages to the buy- side, which I don't think is a legitimate public policy issue.

Let me make one other observation on our experience operating what is in effect a SEF but is in a remaining unregulated environment. I run the largest FX trading platform, electronic platform, in the world, no regulatory compulsion was involved in our customers deciding to do about $200 billion a day in our various platforms. That's about double the size of FX futures just by way of reference. Well over half of that business is done with RFQ electronically. I remain very confident that many of our customers will choose to use competitive RFQ, as outlined in the SEF rules.

That's one of the reasons we're moving into the SEF arena. So I don't believe everything is going to move futures; otherwise, obviously we wouldn't be investing a lot of money in both preparing for the SEF that we're going to launch as well as preparing to help our customers do more futures trading.

I would also point out a fact that is overlooked. There are also advantages to the SEF regime which I think the Commission ought to examine closely, and we've talked to the staff and we're going to continue to talk about this. One very important one is the fact that for the LSOC regime, the fact that the legislation language itself requires for uncleared swaps that buy- side customers have the opportunity to use tri-party custody for margin money. The anomaly, everywhere in the world works that way. All of our overseas buy-side customers use tri-party custody, never had a problem with tri-party custody. We basically believe that futures should be normalized so that futures is not disadvantaged relative to SEF world so the tri-party customer of margin is allowed for futures.

Let me just make two last concluding points. The first point is speaking as somebody who has invested in, as I say, a hedge strategy, SEFs and futures, please focus on getting the SEF rules done. Then we'll have competition decide which work, we'll have some experience to see whether there are problems. We'll take our lumps.

We've got some value proposition that we're going to push, basically the fact that we're trying to solve buy-side problems, not preserve existing franchises that have generated tens of billions of dollars in bank revenue on the market-making side. We'll take our chances. We've made the investment. That's the genius of our markets; that's the genius of futures markets innovation. And if there is a concern about that, I just urge that you don't stray from insisting that the rules for SEFs competing among each other, that we keep a level playing field there, that the requirements be the same for the SEFs, and I think that some of the issues need to be -- I don't think you guys should wimp out basically is my point of view.

And the last point, if you want to worry about an unfair advantage, I would worry about -- and this is the 800-pound gorilla in the room -- is the timing of the regulations on the margining of uncleared bespoke swaps. That's the problem in the marketplace, not the difference between futures and SEF. The problem is the timing, and some of the stuff you're reading now is really quite terrifying because that's just going to drive a truck through the whole thing, and even more important I think, Ananda, than the end user exemptions because the end user exemptions really are meaningless so long as the dealers have these new capital requirements because it will simply be unaffordable for market makers to provide liquidity if they're not able to rely upon cleared instruments and the logic of moving to the most liquid transparent fully futurized is going to be pretty compelling.

Thank you.

MR. SHILTS: All right. Thank you.

Don?

MR. WILSON: Thank you. I would like to thank the Commission for inviting me to come and talk about this important topic. I am the founder of DRW

www.CapitalReportingCompany.com © 2013

Trading Group, which is a proprietary trading firm. I am also the Chairman of FIA PTG, which is an industry group made up of proprietary trading firms; it has about 32 members. I am also, for the sake of full disclosure, the co- inventor of the patent pending methodology, which is the cornerstone of the Eris Interest Rate Swap Futures contract and is also an important element of the recently listed Variance-Swap Futures contract on the CBOE.

Futurization has the potential to be one of the most innovative periods in the history of the futures industry. It's a logical, predictable, and healthy reaction not only to Dodd-Frank, but also to Basel III, which incentivizes standardization. The intent of Dodd- Frank was to prevent another AIG. Futurization will certainly help to achieve this goal.

It's important in this discussion to differentiate between what happened in the energy markets and what's happening in the fixed income markets. In fact, in the energy markets, I would argue that futurization dates back to the launch of ICE and the creation of ClearPort, which was in 2002. The mid-

October transition was a much less significant step. Perhaps the beginning of futurization and fixed income dates back to the launch of Eurodollar futures approximately 30 years ago.

I just want to make a couple of brief comments on this margin debate. I think that a lot of market participants forget that there are actually important differences in the risk to the clearinghouse between identical, economically equivalent cleared swaps and futures. Even for contracts which have very similar liquidity profiles, the swaps market uses LSOC instead of the traditional futures segregation regime.

Under LSOC, as I think everybody is aware, the waterfall in the case of a customer loss is different than in the traditional futures regime. In the futures regime, the loss goes to the clearinghouse much faster because the segregated funds at the FCM, where the customer loss took place, are not at risk.

My view is that LSOC actually increases systemic risk. It certainly, in any case, increases the risk to the clearinghouse, so it's entirely reasonable and it would actually be shocking to me if clearinghouses didn't charge higher margins for cleared swaps than for futures as a result.

Just a brief comment on block trades. Because identical swaps will trade on competing SEFs, unlike the vertical futures models, it makes sense that block thresholds in swaps should be set universally while DCMs historically have been given the latitude to set their thresholds as they see fit subject to the constraints of Core Principle 9. I don't see a reason to alter that approach.

When thinking about the differences in block thresholds across the different regimes, it's important to consider the fact that RFQs on SEFs are essentially private negotiations between a limited number of market participants. In fact, some have advocated one-to-one RFQs, which is simply a block trade by a different name. On DCMs, an RFQ is required to go out to the entire marketplace. That difference in transparency for these types of negotiation processes means that it's entirely reasonable that the block thresholds should be different across these two different venues.

Once again, I would like to thank the

Commission for inviting me here. And thank you.

MR. SHILTS: All right. Thanks.

Walt?

MR. LUKKEN: Thanks, Rick.

I am here on behalf of the Futures Industry Association. Despite that name, the clearing FCMs that FIA represents actually are agnostic to whether the products that clear are swaps or futures. They certainly have the systems in place or are building the systems in place to accommodate both products. I think the key, as has been mentioned today, to getting this right is to ensure that the regulations being put forward are proportional, they're risk based, and they fit the attributes of each of the different products that we're discussing. If the CFTC can get that right, as the Chairman indicated, there will be a natural leveling over time of some of these products that come into the futures space and vice versa.

So in regards to the energy space that's been discussed, I agree with my colleague Don and others that have said that this, despite the revolutionary nature of the rules that they're putting in place in order to allow swaps to be cleared, the energy products are really an evolutionary occurrence that has happened over the last 12 years, as Don mentioned, with the beginning of 2(h) markets, with the CFMA's passage.

Many of you on the ICE, the senior members on the ICE, were around when 2(h) markets began. We started to get some more information over time and we started to layer on futures regulation onto the 2(h) market. So the fact that ICE actually converted these to futures, you know, if I were still around at the Commission back in the day, I would have been popping champagne corks because all the things that happened in the futures markets, the centrally-cleared, the reporting, the large trader reports, all the regulations that go with it over time, to me, that's a healthy thing. And I know today we're talking about the differences between the two markets. I think the key is to make sure that the regulations that are being put on the swap markets are risk based and fit the attributes of those markets.

Clearly, one thing I do want to mention, I, before coming on this job, was at a clearinghouse. You know, the 5-day versus 1-day margin issue is an important one. I do appreciate that the Commission has reserved for itself the ability to adjust the 5-day margin liquidation period for swaps. Having been at a clearinghouse, I know how much testing, how much proof and historical data has to go in to prove the model of whether you can liquidate in 1 day or not. I think in time some of this will adjust on its own in the swap markets, and if truly they are liquid and can show that they can liquidate in a period of time short of 5 days, that it's our hope that the Commission adjusts that accordingly again under this theory that things should be risk based and not just arbitrary in nature.

So with that, I'll pass it on to my next colleague, but I appreciate the opportunity for FIA to present today.

MR. SHILTS: All right.

Dexter?

MR. SENFT: Thank you. ISDA appreciates the opportunity to be here today and to comment on this topic. For those of you who might not know, ISDA stands for the International Swaps and Derivatives

Association, and, not surprisingly, we support safe and efficient derivatives markets, be they cleared OTC, non- cleared OTC, or listed futures or options. Of course, the listed products provide us with the widely traded standard benchmarks that we need, whereas the OTC derivatives provide tailored solutions, accurate hedges, and a bed for innovation of new products.

The three market segments are complementary, they provide support for one another, and we need all of them. We believe it should be a policy objective to promote efficiency and liquidity in each of these, and, indeed, the sheer quantity of outstanding swaps demands that we have robust markets for trading them. It seems clear to us that congressional intent certainly included the preservation of OTC swap markets. And, finally, we think that any material differences in the treatment of swaps or swap futures should be for logical and objective reasons.

Our concern today is that some of the rules do seem arbitrary and seem to create artificial barriers to one derivatives market or another. So what would we suggest the Commission do about this?

Well, we think of rules as falling into three different categories. First you have rules dictated by policy objectives. So those would include business conduct rules, margins, segregation rules, ownership limitations, governance limitations, repository requirements, and so forth. Well, if it's policy, then the rules ought to be reasonably consistent between listed and OTC and, again, differences, to the extent that they exist, should be differences that can be logically explained.

Second, there are rules that should be left to commercial competition because they have the objective of spurring innovation and improving liquidity, so these would include eligibility requirements for market makers or other participants, price discovery mechanisms, order books, RFQs, streaming, transaction protocol matters, order priority rules, iceberg orders, workups, and so forth.

Lastly, there are rules where policy is behind them, but they have to be informed by market data. So just as we would say that the quantity of margin has to be informed by market liquidity and

www.CapitalReportingCompany.com © 2013

volatility, block trade sizes need to consider available liquidity where trade sizes move markets, mandatory execution rules should consider the frequency and regularity of trading.

So in closing, let me just say that ISDA believes that market participants should be given a choice, they should be able to choose which derivative products best suit their needs, and that choice needs to be made on a level regulatory playing field, not one that imposes seemingly arbitrary costs or other barriers.

Thank you.

MR. SHILTS: All right.

Chris?

MR. FERRERI: Thank you. I'm Chris Ferreri, representing the Wholesale Markets Brokers Association, whose members currently operate global, multilateral, lower case swap execution facilities. We are working very hard to operate the upper case swap execution facilities, but this is a business that we know and this is a business that we do.

I would like to briefly discuss the history that led to the Dodd-Frank Act. Dodd-Frank is the law of the land, and as valuable as all of our opinions are, we have the law as our basis, and I think it is critically important for us to consider that. It does not change what is in place for commoditized futures instruments; however, in setting a framework for swaps, Congress adopted something different than the non-fungible futures model. OTC swaps, with their more episodic liquidity, required a different market structure, the futurization of the swaps market perhaps but not the futurization of swaps.

Accordingly, Congress selected and promoted user choice with competitive execution clearing, product fungibility, and trade execution using -- and I'm going to -- the Chairman gave a shout-out to me, I'll shout out to him -- these words are in the statute, "any means of interstate commerce." Congress enacted the laws to ensure that OTC swaps are not owned by one vendor and can be executed on any number of competing systems and platforms including central limit order books, RFQs, price auctions, and multilateral voice systems.

Congressional intent for distinct swaps regulatory regime is thwarted when the name of a product is changed from "swap" to "future" for the sole purpose of moving it from one regulatory framework to another. We should analyze the public policy risks, benefits, and burdens of such regulatory arbitrage and not the commercial interest of any particular company or industry.

DCMs were authorized to set their own futures block trade sizes and change them at their own discretion. SEFs must follow CFTC-established block trade sizes. The swaps block trade distinction by law relates to whether a trade is disseminated as soon as technologically practical -- another phrase that's in the law -- on a delayed basis. This distinction has significant impact on liquidity formation. Simply changing a swap to an economically equivalent future can impact how the trade is negotiated, executed, and reported. As proposed, block size will also determine what mode of trade execution can be used by SEFs, such as electronic order book, RFQ, electronic auction, or hybrid voice and screen brokerage, and any other means of interstate commerce.

The CFTC is imposing a futures model -- in this case, DCMs -- on the Dodd-Frank swaps regime that by law is not the futures model. I raise this today because the CFTC is deliberating on final SEF rules and needs to remove this link of block trade size and method of trade execution. Swap block trades should only impact trade dissemination timing and not trade execution method. Not only is the block trade issue important for futurization but for swaps liquidity information as well.

Now, briefly on margin. There are important differences in the CFTC's Part 39 rules related to liquidation timeframe for swaps and futures. A recent Risk magazine article projects that swaps subject to a 5- day cure period will generate approximately 2.23 times the margin held against futures subject to a 1-day period. These rules should be rewritten so that margin is calculated based on actual traded liquidity and other market data and not on whether an instrument is called a swap or a future.

Relating a swap product as a future should not automatically result in more favorable margin treatment on economic characteristics or otherwise identical. It is troubling that futures exchanges are currently touting the lower margin costs for non-fungible swap futures over swaps as part of their printed sales pitch. If swaps are overmargined, then the additional cost borne to the U.S.

economy where corporate end users have to pay artificially high clearing costs to hedge a business risk. If futures products are undermargined, then clearinghouses will absorb more risk particularly during a liquidity crunch or a downgrade of its clearing members. Remember, these clearinghouses are designated as systemically important financial market utilities under Title VIII of Dodd-Frank. If inadequate margin causes liquidity crisis, concentration of risk at clearinghouses may require the SIFMA to access the Federal Reserve discount window from the U.S. taxpayer on the hook once again.

Finally, urge the CFTC to ensure competition between SEFs and DCMs when finalizing the SEF rules. SEFs must meet impartial access requirements, intention to permit equal and open participation, and vibrant competition for the benefit of users. In contrast, the futures rules protect dominant market forces by permitting them to further entrench their dominant positions and exclude competitors.

If participants prefer futures to swaps, so be it, but it's disingenuous to suggest that swaps and futures are competing on a level playing field with a neutral referee and neutral rules with the outcome driven by product characteristics and user preferences. Even if futurization is inevitable because of a natural migration to order books as swaps become more liquid, it still begs the question why greater liquidity must move to order books operated by a single-silo, non-fungible exchange.

WMBA members and other companies operate sophisticated electronic order books ranging from giants like Bloomberg to startup boutiques. With increased liquidity, why can't these products trade on competitive SEFs and exchanges, offering a wide array of trading methodologies? The Commission should ensure a level playing field for more participants whether for

www.CapitalReportingCompany.com © 2013

swaps or for futures. If two products act and look alike, they should be subject to similar regulations and similar rules of the road.

Thank you again for your time, and I appreciate the opportunity.

MR. SHILTS: All right. Thank you.

Paul?

MR. CAMPBELL: So thank you for the opportunity to be here today. I was at the Commodity Markets Council meeting earlier this week, and Commissioner Wetjen was there as well, and one of the things I heard, I heard frequently, and I would just say the Commissioner heard maybe fervently and patiently is the opportunity for people to come and talk with the Commission and discuss kind of discreet issues and how to solve them.

And so for perspective, I lead at Deloitte, our Energy Regulatory and Risk practice, and so the perspectives I am bringing to you today, I am not speaking on behalf of any of my clients, it's the perspective of we're in the business of implementing these rules, and so we're kind of at the last end of

www.CapitalReportingCompany.com © 2013

trying to look at a rule, assess what the impact is going to be on a client, and then think about, how do we implement that? And so how do we make choices around business processes, systems that are in place, governance that needs to be either created or amended? And that's the real struggle that we deal with. And so the focus of my remarks are really around, what is the challenge around implementing these rules, and then, frankly, what would be helpful to get from the Commission?

And, Ananda, I'll speak to your point they asked in here. And I'm also on the end user panel at the end, and so I'll speak to some other issues I think that are specific to the end user market.

I think one thing to think about just in the shift from swaps to futures is really the impact that that's having on the market, and so the perspective I have on this is we're serving a wide range of clients, and this goes from large global entities that trade, frankly, any commodity you can think of across any geography where markets are traded down to very small users that have maybe one swap on their books, and maybe they have no swaps, and maybe they'll think about putting a deal on next quarter and trying to understand, what are the implications if I do one transaction to hedge one particular risk that I see coming?

And so I think in that, it's important when we talk about the market -- and a number of others have focused on this point -- is it's not just a market, a generic market; right? What we're getting to as you start to provide a regulatory framework here is a segmentation of that market, and so understanding what the impact is on those segments of the market. And so if I look at the energy, the resources, market out there, we're starting to see a very clear segmentation, and I think this comes out of some of the shift from swaps to futures, of maybe four different categories, and one is the dealers, those that have registered already or will register, and then those become self-evident. There is another very large category of companies that are, frankly, traders, and we often think of them as kind of between the $8 billion and long-term the $3 billion de minimis threshold, we think of those as kind of the "tweeners" because they're not at the status yet of a dealer, so they do not have the requirements to comply with those rules, but they are looking forward 2 or 3 years down the line and understanding that they are going to have to meet those requirements going forward.

The third category is companies that are, frankly, trying to do whatever they can to having to avoid the costs required to comply with these rules.

And then the fourth is a category of these people that are other, and that actually comprises the largest segment of the market and the segment of the market that is struggling the most with this. So these are not large institutions that have the technology in place to support the implementation, they don't have experience, and so what we're looking to do is provide them guidance on these issues in a standardized and a programmatic way.

I think the benefit for many participants was the ability not to hit the $8 billion de minimis limit, and I think that provided a lot of clarity in terms of where companies were sitting, it allowed them to frankly not think so much about the qualitative and the quantitative tests, but just to focus on the qualitative test, it's a much easier threshold to work through rather than trying to understand what the qualitative impacts are, of whether you're functioning as a dealer in the market. But that is a large segment that I would say is emerging, and then it's a question as to whether they will migrate towards dealers in the future or they will restrain their trading activity and then move down into just a non-dealer mode or just a standard eligible contract participant.

So as I think about challenges we're having, it's guidance that actually targets those different segments and understanding what the implications are for all of those different segments. If you think of the 80-20 rule, most of the market participants actually fall into those lesser categories, they're not dealers, they're frankly not even the large traders, they're the companies that are going to shift completely to futures or are going to maintain some position in the swaps market, and I'll address that specifically at the end.

From a readiness standpoint, our sense is that maybe 25 percent of the market is in any state of readiness here, and that does not mean at a full state of implementation. Nobody is there because the rules have not yet been finalized. But if I think about maturity around being ready, I mean, they've got a program in place, they've engaged counsel, they're actively making changes to business processes and systems or looking for systems that can support this.

Other than that, there is a large portion of the market that frankly is really struggling with this. We spend a lot of time advising our clients and providing training to them both formally and informally on this, but I would say there is a gap and frankly a dearth of knowledge coming from the Commission and specific guidance on how to implement this.

So the very specific request is, as further guidance comes from the Commission, the more detail we can receive on that, and the more understanding of the different segments that will be receiving that information would be extremely helpful.

Ananda, to speak to your question, I think there is some real risk because there are segments within the energy market that frankly cannot rely upon cleared products because of the nature of their business. They may already be in a process of having an active hedging program, but they're pledging assets against those. That's a very frequent, I would say, hedging strategy and collateral management strategy within the exploration and production business, especially for smaller clients. And similarly, you'll see that with companies that have what I would think of as very strong balance sheets but limited cash flow requirements, and so the ability to post margin on a frequent basis can be a very difficult and damaging thing for them. And I think those are two risks that maybe are unintended. And in the panel this afternoon I'll try to speak about what I see as the unintended consequences coming out of this and the need to look forward and the shift in just frankly commodity prices 2 or 3 years out and the implications this will happen.

Thank you.

MR. SHILTS: All right.

John?

MR. PARSONS: Thanks very much for the opportunity to be here and participate in this conversation. I'll try to use my time to crystallize three quick thoughts of mine out of the last few months of conversations on this futurization issue.

The first thought I would summarize as they're all just derivatives. Before the financial crisis, before Dodd-Frank, the OTC swaps markets encouraged a myth about themselves that swaps were fundamentally different from futures, that they were special, that they were all about customization, unlike those clunky futures contracts.

(Laughter.)

MR. PARSONS: And like many other myths, there was a kernel of truth about it. There is a small segment of swaps markets that is about customization, innovation, thinly traded risks, but that just wasn't the whole story. Because the pre-crisis OTC swaps regime provided a space for customization by accepting it from regulation, that also created a loophole for lots of other transactions to move over to the swaps world and these were standardizable or standardized risks which in the end represented the vast majority of the OTC swaps market.

What we're watching right now is the explosion of that myth because as we see a bunch of standardized transactions just suddenly move over to the futures market, we suddenly realize that that didn't define the whole swaps market, so we have to admit that a standardized derivative is just a standardized derivative, you can manufacture it lots of different ways, you can put the label "swap" on it or you can put the label "futures" on it, but from an economic standpoint of trading the risk, there really isn't any difference.

The second point I want to make is that the

Dodd-Frank Act leveled the playing field. We hear a lot about needing to level the playing field, but if we step back and look at the big picture, that's actually what happened. Pre-crisis, pre-Dodd-Frank, the OTC swap market was not regulated where futures were; the OTC swap market was dark mostly where futures were largely lit; futures were cleared and swaps were not: those three things were the major difference between the two marketplaces. And now with Dodd-Frank, those three things are gone: swaps are now regulated; most of the swaps market has to become lit; and most swaps have to be cleared. Now that those major differences are gone, erased, trade is naturally rethinking where it goes, and you should expect a significant amount of trade to re- sort itself. What we're focused on now is smaller issues, smaller details, important details, but definitely smaller details than those three big ones.

The third point I want to make is that I hope the Commission keeps its eye on the ball. This slogan of creating a level playing field sounds very good, we all want level playing fields, but I don't think it's a very reliable guide for rulemaking actions. In fact, I don't even think it's a very viable long-run strategy for the Commission to pursue in rulemaking. It's not clear to me how feasible it is to constantly and meticulously hunt down any and all regulatory distinctions between swaps and futures regimes.

Pause and think for a moment what that really means as you define the future of CFTC rulemaking.

www.CapitalReportingCompany.com © 2013

You're going to be constantly constructing two distinct regimes, and while you construct two distinct regimes, you're then going to be going over them to make sure that they're exactly the same, and if that isn't the pure definition of the task of Sisyphus, I don't know what is. If a thoroughly level playing field were the objective, it would just be better to have one regime.

An alternative way that I would suggest to approach the rulemaking endeavor is to think about the two marketplaces as serving different needs. I'm not completely sure of exactly what those two different needs should be. Lots of people in the industry know all the different players perhaps better than I do. Maybe the futures market is best for the standardized risk of significant liquidity. Certainly the swaps regime is the only place for customized trades. What you do for other kinds of less liquid and more innovative instruments I'm not sure, but if the CFTC has been tasked with overseeing rules and regulations for two different marketplaces, it seems to me that there has to be some important difference between those two marketplaces, and that difference then naturally plays itself out as you define the rules.

The slogan "leveling the playing field" doesn't quite fit the bill, at least not for me. I don't think it's practical, it's ill-suited to the important task at hand because what you want to do is take advantage of having two different marketplaces to provide industry and society of all sorts a more complete array of the types of instruments that will help them to control risks.

So let me just conclude, the old pre-crisis regime is over, the Dodd-Frank Act has blown away that major boundary between the two marketplaces. It's reimposed these three key principles on both marketplaces. I think those three key principles should apply to both marketplaces to make the markets safe. There probably remains some other finer distinctions that should define the difference between the two marketplaces, and it would be good to try to focus a little bit on, what are those differences that truly define how one market can serve the needs of business differently than the other market?

Thanks for the opportunity to be here.

MR. SHILTS: Thank you very much.

And thank you to everyone for your comments. We don't have a whole lot of time. I have one quick question to begin, and since Congress did create two regimes, one for futures and one for swaps, and for those that have identified particular disparities or issues that they think makes for an uneven playing field or whatever, but I just wondered if people had thought about whether you're talking about pre-trade transparency or post-trade transparency or registration issues or margins or whatever, which of those would be statutory and which of those would be regulatory that would be within something that the Commission could actually address? And if anybody has thought about that and could quickly respond. Anyone?

MR. FERRERI: This is Chris Ferreri, WMBA. I think the key here is that the statute is very clear that the SEF itself becomes the intermediary, that there is no longer bilateral trading. SEF trading, by definition, is not bilateral, there is a third party involved, and the statute made that very clear. The statute also made it clear that we don't care how that

SEF does a trade, we're going to regulate it. And I think that's the thing that's troubling to the association to the extent that there was no definition of mode of execution in the statute based on the block trade size. Block trade sizes were used to protect the liquidity providers making those markets and providing them with a delay of reporting. So I can crystallize that one point in terms of what I think our concern is.

MR. SHILTS: Anyone else?

MR. HARRINGTON: In our comments, we clearly are on the margin issue. So we really look at 39.13, which was established by the Commission itself, which point to the difference required in margin between futures and options and swaps, so obviously that seems pretty on point. There were a lot of different comments obviously made here today, but I think the closing comments from Mr. Parsons, you really have equalized the products, and therefore unless there is a liquidity difference -- and there is, except it goes the other way -- it doesn't make sense to have a different margin regime for the two products.

MR. LEWIS: Yeah, just to emphasize that I disagree completely, you've established a minimum in terms of the margining regime, you're out here killing the back. I mean, what you're essentially criticizing the minimum is to say Kim doesn't have to do 1 day for futures that are illiquid, and she won't. These guys have been doing this for -- what? -- since 1921, I guess, when BOTSE (ph) got created, and they've survived world wars, crises, whatever you want to name. Is the 1 versus 5-day as a minimum? Well, again, is 5 days the appropriate level? Is it enough? is the more important question.

So I think you've gone to the heart of it. Whether you had to do more than that, I think some of the detail may be excessive in terms of how much you've replicated the regulations for DCMs and SEFs, which is just sort of needlessly, I think, adding expense, but trusting the CCPs, look it, if we don't trust the CCPs to set margins the right way, that's a much bigger problem than trying to regulate SEFs. And, again, let's let some competition take place and see what the customers like.

MR. SHILTS: And that's going to be the

subject of the next panel. So does anybody have any other comments on my question without focusing on margins and clearing? Because we're going to be talking about that shortly.

Yeah, Bryan?

MR. DURKIN: Right. I'll leave that to my colleague Kim Taylor, who will have plenty to say, but suffice it to say there are very distinct differences, and to be generalizing the way it's being generalized today I think could be very damaging to the overall marketplace because there are distinctive risk differences, which Kim will outline.

There have been some other generalizations made here that I just can't sit here and be quiet with respect to the lack of parity of treatment between swaps and futures as they pertain to the transparency of these products and these markets, and the suggestion that moving any type of similar product or economically equivalently similar product or however it's been categorized today to a less transparent marketplace and trying to tie that to a futures market is just unacceptable to have to listen to that because the futures markets have many, many decades of development, and these decades of development were premised on transparency and openness. The distribution of our products and our markets are real-time. The information associated with that from a market data perspective, from a clearing perspective, is real-time.

There has been suggestion here that moving to the futures market is moving to a block market. Let's be clear: we do provide block facilities and block executions across a variety of our asset classes, but that represents about maybe less than 3 percent of the overall marketplace in the futures market and the exchange trade derivative space.

So when I allude to there being 11 million contracts a day that are traded in the futures market, those are done via a central limit order book primarily. The block transactions themselves are there to assist and be responsive to a marketplace to facilitate the execution of larger executions, and again that's being responsive to a marketplace and serving a very strong risk management need.

MR. FARLEY: Can I just piggyback on that for just one moment? It's nice for once to be on the same side of an issue with Bryan.

(Laughter.)

MR. FARLEY: In some ways, I just want to reiterate what he said, but just put a fine point on it. I've read in two articles over the last several weeks that futures prices are reported on a delayed basis, and it's just one of those myths that just kind of persists, one guy writes it and then somebody else copies it. Just for the benefit of everyone, that's wrong. Futures trades are reported instantaneously.

And furthermore, I know in the case of ICE -- and we, too, are low single digits for the aggregate number of block transactions not dissimilar from the number Bryan quoted -- in the case of ICE, we actually put our blocks out in many cases in 5 minutes and some other cases in 10 minutes. The last I checked, that's actually quicker than any swap goes out irrespective of whether or not it was a block. So that's all.

MR. OLESKY: I think the question is not the current state, I think the question is, what will be the future state? So, really, in response to that, I

www.CapitalReportingCompany.com © 2013

wonder when we're talking about swap futures, whether they're credit or rates driven, we expect the same low percentage of those products to be block.

MR. SHILTS: Yeah, Bryan.

MR. DURKIN: I'm happy to respond to that, Lee. First of all, the swap futures product that was developed was driven by many of our large bank and OTC clients that wanted access to a standardized futures product that would trade in accordance with a central limit order book mechanism, and so again we are providing that very fixed, very standardized product which is not in and of the same as an interest rate swap which has many variable components associated with it, and we do believe that it will cultivate into a very similar phenomena as we experienced with our Treasuries and our Eurodollar complex. Again, that is catering to a specific need of a specific segment of the marketplace. We believe that the two will go hand-in-hand.

MR. OLESKY: See, one of the questions or points I was making before is we do see a difference here in a block that occurs through a futures exchange that's essentially a bilateral transaction between two parties and is outside of the order book versus a SEF structure where you have an RFQ that goes out to five different participants.

You can make -- and I think the Professor did make -- a fair point that these are different markets, but the fact is we're starting to regulate or will be regulating through SEF the OTC swaps market, and I think you have to have a view as whether or not you're going to embed a regulatory advantage in terms of transparency to one or the other. That is a fact. If it's a bilateral transaction that's a block that does not go through the order book, that is less transparent than an RFQ that's going out to five.

MR. SHILTS: Yeah, and we're going to be talking some more about blocks and those types of things this afternoon, but the discussion is interesting. We're a little bit over, but does anyone have more comments?

MR. MARON: Yeah, just to your point about what you can do from a regulatory perspective in order to ensure that this was ordered properly. The issue really is providing choice to those that participate in the markets and allowing them to select whether they want to do futures or swaps, and if one side wins, that's great, and the market will decide, but it's making sure that there is a level landscape that allows that decision to be made and even in a transparent manner.

If indeed certain new products are created that are fixed and standardized but are in many ways taking the liquidity away from those that are not fixed and standardized, and it disadvantages those that need that flexibility and they've lost liquidity and the bid offer spread goes wide and the number of market makers, market participants, dissipates, then all of us are hurt by that process.

So if you can, on a regulatory basis, make sure that you provide an even level playing field, then I think we're all able to compete evenly.

MR. SHILTS: Thank you.

MR. RHODE: I would just like to point that the CME and its comment letter on the proposed block rule last year did suggest that perhaps SEFs and DCMs be allowed to set their own block level. So perhaps that might be the best solution between by taking the CME's view on how SEFs and DCMs should be allowed to set their block levels given their comments on the proposed block rule.

MR. LEWIS: One other point which is empirical, which is that in our experience with RFQ and FX, typically market makers make tighter prices in RFQ than they do in a CLOB. So I just make the point that some of this perceived disadvantage of the SEF I think is misplaced. More generally, I think underestimating the importance of continuous pricing as a reference -- and I'm not talking to small energy firms -- the point is well taken by the Deloitte's guy -- I'm talking about public asset managers. Look it, they've got nowhere to hide. They've got to trade at the best price or they get a visit to the slam, as I said before.

So it is a huge distinction. It's not bilateral; that's a complete misnomer. You have to demonstrate best execution. That has nothing to do with the CFTC, that's got to do with their fiduciary responsibilities.

MR. SHILTS: Well, we've gone a little over. Does anyone else have one last comment before we close this session?

(No audible response.)

MR. SHILTS: Well, if not, well, thank you very -- oh, I'm sorry. Oh.

COMMISSIONER WETJEN: Rick, can I ask a question? Some have alluded to some possible responses, I guess, to the question I'm about to ask, but, you know, the natural order of things as far as the Commission's work here is to finalize the rules that we've already put out for comment, and so we have a collection of trade execution- related rules whose comment periods have ended and we're going to try and finalize soon. We also have our cross- border guidance that was put out for comment; we need to finalize that sometime relatively soon as well.

So looking at the context of the immediate tasks in front of the Commission right now that we have rulemakings, what do we need to be thinking about in those rules that address some of the issues that are raised here? The gentleman from Tabb suggested one idea, although there might be reasons why that might be difficult for us to do, but I would interested in hearing what we should be thinking about doing in these rules that we're about to finalize that might address some of the issues we're talking about. For example, with the SEF rule we have a lot of issues around different trading methodologies of whether or not to permit them or to what degree and so on. And so I would be really interested in hearing some people share their thoughts about that.

MR. SHILTS: Yeah, Bryan?

MR. DURKIN: Commissioner, thank you so much for bringing that point up.

COMMISSIONER WETJEN: Is it okay if I stay seated here for a minute?

(Laughter.)

COMMISSIONER WETJEN: Okay.

MR. DURKIN: It's very important, and some of my colleagues here have said, we need to get clarity on the SEF rules and what the rules for trade execution are going to incorporate. There is definitely a lack of clarity in terms of what the RFQ environment is going to allow for. Is it going to be RFQ for five? Is it going to be RFQ for one? Is it going to be something in between? Those kinds of decisions I think will have an impact and will inform a lot of the discussion that we've been having today in the context of trade execution and thresholds and things of that nature.

The marketplace really is just very uncertain in terms of what the outcome and the evolution of those rules that remain pending but unknown to this group, and so whatever we can do to get some clarity there will be very helpful and will inform a lot of this.

MR. FERRERI: And just one other comment. These SEFs were envisioned to be competing platforms -- right? -- because competition is positive for the end user. That process of having open outcry markets that are similar to pits except there are only SEF operators as opposed to traders in the SEF help to promote the introduction of new prices and better prices. The notion of workup in the wholesale market where a trader is exposed, you know, smaller amounts of a trade, but the entire market is notified it's trading at this price, "Would anybody care to trade at this price?" and to draw on that liquidity.

It's also important to know that we talk about the liquidity of swaps. There are some days, quite frankly, when the 10-year interest swap is not very liquid. Right? So the product characteristics may be very liquid as an asset that trades because of the large notional size it can trade in, but there are periods of time when liquidity vanishes. And it's been the 70-, 80- , 90-year history of the wholesale market operators that show there are ways to draw liquidity back into the market.

So I think as you're looking at these execution rules, it's keenly important to stay true to the statute, to the "any means" reference, and to really address the fact that these are competing platforms looking to draw liquidity.

MR. SHILTS: Yeah, Dexter.

MR. SENFT: My answer to your question would be to simply point out that although it's tempting to discuss each of these various rules as if it were an island unto itself, they are not, many of the rules are quite interlinked. I think a large concern of the swap market is the inadvertent transmission of too much information into the marketplace for somebody trying to do a fairly large size trade, that that can be harmful to liquidity.

So that information dissemination takes place partly because of trade reporting rules, although those rules are already done and implemented, partly because of the threshold where block rules kick in, and partly in terms of how many people need to see an RFQ. So the Commission does have the ability in writing the rules to consider these interactions. It's only harmful if sort of everything goes the wrong way to the extent that trades are reported immediately and block sizes are very large and lots of people need to see RFQs, then you have a potential problem for the large size trades. So that's really our concern.

MR. MARON: The only other thing I would add to that, just to build on that, is when you put the rules forward, making sure that we don't disadvantage one of the mechanisms over another mechanism or under

www.CapitalReportingCompany.com © 2013

another mechanism, so that all of the opportunities that were made available for either trading or price reporting are all treated equally and we don't flotate through the embargo rule, say that we've got five different ways of doing it, but if you use the fifth, you're disadvantaged relative to the four, or we do make it available for trading, should we make a mechanism to deem that something as well and provide public comment during that process?

MR. WETJEN: Thanks very much.

MR. SHILTS: Commissioner O'Malia.

COMMISSIONER O'MALIA: I have a question for the panel. I think the -- kind of the academic and the reality of how these markets trade are in somewhat conflict and I'm wondering when we have illiquid products that end up in a futures market, we take the -- we've accommodated the move with energy products with flexible block limits.

When we want to apply kind of the academic standard of what futures market should be and getting a certain percentage -- this is related to that Core Principle 9 debate, in this -- while the markets are trying to find their equilibrium, what should we be thinking about and how tolerant should we be or how flexible should the Commission be in allowing some products to try to futurize and see if they work and if not should we have a process to kick them out, move them back into the swaps market; how disruptive is that behavior? Is it unpredictable if the Commission isn't clear about its rules and where -- what we're going to tolerate? I'm interested to understand -- you know we can draft black and white rules but in reality they're not going to trade in necessarily black and white rules.

So what are your thoughts on any of that and how flexible should we be?

MR. CAMPBELL: So I'll address that. I guess two points on that. One is, be very tolerant. Because I think when we talk certainly about the energy markets we're not talking about a static market. You know, I think if we think about volatility and the change in prices and what that does to the people that are either burning fuel or producing other products with that, these are incredibly volatile markets that can move

www.CapitalReportingCompany.com © 2013

over the course of a day or a weekend given weather shifts in the northeast or the southwest or a hurricane comes through the gulf.

And so the ability of those markets to react to what's physically happening to the supply and demand fundamentals I think is critical to understand. So I think one be tolerant but the other is just as important, be clear that you're allowing some period of transition and you're willing to tolerate both that happened. The risk in this comes back to what I think Ananda was asking, the risk is that a market -- and a market is just not as their facility in place to do that but are there willing and knowledgeable participants in that market on both sides? Does that market exist and is it there to support the needs of the end users to actually get transactions done. And the risk is, if everything moves towards a standardized product that there will be a limit of the number of people that are able to facility the quick reaction to I need to hedge a portion of my book or a portion of my production or a portion of my production or my plant portfolio going forward that may not exist or there may not be enough liquidity in that market to exist.

So I think that's a risk of not allowing some transition and recognizing there's a need sometimes for those markets to react very quickly.

MR. RHODE: Commissioner, I think clearing is also part of the process of standardization. It allows the product to evolve. What was interesting out of the ICE energy conversion was that it was pretty seamless but that was a product that had been clearing for several years.

So that was a process that had allowed standardization which had allowed a conversion to futures. What we're looking at right now of course is products which aren't actively clearing but there is a futures alternative which is standardized and appears to be comparatively, well, rigid within the construct but I think it's the process of clearing and demonstration of clearing and a sufficient level of open interest which introduces the standardization which makes the migration easier.

MR. WILSON: The members of the FIA PTG are generally big proponents of encouraging markets to migrate to central limit order books. Having said that, we recognize the importance of block trades, for trades which would otherwise be disruptive to the central limit order book or for instruments which are perhaps less liquid.

The energy markets are very interesting case study and I think that it's obviously important to not do anything that will disrupt those markets. Insisting that if the markets don't, you know, behave in a certain way that they should be delisted or converted to swaps would be incredibly disruptive. Just the fear of that would negatively impact liquidity in a major way.

I think that rather than taking approaches like that it's more appropriate to work with the exchanges to make sure that the markets are traded in a way that's consistent with the kind of guiding principles of Core Principle 9 and you know, in the energy markets, for instance, the front months are much more liquid than the back months.

And so it's entirely reasonable in my view to have a more nuanced block trade threshold that will encourage some of the very liquid transparent, easy to price instruments to migrate more to a screen while still permitting the less liquid, more difficult to price instruments to be traded as they currently are using blocks.

MR. SHILTS: Any other comments?

COMMISSIONER O'MALIA: I have one more question. The issue of liquidity has come up several times in many contexts with both trying to understand what the appropriate margining level is. Jeffrey, I think you brought it up in context to the made available for trade. I'd like to understand you know, when making a made available for trade determination as we develop these rules and consistent with Commissioner Wetjens' question, what do we need to think about in terms of liquidity as it relates to both clearing and made available for trade?

MR. MARON: If I could, just to respond to that, in deciding whether to make something available for trade and forcing it onto a screen and onto SEFs and away from the ability for folks to trade those swaps even if they choose to clear them through other mechanisms, we need to be cognizant of all the different mechanisms that were originally numerated in the rules that were put forward. So rather than choosing just one of those but to look across all of them and then maintaining that all of those criteria remain true and in force once it moves to a SEF. So that we don't end up in a situation where bid offer spreads widen or the number of market participants and supporters actually make markets in those sectors, step away once they're forced to trade in a certain mechanism rather than in others.

So I think it's also important to provide an open comment period for the public to speak to the issues and for the Commission to make the determination rather for individuals to have to make the determination. But also as mentioned for there to be a process to de-MAT or to take something away for trading after a period of time if indeed it doesn't meet the criteria that was originally set out.

MR. OLESKY: We've expressed a view on the made available to trade issue. Because we're trading a lot of interest rate swaps and CDS indices today and there's a tremendous amount of pricing across the curve and in a variety of instruments on platforms like Tradeweb and Bloomberg.

So our perspective on that was take a look at what's happening today as an example and possibly you know, fix activity at some agreed upon evidence that there is liquidity today and set that in stone for a period of time and you know, allow yourself to get some experience and some data to support advancing beyond the limits of what the market can support today.

So I mean there's a lot of activity that's happening electronically and pricing that's automated. That should be surveyed, assessed, that's a huge percentage of the market today.

MR. HARRINGTON: I was just going to comment. I think it's -- that's an area where we would look to the clearinghouses, you know, basically looking at what's going on in cleared open interest, you know, is there enough volume that's already sitting out there.

You know there was a question during the discussion yesterday at the Tabb forum regarding self-certification and that's an area where we think really does not make a lot of sense to have the self-certifying. You know that quickly creates the risk of a race to the bottom. You know, we do believe that the Commission, working with the clearing houses, you know that seems to us to be the right place where an MAT would be made, you know and then the SEFs would basically put the contract on or not.

Because at the end of the day, you know, both Lee and I and Chris, you know, we're not providing liquidity, right? We're a source of liquidity, but we're not actually providing it ourselves and therefore the clearinghouse has determined that there is enough open interest or enough activity for the contract to actually clear. The Commission sees that and then basically we would get a notification from you that this would now go on the SEF and we would open the market.

MR. LEWIS: Two points, I guess, to both Commissioners' points. Number one, I think the biggest perversion is caused by delay and uncertainty, and I think just finalizing the rules, period, even if they're less than perfect, is more important than the adjustments that are going to be made between now and then. I think the danger we're running is that we're really -- I think there are a lot of perverse consequences of the current interregnum, if you will, between this regime. Everybody knows the new regime is coming. I think that's the bigger danger.

And the other point I'd say, which may be unrealistic given the way the country is run, is I get a picture of Occam, as in Occam's razor, for as you go through this, which is basically the simplest is the best, and I think if you really took a pencil to some of the rulemaking, an awful lot could drop out. I think that the core principles are terrific. I think you just run the risk of unintended consequences as you attempt to improve upon them, and I think basically so long as -- I'll take the point of the professor not to talk about level playing field, but basically keep it simple, very clear and easy to understand what the rules of the road are for everybody that's competing with each other in the SEF space, and let it go and then watch carefully what happens and basically trust the CCPs to basically decide what the margining regime should be subject to your oversight.

MR. SHILTS: Any final comments?

(No response.)

MR. SHILTS: All right. Well, thank you all very much for your participation on the panel. I think we'll take -- what do you think, five minutes, ten, five? We're going to go take a five-minute break and we'll start back here --

MR. RADHAKRISHNAN: Invite the panelists in Panel 2 to come up and take their seats. Thanks.

MR. SHILTS: So by 11:40.

(A brief recess was taken.)

MR. SHILTS: Just quick I want to make one kind of administrative announcement. We appreciate all of the many comments so far, but as an administrative housekeeping matter, we note that because today's presentations have touched on the pending SEF rule, in the roundtable, that that will be placed on the administrative record for that rulemaking.

So thank you.

MR. RADHAKRISHNAN: So thank you very much. This is the second panel on clearing and margin

requirements for swaps and futures. I think what we're going to do since we're having such a late start, we're going to start lunch at 12:30 and come back at 1:30 instead of coming back a 1:00. So Panel 3 will start at
1:30.

Okay. Let's do introductions first and then I'll go through my short presentation.

So again, I'm Ananda Radhakrishnan, Director of Division of Clearing and Risk.

MS. WINGATE: Tracey Wingate, Special Counsel, Division of Clearing and Risk.

MR. ZUBROD: Luke Zubrod, Chatham Financial.

MR. CAWLEY: James Cawley, Javelin Capital Markets.

MR. OLSEN: I'm Dave Olsen with JP Morgan, and I'm representing the FIA.

MS. TAYLOR: Kim Taylor, CME Clearing.

MR. OWENS: Sean Owens, Woodbine Associates.

MR. WILSON: Don Wilson of DRW, representing
FIA
PTG.

MR. BRADY: Neal Brady, Eris Exchange.

MR. HATTEM: Jack Hattem, BlackRock.

MR. MAGUIRE: Daniel Maguire, LCH Clearnet Group.

MR. RADHAKRISHNAN: I'm going to make a short presentation and then I'll invite each of the panelists, similar to the last panel, to make, you know, remarks for what, four minutes and then we can have questions, and so on.

What we're going to discuss here is clearing and margin, and I think I've already sort of set the stage for clearing in that there is a distinction between clearing of futures and swaps, and one of the key distinctive issues is that all futures contracts that are traded on a DCM, a designated contract market, must be cleared. This is Core Principle 11 for DCMs. They must be cleared by a CFTC registered derivatives clearing organization or DCO.

Contracts that are in swaps, the statutory regime is somewhat different. First of all, it requires the Commission to make a determination that certain classes of swaps have to be cleared, which the

Commission has done in respect of interest rate swaps and CDS, and then secondly, not every participant is required to clear a mandated swap. So even if they engage in a swap that the Commission has determined must be cleared, not every participant has to clear.

The example in the statute are the so-called end users. You know, end users are not required to clear. They can if they want to, and as you've seen, you know, the Commission has made certain proposals to exempt other people, other categories of people from the clearing requirement. So those are two distinctions.

Now, let's talk about margin. So I've got a short presentation. The relevant regulatory provision is 39.13(g)(2)(ii). So essentially I'm going to skip and go to the heart of the matter.

At a minimum, DCO has to use a minimum liquidation time for one day for futures and options. They can go greater than that, but they must do one day for futures and options. A minimum liquidation time for one day for agricultural and energy and metal swaps, and then for all other swaps it's five days.

The Commission did reserve for itself to prescribe a longer liquidation time as appropriate based on specific characteristics or shorter liquidation time, and the Commission can do that either on its own volition or at the petition of anybody who wants to petition the Commission.

So that being the case, it's no secret that there have been some comments that the liquidation time period for a particular CME product, the swap futures product, should be five days because it is, quote, unquote, a swap. And my response has been, "Huh, I thought it was a futures contract." And the Commission has spoken about futures contracts, but I guess that's not the end of the debate, and that's why we're having this panel.

Hey, Tom, welcome back.

MR. FARLEY: Sorry. Thanks.

MR. RADHAKRISHNAN: That's okay. So Tom Farley from ICE.

So I'd like to start, and instead of starting with the clearinghouses, I'm going to start with the end users. So I'm going to start with end users or other participants, and I'll have the clearinghouses finish or go to the end. So let's start with Luke, and, Luke, tell me who you're representing.

MR. ZUBROD: Sure. Good afternoon, and again, thank you for the opportunity to offer my perspective on futurization of the swaps market.

My name is Luke Zubrod, and I'm Director of Risk and Regulatory Advisory Services at Chatham Financial.

Chatham is an independent advisor to businesses that use derivatives to manage interest rate, foreign currency, and commodity risks. A global firm based in Pennsylvania, Chatham serves as a trusted advisor to over 1,000 clients ranging from Fortune 100 companies to small businesses.

Consequently, my views today reflect the perspective of hedgers, and because I will offer the perspective of non-financial hedgers in the fourth panel, I'll focus on financial entity hedgers in this panel.

The topic of futurization is an important one for financial entity hedgers. Such entities include regional banks, real estate funds, leasing companies and others. Like non-financial end users, financial entity hedgers have long valued the over-the-counter derivatives market because of the ability to customize them to perfectly mitigate a company's idiosyncratic risks and because of the ability to bilaterally negotiate margin arrangements with swap dealer counterparties.

Regulatory actions that create an incentive for financial entity hedgers to use futures would have at least two adverse consequences:

One, basis risk. Regulatory incentives that encourage futures could cause companies to retain risks that they have historically transferred to their swap dealer counterparties, entities that are much better equipped to manage those risks. This basis risk caused by mismatches between a hedge and the risk that hedge is designed to address poses the threat of loss for financial entity hedgers, and it's a loss that could be most severe in times of market stress.

Number two, accounting ineffectiveness. Basis risk is reflected in financial statements as accounting ineffectiveness. Because accounting ineffectiveness and the income statement volatility it creates is difficult or impossible to control, public companies often avoid hedging strategies that might result in ineffectiveness.

I'd like to identify an area in which regulators can ensure its proposals do not adversely impact financial entities' ability to reduce risk through hedging: initial margin. While some financial entity hedgers, including regional banks, are accustomed to posting variation margin, few are accustomed to posting initial margin.

Initial margin requirements represent an unproductive use of capital for financial entity hedgers, especially those who do not have unencumbered securities which they can post to meet such requirements. Consequently, many financial entity hedgers will seek products that minimize initial margin.

Current and proposed differentials between uncleared and cleared swaps and between cleared swaps and futures will create incentives for financial entity hedgers to use futures, incentives that bring with them the aforementioned adverse consequences of basis risk and accounting ineffectiveness.

Harmonizing initial margin requirements between cleared swaps and futures would reduce these adverse consequences. Additionally, eliminating initial margin or allowing for bilaterally negotiated initial margin thresholds on uncleared swaps would further serve to ensure that financial entity hedgers are not encouraged to use products that do not meet their needs and that foist upon them the unnecessary adverse consequences that I mentioned earlier.

Thank you.

MR. RADHAKRISHNAN: Jamie.

MR. CAWLEY: Thanks, Ananda.

My name is James Cawley. I'm Chief Executive Officer of Javelin Capital Markets, an all-to-all trade execution venue for interest rate and credit default swaps that expects to register as a swap execution facility or DCM as the rules are finalized. Thanks for inviting me here to participate today.

Swaps and futures in swaps are economically equivalent to each other and should be margined essentially the same way within the clearinghouse. Swaps and their futures' cousins trade in the same currency, are benched off the same index, LIBOR, and are expected to be used interchangeably by market participants for hedging or speculative purposes. To be sure, in certain instances interest rate swap futures accept physical delivery of the underlying swap itself, and in fact, such economic equivalence is confirmed by the fact that to trade such a physical delivery swap, you must open and maintain a swaps clearing account to be prepared to accept its delivery.

That swaps and futures in swaps should be measured in the same way is underlined by the fact that the margin calculation can flip from one-day VaR calculation to a five-day VaR, which is the VaR calculation on the underlying swap upon delivery.

We argue then that such a future on a swap might be nothing more than a forward swap agreement and thus both should be margined in the same way. There are those who argue that swaps and futures are different because futures represent fewer line items in the clearinghouse and swaps represent hundreds of even thousands. Thus, swaps could be more difficult to liquidate in a distress scenario.

For some this may be a red herring. It's well established that swaps trade in a risk managed, not widget-like, where each swap is individually hedged using exact similar swaps but on a more holistic or portfolio basis where each swap is margined against the curve, where risk and liquidity are viewed on a more continuous and economically equivalent basis.

It is expected that market practitioners will risk-manage swap futures exactly the same way, irrespective of line count. Moreover, as history has shown, moving portfolios from seller to buyer in distress scenarios has become more routine over time, whether it be Orange County in the mid-'90s or most recently AIG and Lehman irrespective of line count.

And if line count is the issue, should swaps that trade to specific IMM dates that have fixed coupons with up-front cash payments clear on the exact same margins as futures do? Both would, by definition, have the same reduced count of line items in the clearinghouse.

Additionally, there are those who argue that swaps and futures in swaps should clear on different margins because futures are more liquid than swaps. But is this really the case?

Consider this. Yesterday the total notional traded of LIBOR-based swap futures was a combined 153 million, and in the dollar swap world it was estimated that 200 billion notional traded for the same day. Interest rate swaps are more liquid by that calculation by a ratio of 1,300 to one.

For swaps and futures in swaps to have different margin calculations also has considerable policy implications for the economy. If one product, the margin calculation, is much lower than the other, which is correct, what happens to the clearinghouse in the distress scenario if it becomes evident that not enough margin was collected against the lower margin product? Does the taxpayer now enter the breach to cover the shortfall because DCOs have miscalculated and they become systemically important?

Or consider the product with the higher

margin collected against it. Could it not be the case that users of such a product are being unfairly penalized as too much margin is collected against their trades? As a consequence, does this not force market participants out towards the cheaper market unfairly?

In conclusion, Javelin supports the open and fair development of both markets. In fact, the creation of a new product that adds liquidity to the marketplace should be welcomed, but it should be done in such a way that protects systemic integrity, competition and the end user.

The Commission should adopt a more flexible margin approach that more accurately considers the fact that both swaps and futures in swaps are economically equivalent. Their risk characteristics are the same, but may also change over time. Both products should clear on similar margin calculations and, to be sure, liquidity should be a consideration, but it should also be recognized that liquidity will change for both products as the market democratizes and becomes more transparent and competitive.

Swaps already liquid will increase in volume as more dealers compete and new liquidity providers enter the space, along with new execution venues, such as all- to-all limit books.

The Commission should immediately pass the SEF rules, and you've heard that a few times now today, but also as an interim step, we suggest that further certification of swap futures be halted until they can be studied for future and full implications.

Thank you, and I look forward to your questions.

MR. RADHAKRISHNAN: Thanks, Jimmy.

Dave.

MR. OLSEN: Thanks.

I'm Dave Olsen. I run the clearing businesses at JP Morgan, and as I said previously, I'm representing the FIA today.

I think first and foremost we're very supportive of the innovation of financial products that allow for end users to safely manage their risks and get the exposures that they'd like to have, and futurization or new futures products are certainly included in that advocacy, and we see that as a great contribution to the new market structure and endorse it fully.

That said, we do think there are some issues with the framework that should be addressed to make sure that it's as safe and effective for the entire market as it can be.

I had a friend in college once tell me that he could never live in Europe because he wouldn't like the weather, and for a long time that used to be one of my favorite examples of the pitfalls of generalization, until now where examining the, in my view, arbitrary delineation between a one or two-day cure period for listed futures, a five-day cure period for cleared OTC derivatives, and the proposed ten-day cure period of non- cleared OTC derivatives seems to bundle an incredibly diverse array of financial risks into a shorthand liquidation horizon that we know in practice can't be true.

Just in the futures complex, looking at the difference in liquidating S&P E-minis relative to long dated yellow maize or tin contracts, you have very long liquidation tails on some futures and other futures can be liquidated almost immediately through the central limit order book.

The same, too, in OTC derivatives markets today, whether you're looking at two-year interest rate swaps or an aged ten-year high yield index that's rolled down the curve three or four years.

So moving to a risk-based and liquidity-based set of principles for the derivation of liquidation horizons we see as an extremely important step in providing both the right framework for innovation as well as safety and soundness for FCMs, DCOs and ultimately the American taxpayer.

That said, we do accept that both clearinghouses and FCMs each have a role to play in supply leverage to the system. We don't advocate for true full protection for any loss that could be experienced in having that pre-margined. That would be unnecessary and would be an unnecessary drain on the liquidity in the system.

But for like risks and like instruments, we do think comparable margin parameters are important, and part of the innovation that we see or part of the movement that we see in the market today, although elements are true value added innovation, we believe that some of the moves to futurized contracts are quite overtly driven by an effort to reduce either margin rules or the other elements of regulatory reform.

I'll just read the second bullet in the Eris material that they make available on their Website in describing their futures contract. It reads under Eris Exchange Overview, the second bullet being, "No swaps regulatory overhead or swaps reporting."

True, but we think that and other marketing material put out by other exchanges and clearinghouses jumps right to the key point of you can create a swap exposure and post future style margin, and that's one of the big reasons for use of the product.

The final thing I'd like the Commission to consider is we think a lot about liquidation horizon in one or five or ten. We know that there's a balance. We know that there's a portfolio effect. Some will be more liquid; some will be less liquid, but what's often lost in the discussion is the consideration of when the liquidation can actually begin.

We might all agree that it could take 24 or 48 hours or more to liquidate a portfolio, but in the futures market and in most elements of the OTC market today, if one of our customers trades at the open on Monday morning, that position typically is not margined; a margin call doesn't go out until the following morning on Tuesday. That customer then has typically until the end of the Fedwire cutoff at least in the U.S. Tuesday night, and many end users with market power negotiate an additional full day cure period to be able to satisfy a default before liquidation can begin.

So you're typically looking at a minimum of a three-day period where you have to endure market volatility before you can even start the process of a liquidation. In the OTC swaps market, five days does cover a log of those administrative elements and documentation elements, but the consideration of either standards on how far in advance cure periods can be given to customers or enforcement by the CCPs themselves seems appropriate.

Thank you.

MR. RADHAKRISHNAN: Thanks, Dave.

Sean.

MR. OWENS: Yes, hi. Good morning. I appreciate the opportunity to be here today and to contribute to today's discussion.

My name is Sean Owens. I'm the Director of Fixed Income and OTC Derivatives for Woodbine Associates. We're an independent capital markets consulting firm.

And I just wanted to come back and answer your question you posed earlier, you know. Is the migration from swaps to futures, you know, good for the market?

And, you know, I think it is, and I think it's what was intended under the Dodd-Frank framework, you know, just provided that we've got the right economic framework and incentives in place at least at the start.

And you know, just to recap that, you know, Dodd-Frank through both its capital and margin requirements, you know, makes customized products which are typically riskier, you know, more expensive and more capital intensive than, you know, standardized products and in futures contracts. You know, non-cleared swaps are, you know, likely going to be subject to, you know, ten-day VaR for initial margin requirements. You know, they've got higher capital, higher risk rate. They've got to incorporate CVA VaR in their counterparty credit charge, you know, versus cleared swaps which are, you know, still customizable products, you know, which are being margined, you know, with five days and given a two percent risk rate versus futures, which are completely generic product, generic risk transfer, you know, one-day VaR.

So you know, each product has got margin requirements that reflect its inherent risk and its particular characteristics, you know, be it either a risk profile, liquidity or, you know, degree of standardization.

So for this framework to continue to be effective, you know, moving forward, you know, the initial margin requirements for new products need to reflect their characteristics as well, and you know, this is independent of, you know, the underlying instrument which a swap or a futures contract references, and ultimately whether the label placed on a contract, whether it's, you know, a swap, called a swap or a future, it really comes down to the risk of the product.

A couple of good examples are, you know, the Eris flex contracts. You know, they look like a swap. They've got customizable start dates, end dates, coupons. You know, for all intents and purposes, they have similar risk characteristics to a swap and are margined as such.

You know, alternatively, the new deliverable swap futures contracts, you know, are standardized. They have many of the features, you know, of a traditional futures contract, very similar to the bond contract itself in a lot of ways. They're not customizable, you know, quarterly IMM settlement dates, you know, set coupon, and should be margined, you know, as such, similarly as normal future with, you know, one-day margining.

As far as with regards to the underlying instrument, it's largely irrelevant, you know, whether it's a bond, a swap, a physical commodity, you know, or even a widget for that matter. What matters is the risk characteristics of the product that's being traded, and that will ultimately determine its, you know, liquidity in the market and its replacement cost in a default situation.

So as futurization continues, you know, it's important to ensure that your new products that are being created to transfer risk as participants move from the swaps market into the futures market, you know, seeking capital efficiency, that these products are margined, you know, in accordance with their risk, you know, rather than what they're necessarily called or what they may reference.

So thank you.

MR. RADHAKRISHNAN: Thanks, Sean.

Don.

MR. WILSON: Thank you, and thank you for inviting me to serve on more than one panel. This will give me the opportunity to delve into some details and elaborate on some of my comments from the prior panel.

To summarize what I said before, futurization is a good thing, and talking specifically about the margin requirements, you know, I think that one of the things that everybody agrees is that there are important differences between swaps and futures, and therefore, it's entirely reasonable that swaps and futures should have different margin requirements.

Although the SEF rules have not been finalized, it's clear that swap trading will be more opaque than futures trading.

One of the things that I touched on in my prior comments is that swaps incur greater risk to the clearinghouse than economically equivalent and equally liquid futures contracts. This is because swaps use LSOC instead of the traditional futures segregation regime. Let me elaborate on that a little bit.

If a customer who is trading swaps blows up, then the first loss goes to their FCM. If the FCM doesn't have enough money to cover that loss, then the next loss goes into the default fund.

In the case of futures, the waterfall is slightly different. The customer blows up. FCM's money is on the line next. Thereafter the loss actually comes back into the SEG fund's pool at that FCM. After that pool has been exhausted, then the loss goes into the clearinghouse.

Now, there are some people who think that that system puts their money at undue risk. As somebody who has very significant amounts of money posted at FCMs, let me tell you that I am actually more comfortable with the futures model than the LSOC model. The reason for that is, well, first of all, we select our FCMs very carefully. We select well capitalized FCMs that have large SEG funds pools. So even in the financial crisis when people were pulling their money out of banks and putting it under mattresses, we felt that our risk of loss from money housed at FCMs was relatively low.

You know, the reason for that is that generally our FCMs had over a billion dollars of capital and SEG funds pools of, you know, over $10 billion. So a single customer would have to lose all of their money plus over a billion dollars, and even if they managed to do that, let's say they lost $2 billion more than they had then and were in a SEG funds pool with $10 billion in it. Then we would use ten percent of our money. It's a risk that we could live with.

In the LSOC framework, obviously if a customer loses $2 billion, well, first of all, they may be at an FCM that's not very well capitalized. In LSOC they don't have any incentive; they have very little incentive to choose a well capitalized FCM with a large SEG funds pool. So if they lose $2 billion and their FCM is thinly capitalized, the clearing default fund is immediately impaired and potentially the whole system is at risk.

So in my view, the futures model imposes a lower risk to the overall system than LSOC, and certainly from the perspective of the clearinghouse, it's reasonable that the clearinghouse would demand a higher margin from an LSOC cleared contract than a traditional futures contract. It's only rational.

Now, I'm a big proponent of choice and one of the interesting byproducts of this dual segregation regime is that in many cases now the customer can elect to move your dollar futures or Treasury futures over into LSOC, and in doing so they will be required to post greater margin. Their money will not have the fellow customer risk in the process of doing so. So it's a tradeoff. It's a rational tradeoff. Some people may elect to do that. Personally, I would rather go the other way.

So in any case, this differential that a lot of people are very upset about in margins, I don't know of one-day versus five-day is the right difference. I'm not opining on that, but certainly it's logical that there should be a difference, and you know, I think that -- I'm sure that Kim will continue to do a good job of deciding how to set the margin requirements appropriately.

Thank you.

MR. RADHAKRISHNAN: Thanks, Don.

Neal, I'm going to skip you.

MR. BRADY: Okay.

MR. RADHAKRISHNAN: Because you're the same as the DCO. So I'm going to go to Jack next.

MR. HATTEM: Hi, I'd like to thank the Commission first off. I'm Jack Hattem from BlackRock. We're a diversified global asset manager and I'm responsible for rates derivative investing within our fundamental fixed income group. I'd like to offer a perspective from the buy side.

We're a significant user of derivatives and our team spends a lot of time thinking about and working on the challenges in the market as it evolves. The go-live at Dodd-Frank will require portfolio managers, traders and market makers alike to rethink processes.

The amount of collateral being posted will be substantially greater than is posted today. The market is going through a period of innovation and new products will emerge. As a fiduciary our objectives include pricing, market depth and counter-party risk. The success of any new product will be driven by liquidity.

Futurization of swaps is another evolution of the derivative markets as we move along the path of standardization. We'd expect many aspects of the swaps market to take on more standardized characteristics. Swaps compression or the reduction of line items is an important risk management tool that standardization aids.

Like compression there's a variety of operational efficiencies to be gained from increased standardization. So it's natural to see more swaps futures products trading. The CME's deliverable contract and Eris's cash contractor are two examples. Still challenges remain. These include the consistency of pricing between the futures and the non-futures instruments whose risks they replicate.

With any deliverable contract the fluidity of the role remains essential. Additionally with any new instrument there are legal nuances which must be fully vetted before it's widely adopted by the marketplace. For the buy side, this can be a challenge of greater magnitude given the breadth of our business and the sheer number of separate accounts we manage.

Of utmost importance remains liquidity both when entering and exiting the trade in addition to the soundness of the framework. Margining is an important element to managing any futures position. Anywhere we're going to find appropriate margin efficiency will help the end user.

The short VaR calculation is appropriate for futures but we must consider the variables driving the VaR determination including liquidity and volatility and what can make them change. The transition to a more standardized market will happen gradually. Watching the rates options market there is no observable gap risk priced into the system.

Trading books of several aspects of risks and varied risk profiles will evolve over time. And the market already transacts in fixed coupon IMM swaps, instruments that have standardized features. The increase in these volumes suggest that the market is along the path of transition as traders are thinking about how to efficiently manage their portfolios.

Central clearing adds to this fundability. One attractive aspect of a fixed rate IMM swap or a swaps future with common terms is fundability within a portfolio's context. This idea can be extended when thinking of solutions regarding CCP resolution. The market is evolving to decouple execution risk from counter-party risk and we should consider the potential for increased substitutability within the system by allowing fundability across CCPs.

In sum, it's important that all participants within the derivatives ecosystem work together to discuss and address these issues. Our goal as I investors is to seek safe, deep and liquid markets. And for BlackRock, this is where our fiduciary duty to our clients is best served.

The connectivity like panels like these provides to all participants is invaluable. Thank you very much for your time.

MR. RADHAKRISHNAN: And now I'll go to the infrastructures. Lady always goes first, so Kim.

MS. TAYLOR: Thanks, Ananda, thanks for having us today. There's been a lot of discussion in these panels about the intent of Dodd-Frank. And I just briefly want to take it up a notch and talk a little bit about the intent that I think the political leaders globally had with the overall changes in the financial services markets. And I think it had to do with the fact that the crisis showed us that there were non-transparent losses that when -- that had been unrealized and when they became realized, they were --

they caused huge credit issues.

The capital reserves were insufficient to weather those market turns and the market was extremely fragile to the collapse of any one counterparty which results in more margin calls which resulted in distress sales. It was a downward spiral and the real problem was that there needed to be a bailout.

So I think at a very high level what the political leaders are trying to achieve is an environment that is more resilient to the need for a bailout. And I think that actually you know, Dodd-Frank is the US implementation of those principles and I think that changes in the swap market that help make it more resilient in to credit events are consistent with that objective. And I think enhanced use of futures is also consistent with those objectives.

So I think that you know, either one of those works. As far as the market practices associated with risk management, Jamie talked about the fact that he thinks that swaps and futures should be margined effectively the same way and what I would say to that is I agree. And they are. And that is not inconsistent with there being a different coverage period that is applied to one set of products with one set of characteristics and a longer coverage period being applied to another set of products with another set of characteristics.

Just real briefly, I want to touch on some of the characteristics that we find important in looking at how we margin different products and maybe at the outset I would like to point out that as we evaluated entering the over-the-counter swaps clearing arena, before there even were regulations that were propagated about any kind of margin coverage period minimum, we had already determined that the margin coverage period we were going to target for the credit default swaps and the interest rate swaps was five days.

So it is both a risk management determination on our part and it is a regulatory minimum at this point. So some of the characteristics that go into that decision include the standardization of the product.

The futures contract is wholly defined. There are 30 variables on a swap, even the vanilla ones. So there's hundreds of different configurations. You end up with a lot more line items. That does a couple of things. One is it doesn't allow the liquidity to be concentrated. So it's not as easy for us to take a portfolio and sell it into an open market if the liquidity is not concentrated in a few instruments.

If you take a look at the Lehman situation as an example of this, the -- if you had a position in every one of the CME interest rate futures, you would have something like 40 or 50 line items. The intel is that the Lehman option, the Lehman swaps portfolio at LCH was some 60,000 line items. So it's an order of magnitude difference in the ability to concentrate the liquidity.

Also the accessibility, the transparency and the continuity of the liquidity is very different now. Might not always be but it's very different now in the way that we would be able to access that liquidity for an interest rate swap versus the way we can access or observe the liquidity for an interest rate future.

The Chairman mentioned differences in the open exposure and the daily turnover. I think Jamie focused on the amount of turnover but the relevant from the clearinghouse's point of view is what does the turnover look like relative to the exposure I'm holding open. And if you look at it that way, interest rate futures turn over I think about 25 times a year and the swaps market turns over about two and a half times a year.

So the liquidity that you can access is very different. There's also what I call the diversity of market composition. This is important both in terms of the resiliency of the liquidity in the market. It's not so susceptible to the removal of one or two participants. There are reportedly like five million, estimated five million participants in the futures markets and about 30,000 participants in the swaps market. So there's an order of magnitude difference there as well.

The compression or the netting, what I call the positional versus the transactional approach to clearing generally speaking futures net down to very few positions and swaps proliferate more positions. There's more opportunity to net in a cleared environment than there is in a bilateral environment but it still is not -- it's still going to be an order of magnitude difference.

And then the real issue is the default management, the ease of the liquidation. With futures we have a number of choices generally on how we can liquidate. We can go to the open market, we can go to a privately negotiated transaction with one or more counter-parties or we can run an auction and have a set of competitive bidders.

And we may do one or the other of those three things depending on the circumstances and the portfolio that we're holding. With swaps, because of the nature of the exposure and because of the size of the portfolio and because of the liquidity profile now, we really only have a single choice which is to run an auction. I think that won't always be true either. But it is true right now that our best way of liquidating is to use an auction and actually the participation in that auction is also somewhat limited by the kind of breadth of the portfolio in a way that futures are not so limited.

It's much easier for a wider variety of

participants to participate in an auction for futures. So those are some of the highlights of the reasons why you can effectively be margining those two products the same way and come up with different coverage targets that would be necessary.

And then I just want to talk a little bit about the kind of I guess the pyramid of minimums that I guess I would say. Dave talked a little bit about the liquidation horizon and what an FCM faces. So I think it's important for an FCM to be able to charge the margin that it feels it needs and it can.

The CFTC's minimum basically imposes a baseline that a clearinghouse can't go below. And then a clearinghouse is going to make a risk assessment on the profile that it faces and charge the clearing members the clearinghouse minimum. And generally speaking the clearinghouse minimum applies as the minimum that clearing members are required to collect from their customers but they're free to assess the risk profile that they face, the portfolio composition that their customers have and the credit-worthiness of their customers and charge additional margin above that.

So there is the freedom for risk management to occur appropriately at all levels.

MR. RADHAKRISHNAN: Thanks, Kim.

Dan?

MR. MAGUIRE: Thank you, Ananda and thank you for inviting us here today. So I represent LCH Clearnet Group based in the US and just a bit of background to the

LCH Clearnet Group, established in 1888, a long history in being a clearinghouse, a DCO for futures across a vast array of different products:

equity, cash repo and OTC swaps.

In terms of who we are and what we do, in terms of swaps, we clear about 60 to 70 percent of the global OTC interest rate swap market. If you believe statistics that's around $360, $370 trillion. In the buy side through moves to clear, we now clear 19 out of the 20 trillion that's been cleared year-to-date in 15 currencies.

And just to make Kim's point, you know, in terms of liquidity and the flow in the market, we clear on average about $2 trillion a day. So I think the sort of the throughput is much higher than maybe was alluded to.

And on top of that, we've compressed $170 trillion. So there's lot of tools in the interest rate market but we're talking about the future rather than what we do today.

So moving on, I think I want to talk about three different things today, transparency, choice but most importantly risk management and regulatory arbitrage seems to be the phrase we're using. So first of all in the transparency, I think it's an interesting two and a half years since I arrived in the States and I was involved in the CFTC round tables and rule-making. I think we should congratulate the CFTC staff.

We've seen the OCT market move from what was declared as an opaque and closed access or closed shop market over two and a half years and we're by no means there yet. But over the two and a half years, we've seen it become more open, more transparent. We have now 75 dealers clearing direct. We have indirect clients that are entering and clearing by the FCM community as well. We have many execution menus joining in the clearinghouse direct as well.

So I think open access has definitely been a key part of that. OTC is standardized as well and I think it's learned a lot from its futures partners in that respect. We see much more standardized work flow in the clearing space standardized docks. I should add again, we're not done; got lots to do but I think there's been a standardization around process, which has been welcome.

And then disclosure as well. The OTC market was opaque. Now it's doing real-time importing. It's got more clearer customer protection rules. It's got real- time pricing reports in it as well. So some good work has been done there and I think the irony now as you sit here from two and a half years ago when I sat here, OTC was arguing that it was different to futures. Now we're hearing that futures is different to OTC. So I think maybe the two things have come a little bit closer but we're still not there yet.

Talking about choice. Cleared OTC means safer OTC maybe. But one of the key things is we maintain client choice at the execution and product level. Everyone seems to bundle execution and clearing together but they are two separate things. And the vast majority of the OTC customers across the globe are hedging real and non-standard risk exposures.

Now, sometimes those are moving to more standardized in terms of the trading pattern but this is really the origin of OTC. The OTC didn't come about to get around a regulatory aspect. It came about to hedge some of the things that my partners on the table have spoken about today.

So the idiosyncratic risks from the, you know, main street to market. So forcing the standardized listed products onto a limited number of execution menus is not really providing the clients maximum choice and maximum competition. We believe that you can have a customized product available at multiple execution venues where the clearinghouse and the execution venues are competing but can be cleared in a standardized and most importantly, a well-risk managed way.

And I think one of the testaments to that which is predating the G20 commitment globally, predates the Dodd-Frank that I went to in 2010. It's when we, LCH closed out the Lehman portfolio and Kim was spot-on. Just over 66,000 trades, five currencies, $9 trillion out to 30 years. But the key point in that is it sounds a lot but we cope with that very well. Had we not maybe swaps clearing wouldn't be a good idea.

The reality is, is we used about 20 -- sorry, maybe 30 to 40 percent of the defaulters initial margin, the remainder went back to the defaulters estates and everybody was immunized and no one lost a penny. No one lost a cent.

So moving onto the most important part I think is about risk and the potential for regulatory arbitrage to evolve in the market today. I think it was Isaac Newton and his laws of motion said every action has to have an equal and opposite reaction and in my view, having worked in risk management for some time, risk moves, risk morphs but it does not disappear.

And that's very analogous to what we're talking about here. If we jam an OTC-cleared executed

-- sorry, an OTC executed, cleared $400 trillion rate market into a listed and cleared executed $20 trillion rate market by the exchanges, it's likely to have some stress, some consequence, some intended consequences -- sorry, some unintended consequences.

So for us, the cleared interest rate swaps and cleared interest rate futures are simply just the product and we seem to be very fixated on the product. The real underlying market is the interest rate market. Not swaps, not futures, quite frankly, not bonds either. And re-characterizing risk from swaps to futures in our view is really missing the point.

In futurization, the market risk will remain. It's merely just transferred from one product to another. So at the end of the day, the vehicle that you drive to get rates exposure, interest rates exposure is very simply a product. Futures, swaps, bonds, options or any other innovative product that comes out over time, the key concern for a clearinghouse from a risk management and closeout standpoint and from a systemic and regulatory risk perspective is as simple as follows.

You need to know the vehicle that you're going to drive to get out of a problem. That's the default. Secondly, you need to understand, will the vehicle be there when you have that event? And can you actually get your hands on that vehicle? That's liquidity or scarcity of product.

And finally, once you've got the product, will you have enough gas, financial resources, margin, default fund and the like to actually drive your way to safety? Because that's the most important point for systemic risk reduction.

So to try and wrap up, we think it's simply artificial and potentially a regulatory quirk that a 10 million DV01 risk position enlisted LAN would attract one or two-day margin. Whereas a similar 10 million in DV01 risk in OTC land would attract five days or more. The key in all of this from a risk management standpoint is about liquidity and having access to it in the prevailing and underlying market.

And it's really for the practitioners to determine what the best holding period is around that. I agree with David's comments; risk-based and liquidity- based holding periods are the key to all of this and maybe we should look as an industry in conjunction with the regulators at both future swaps and other product holding periods rather than just having a one-size-fits- all for all of these. Otherwise, we could end up with some form of concentration risk or liquidity risk or in fact closeout risk at the CCP. Thank you.

MR. RADHAKRISHNAN: Thanks, Dan. Neal?

MR. BRADY: Thanks, Ananda, and to the Commission for the invitation to speak here today at the roundtable. My name is Neal Brady. I am CEO of Eris Exchange, a DCM offering interest rate swap futures contracts.

Eris Exchange is futurized interest rate swaps by offering an innovative futures contract that embeds the cash flows of an OTC swap. CME Clearing, you know, Kim and her very professional team, clearly contract and set the margin levels. Eris contracts trade and clears cash-level futures from inception to termination, meaning they are subject to futures regulatory regime from start to finish and do not physically deliver into swaps.

Eris Exchange was formed in the first half of 2010, prior to the passage of the act itself, much less any of the subsequent CFTC rules we're discussing today. At Eris, we foresaw the imposition of regulatory and capital requirements on previously under-regulated OTC swaps would be the tipping point that would push the most liquid swaps to migrate to futures. The migration from OTC to futures is part of a well-recognized life cycle of derivatives products, and we shouldn't be surprised to see this phenomenon playing out for certain liquid swaps.

Despite being futures, Eris products did not have one-day VaR margins. CME Clearing requires five-day VaR margins for Eris flex contracts, as was mentioned in one of the earlier comments. These flex contracts mirror the date and rate flexibility of trading interest rate swaps. For Eris standards, which are, as the name implies, more standardized and futurized in their construction, CME Clearing currently requires two-day VaR margin.

We believe that the Commission's finalized

www.CapitalReportingCompany.com © 2013

DCO rules properly recognizes distinct structural frameworks of swaps and futures in setting initial margins, even for products based on common indices. Futures markets are supported by a larger, more diverse set of participants, have more firms qualified to participate in default auctions, and are often backed by larger clearing guarantee funds and our cleared swaps. Interest rates futures have traded for many years and fully transparent, all-to-all central limit order books while the Dodd-Frank rules for electing trade of cleared swaps have yet to be finalized and will permit swaps to be traded in more opaque RFQ mechanisms.

At this point, I just want to respond to Dave's comment earlier because the Eris marketing material was mentioned. We do very clearly state that we're not subject to swap price reporting, swap regulatory regime. We're unabashed in saying we follow the futures guidelines in the well-known regulatory framework. And specifically on pricing, we have a -- and we'll get to this in the session after lunch, but we have a mandatory central limit order book with anonymous streaming prices. Our RFQs, our all-to-all prices are reported real time. In fact, our prices are reported on our website, the same place where our marketing brochure talks about not being subject to swap pricing regimes. They are two distinct regulatory regimes. That's a very key point that was mentioned by Professor Parsons earlier. I think that sort of underpins a lot of our position on both the margin and the block trade issue.

On the clearing side, futures markets have for years offered real-time clearing intraday collection of variation margin, automated give-up capabilities. For clearing at Eris, these practices are either new or in some cases not implemented. Perhaps most importantly, the CFTC's guidelines prudently recognize that the swap clearing framework has yet to be fully tested. To my knowledge, the DCO has not yet handled the default involving new cleared swaps, nor has the new 4d(f) account class been tested by a major bankruptcy.

A recent article in Risk magazine highlighted one possible issue that could complicate swap defaults related to treatment of pension fund assets under ERISA, which was clarified for futures by the Department of Labor more than 20 years ago. This particular issue affecting cleared swap margin was recognized in advance and seems to be on track for resolution before causing any real damage, but until we observe multiple successful defaults involving cleared swaps and gain confidence that all similar operational legal risks have been unearthed, it seems prudent to err on the side of caution in setting margin levels.

DCOs are the foremost authorities on appropriate margin levels. And their actions demonstrate similar prudence. The final DCO rules, Ananda, you mentioned in the opening here stipulate minimum five-day margins for IRS and permit DCOs to petition the CFTC for reductions. Since then, no DCO has submitted to the Commission a request to lower IRS margins. And, to our knowledge, no DCO has stated publicly that they would set margins lower if the CFTC mandate were relaxed. LCH continues at our IRS margins for customers at a seven-day VaR level in excess of the CFTC minimum.

In short, the industry's and regulators' conservative approach to setting margin levels for new and untested cleared swaps is warranted. And the market evolution of certain liquid swaps to efficient, highly regulated, and well-tested futures markets should be expected and welcomed.

Thanks.

MR. RADHAKRISHNAN: Thanks, Neal. Tom?

MR. FARLEY: Thanks, Ananda. And thanks again for allowing ICE to be a part of Panel 2.

I was struck by the clarity and completeness of Tim's comments, and I was also struck by the fact -- the degree to which many of our comments overlapped with my own. So I am going to kind of recraft and ad lib a little bit so as to shorten my comments, not drag everybody through some of the same arguments, which Kim said better than I would.

ICE operates five clearinghouses. We operate them on both sides of the Atlantic. And we operate two leading OTC clearinghouses and two leading futures clearinghouses. The reason why I go through that kind of quasi brochure is to tell you that we are pretty well- positioned to talk about this margin issue, specifically with respect to swaps v. futures.

Our risk managers and the heads of our clearinghouses, they ask the questions for any given portfolio, how long will it take me to liquidate this thing, and how much might it cost me? There's been a lot of conversation today, which I wholeheartedly agree with, that fundamentally the most important thing with each particular product is, what is the liquidity of that product? And that's the analysis we do.

And I won't get into the definition of liquidity, although we could discuss that if there is a follow-up question. But there are two other points, and Kim touched on them to some extent but I want to reiterate. One is, how operationally complex is that liquidation? And let me pick an extreme example for effect because I think it will help with the example.

In the futures model, in many cases, you have a DCM and a DCO which are affiliated and they are under common control. Operationally, quite frankly, that is pretty easy when it comes to liquidating a portfolio. I personally have been part of it, unfortunately, multiple times. And I have seen in that scenario it's quite simple.

Conversely, if you imagine a scenario where perhaps, again, exaggerating for effect, there are 20 SEFs as well as trades that are maybe being blocked in and there is one DCO, there is operational complexity of a whole different sort. And I think reasonable people can agree on that.

And, then, finally -- and, again, I won't go through the whole thing because Don said this in a very articulate way -- there are fundamental differences with the customer segregation regime. So when our risk managers start saying, "Well, how much might this cost me?" that is related to the question of "What is in my waterfall?" And, with respect to OTC, there's less in the waterfall. There just is. That is fact-based.

So as we step back and we think about what is the role of government here -- and I won't get into the role of government; we could have another whole-day panel to discuss that -- I am stipulating that the role of government here, the role of the CFTC, is to set some reasonable minimum standards because we don't want people competing on risk.

And I heard in the first panel the comment that one-day v. five-day is arbitrary. I agree. It's arbitrary. It's also arbitrary that New York Avenue's 35 miles an hour and then you get to the Washington Times Building and it goes to 45. That's reasonable. Sixteen years old is the age to get a driver's license. It's arbitrary, but it's reasonable. And as we look at one- day and five-day and we look at how different a cleared swap is from a future, is one-day the perfect number in all cases; five-day the perfect number? No. But to our mind, it's reasonable.

I just want to highlight a second issue that we think is very important. And it may not be the issue du jour that is discussed in this panel, but it's worthy of mention. We are concerned still about the possibility of jurisdictional disharmony with respect to margins and specifically minimum margins. The RTS, which is the rule set attached to EMIR, if I'm getting all of the acronym soup right, is still not finalized, but we're not clear yet that they are on the same regime that we are here in the U.S.; i.e., one-day/five-day. And, no matter if it's one-day, five-day, or half a day, three days, or whatever the number is, boy, western Europe, at a minimum, and the U.S.

should have the same number or else you could get some really odd regulatory arbitrage going on.

Thank you.

MR. RADHAKRISHNAN: Thank you.

Let me invite the commissioners. Have you got any questions? Would you like to ask them? Okay.

So let me start off by telling you what the Commission said in its proposing release for this particular product. In the proposing release, which appeared in the Federal Register on January 20th, 2011, the Commission said a minimum one business day when they talk about futures is the current standard that DCOs generally apply to futures and options for futures contracts. And that is why they propose one day. They originally proposed one day for swaps that were going to be traded on a DCM, if I'm not mistaken, but then, based on comments, backed off on it.

Now, from a staff perspective, I'm going to ask a question. And you folks tell me whether we are misinformed. I think staff is comfortable with one day because it has been the practice, but also, all things remaining equal, you can trace the growth in open interest to volume, right, to transactions, which we, the CFTC, have a view into because it's traded on a DCM, all things remaining equal.

In the cleared swaps arena, we cannot do that because I don't disbelieve you when you say that swaps are liquid, but we don't have a view. CFTC doesn't have a view.

Now, you could say you could subscribe to screens and so on. To me, that is not the same. And I know I am showing my bias, but I am very biased towards our regulatory scheme. That is not the same as a platform that Rick and his colleagues oversee as a DCM.

So what I'm asking is, is that a fair basis to make the distinction or is that a fair basis for us to have comfort that a futures portfolio can be liquidated in one day because, all things remaining equal, you know, we are comfortable, we have a view into the liquidity or whatever you want to call it? And, part two, assuming the Commission finalizes the

SEF rules and you see swaps being made available to trade, is that the time for us to rethink about the one-day minimum for swaps insofar as they are traded on a DCM or SEF?

MR. OLSEN: My first comment would be that a single liquidation horizon that applies to all instruments within one product set I think has natural trade-offs and maybe an explicit recognition that there is a portfolio effect. You will have some contracts that are impossible to liquidate in one day, and you will have others that are able to be liquidated very quickly. And you are a bit reliant upon the composition of any one, FCM's portfolio probably most urgently and maybe by extension one customer's portfolio.

So I think the analysis needs to move beyond futures have this liquidity profile and swaps have that liquidity profile. I think the micro structure of the contracts, you know, my suspicion is if Kim's numbers are right, if there are 30,000 participants in this market, by relabeling in the future, I wouldn't suspect that all 5 million futures participants will start trading that contract. They'll probably keep trading the contracts that they were trading before.

So I think the determination should be made on, what are the risk attributes at a more if not contract- by-contract, at least sector-by-sector level applied to both swaps and futures would be a productive path.

MS. TAYLOR: I just want to explain a little bit about how we apply that because I don't disagree that -- it's not as simple as saying, "Here's the margin requirement for all futures, and here's the margin requirement for all swaps." And that's not the way we look at it.

If you looked at the coverage levels that we apply across the pool of futures that we clear, I think you would find that in many cases, it is a one-day coverage, but in many cases, it is a two-day coverage or somewhere in between. It is more than the one-day coverage, even on some of the very kind of largest, most liquid products that we clear. The S&P, the Eurodollar, both of those products are not set at the one-day standard at this point in time. There probably have been points in time when they have been, but we're at a very low-volatility environment right now. We don't want to lower that all the way. We don't want to go all the way down. So there are statistical factors and there are judgment and experience factors that go into assessing that.

As far as the points Dave was making about the makeup of the portfolio, that is something that we also address in ways that go beyond the minimum margin. If we have got a very concentrated portfolio, we have got a very concentrated product set, we have got a clearing member with a big portion of the market, then we have other tools that we can apply in addition to the minimum margin. Sometimes the configuration of the exposure will call for the market as a whole to be margined at a higher level. Sometimes it will call for higher margins to be targeted to the party that is posing the heightened risk profile. So there are other things in addition to the minimum margin levels.

And then you kind of made a point about some products within -- you know, let's take the energy product set as an example. Some products within that energy product set, highly liquid, central limit order book, trade all the time. Some products don't trade as frequently. And what we found when we needed to liquidate a portfolio that included the whole spectrum of those products is it was very easy to liquidate the whole thing as a pool. And it all liquidated in -- I think we gave people the final portfolio on the Lehman portfolio at like 2:00 or 3:00 o'clock in the morning. We held the auction at 8:00 in the morning, so 5 hours. They were able to price that operationally, bring it in, value it, and do their bids. And that included a spectrum of, you know, futures with varying levels of overall turnover.

MR. CAWLEY: Ananda, just to be clear, are you saying that within the futures regime, you have an observable market for liquidity and so, therefore, you know what you know and you know you can liquidate at a given day?

MR. RADHAKRISHNAN: All things remaining equal -

-

MR. CAWLEY: Right.

MR. RADHAKRISHNAN: -- because the Commission has a view into trading, and so on.

MR. CAWLEY: Rick oversees it. So you know it's a regulated marketplace and so on. But Rick oversees the actual --

MR. RADHAKRISHNAN: Yes, yes.

MR. CAWLEY: Okay. So two things. One is one has to be careful not to assume that just because today it doesn't trade in an exchange, it's not trading; right? Swaps are trading every day. So the challenge, then, is how do you over -- you know, you can't assume that. So how, then, do you measure that liquidity in the marketplace today? And you can't just walk away and say, "Well, it's not -- we can't see it. So, therefore, it's not trading in a regulated marketplace yet. So, therefore, we're just going to assume the worst and assume that it is not trading."

The challenge is for you to go out and gather that data. And that data is available. The other thing is you need to be mindful that the SEF rules are still not upon us. So you got this interregnum period where there is still a lack of transparency in the

www.CapitalReportingCompany.com © 2013

marketplace. And that is going to change.

So, to the second part of your question, which is, you know, how do we observe it now but then how do we account for it in the future, the simple answer is, if you can pass the SEF rules quicker and the market can then become more of an observable marketplace with transparency and trade reporting and so forth, then you're going to have a much better set of data on which to base your decision. What I would say, though, is I would recommend that you move, be prepared to move, quickly and observe that quickly into, you know, it doesn't become two years or three years, it becomes a three-month or six-month event.

MR. MAGUIRE: Ananda, I think your challenge is just as much our challenge as well as DCOs. You know, we are risk managers ultimately. I think we have a healthy paranoia around this. So we'll try not to be too geeky as I try to explain what we do, but, look, the past is maybe an indication of the future, but it is by no means -- well, it has been very much prudent in the past. That is not always the case.

So what we do every day, we are religious about back testing. We back test to a very high standard, a very high confidence interval. And what does back testing mean without getting too nerdy about it? It means we look at the positions we have, not the 66,000 swaps we have with Lehman. You break that down into positions that are analogous to concentration and contracts and futures. You break that down into positions. And you say, "How much would I need to trade in the market to get out of this position?" And what you are doing there every day is you are challenging the assumptions of your margin model. We say five days. As everybody said, it's arbitrary. We have been doing five days for swaps since 1999. It seemed to work okay in Lehman, but maybe it's time for everyone to review it. You are challenging those assumptions every single day across every single portfolio.

And, to give you some context, when we closed out Lehman, 66,000 trades just sounds like a lot of clutter. We actually hedged out. We have 100 trades in the market. So 66,000 trades doesn't mean 66,000 trades I have got to go hedge. It doesn't mean I need to go to 20 SEFs. It's actually quite easy to access the market, even easier now with the opening up of the execution venues.

So when we do this, we are really looking at concentration, but I think the data that is available to us is available to you as well. I know we obviously share a DCO with you. I think it behooves all of us to really get our hands around what is actually being traded in the market. I think SDRs would hold that.

And I think the other thing is making sure that all of these assumptions that we have via back testing, concentration risk, that we actually test these things. And we do things we'll refer to as fire drills. And I think that is a very important way of proving what is the right number.

And what are the qualifying criteria to all of the 75 direct clearing members of swap clear is you must participate every six months on a mandatory basis. And we go and basically simulate a default, which to anybody else, it's like simulating a disaster recovery-type exercise. Our disaster's default. You simulate that default. And every single participant has to give us prices to hedge the buck. We don't sell open risk in the auction. We go into the market trade and hedge the portfolio. We package it. Then we auction it. We do that every six months. And those portfolios are much bigger than Lehman, but also we have changed the way we do this so everyone can participate and not relative to their size and proportionality. But those are the real tests. What are the prices you are getting when you go to the market and you assume a dark day, a high- volatility, low-liquidity day? You get the prices. You see what the values of them is on the hedge and the auction. And that is how we really prove out to the best of our ability our assumptions and our model, I think, you know, something we will continue to share with the Commission, but I think that is another way of really proving out whether five days, two days, ten days is the right number.

MR. RADHAKRISHNAN: I wish we could continue the discussion, but, you know, I have been told we need to finish. So thank you very much.

And, you know, don't we have a record or something? So if people want to send written materials, they should send it to us because it is obviously not going to be the first time that we have a discussion of this nature.

So come back at 1:30 or 2:00 o'clock? How about 1:45. Split the difference, 1:45. And Panel number 3 will start. So thank you.

(Whereupon, at 11:20 a.m, a luncheon recess was taken.)

A F T E R N O O N S E S S I O N

MR. SHILTS: I think we'll try to get started. I'm going to turn this over to Abigail Knauff, who is going to start the third panel here. Abigail?

MS. KNAUFF: Hi. Panel 3 will focus on transaction-related matters for swaps and futures, including block trade provisions. We are interested in hearing panelists' views on any challenges or issues that resulted from the recent conversion of cleared swap products to futures contracts for the Commission's current block trade proposals. The Commission has proposed a swap block trade, which has swap categories and methodologies for setting appropriate minimum block sizes for those categories and has also proposed acceptable practices governing the pricing and size of block trades for futures.

We look forward to the discussion about any issues or changes regarding consistency between swaps, futures regulations to existing regulations, or to future Dodd-Frank rulemakings.

Before we get into the discussion, I would like to go around the table and have everyone introduce themselves and identify who they represent.

MR. DURKIN: Good afternoon. I am Bryan Durkin, COO of the CME Group.

MR. FARLEY: Thomas Farley, IntercontinentalExchange.

MR. CALLAHAN: Tom Callahan, CEO NYSE Liffe US.

MR. PESTONE: Wayne Pestone, Chief Regulatory Officer, FXall, Thomson-Reuters Company.

MR. CAWLEY: James Cawley, CEO, Javelin Capital Markets.

MR. LEE: Robert Lee, Deutsche Bank.

MR. THUM: Bill Thum, principal at Vanguard.

MR. HIRANI: Sunil Hirani, CEO of trueEX.

MR. EMMITT: Bill Emmitt, President of PVM Oil Associates in the U.S.

MR. BRADY: Neal Brady, Eris Exchange.

MR. JESKE: Jerry Jeske, Group Chief Compliance Officer, Mecuria Energy Trading.

MR. WILSON: Don Wilson, DRW Trading and Chairman of FIA PTG.

MS. KNAUFF: Thank you.

To quickly review the format, each panelist will provide their prepared remarks for four minutes or less. Once we hear the panelists' prepared remarks, we will then start an open discussion. So that we can hear from everyone, please hold your follow-up comments until either your remarks or until after all panelists have had the opportunity to make their prepared remarks. And we will start with --

MR. DURKIN: Good afternoon. You know, in just a little more than three months, the new swap regulatory regime has had an acute impact on the energy markets. Although NYMEX energy contracts have always been listed as standardized futures contracts, many of these saw very little trading activity in the listed markets because of the esoteric nature of many of the products that we support. Instead, many of our market participants relied on historically prevalent swap execution protocols and then exchange that contract for an economically equivalent product in our listed futures. This trade type was permissible under the Commodity Exchange Act and CFTC regulations because it was accepted by the exchange and the exchange rules.

Facing an uncertain application of the new swap rules last October, customers asked us for a more flexible and certain means of executing our listed futures contracts. In response, we permitted new block trades and made more products available on our Globex platform.

Now CME continues to support and we fought hard to retain the EFS trading model, which allows customers to retain their choice of transacting these instruments via either OTC swaps, which will now be subject to the CFTC regulations. We have adopted our block levels to prevent significant disruption for our customers while we were transitioning during this period. We have seen a tremendous transition in many

www.CapitalReportingCompany.com © 2013

of our markets from OTC trade type to the exchange-traded block. We believe that the thresholds that we have established need to stay in place absolutely until the full extent of the swap rules are clearly defined and evident to the marketplace. We also need to give appropriate time for the marketplace to adapt and adjust to whatever that criteria is going to be.

By encouraging more blocks and movement into the futures, our plans serve the regulatory interest, we strongly believe, of transparency. The new block trading allowed regulators and others to access real-time transaction pricing and size data, which is located on our website and is fully available through our market data feats.

Additionally, we believe that the changes we have made to our block thresholds not only avoided market dislocation, but provided customers with more choice and more flexibility.

As to timing, we firmly believe that the Commission should first finalize the SEF and the market available to trade rules before it considers block rules for swap and futures. This is a logical sequence to avoid potential harm to our customers and to market liquidity.

There's a lot of unknown questions that still need to be clarified and validated: whether SEFs can operate by voice or RFQ to one, rather than RFQ to five, in the scope of the trading mandate, or the impact that MAT rules will have on products, how they will be required to trade on a SEF, and what will dictate the role of blocks in those swap markets.

So one of the underlying principles that we would like to leave for the distinguished panels and the staff of the Commission is it is very, very imperative that clarity be made in the context of the SEF rules and the MAT rules. That will inform any further decision- making. And in the meantime, clarity is important to the marketplace, a marketplace that, you know, has been operating with a certain level of uncertainty, the transition I think has been very seamless. We have been able to maintain the integrity of that marketplace. And through the transitioning, it is most definitely I think underscoring the imperatives that you have outlined as a part of the rulemaking.

MR. FARLEY: Markets have had the notion of anonymous negotiation of trading privilege and confidential portion of the market, if you will, for ages. And they will continue to do so. And we encourage staff to keep that in mind as you are contemplating block trades, both for swaps and for futures, and specifically ask you to consider the important role of these trade types in managing slippage for larger size trades to understand the valuable role that brokers perform as part of this function and, in particular, to understand the value of block trades, particularly in a newer or more illiquid market, where allowing block trades is a way to build open interest, which is itself a way to build more liquidity, perhaps paraphrasing a bit of what Don Wilson said on an earlier panel that I won't belabor because he is also on this panel, we think it is important for staff to understand that these smaller markets may well have a higher percentage of blocks relative to the overall volume in that particular market versus, say, a highly liquid market. Think of, for instance, our Henry Hub futures contract versus --

I don't know -- a more illiquid power delivery location, for example.

I wanted to touch on quickly -- Commissioner O'Malia asked a question about, well, what happens if they're all blocks -- I'm paraphrasing; those weren't his exact words -- and how do we address that? Could we delist the contract or force it to migrate to a swap? We think that is a bad idea. And we think that would be disruptive. But we do think there are other ways to deal with that issue and to work with the DCMs and perhaps the SEFs to increase pre-trade price transparency over time.

Just two final points. First, to the extent there are rules for block sizes for SEF-traded markets or even DCM-traded markets, we think it is imperative that you leave it up to those SEFs and those DCMs to determine those block sizes. That will be it perhaps, subject to some guidance or some guideline that you put forth, but we ask that you leave it in our hands to be able to update that periodically from time to time because, as we have seen in other analogous situations, that set of shared -- or sharing the responsibilities in that way creates room for a little more innovation and more rapid response time on behalf of SEF and DCM managers.

That's all I have.

MR. CALLAHAN: My name is Tom Callahan. I am the CEO of NYSE Liffe US, which is the U.S. futures exchange or NYSE Euronext. We trade precious metals futures, equity index futures, and interest rate futures. I would like to thank the Commission for giving me the opportunity to participate in today's roundtable.

At NYSE Liffe US, we are focused on the operation of our DCM. We don't have plans to launch a SEF. Accordingly, we would like to emphasize that whatever regulations the Commission adopts for SEFs, it not unintentionally negatively impact the operation of DCMs. It should be noted that DCMs functioned admirably through the financial crisis. When the OTC and other markets froze up, DCMs remained stable and liquid. So when questions are raised regarding the application of the same block trade regulations to DCMs as they are imposed on SEFs, we are concerned that, once again, we are considering fixing something that is simply not broken.

As noted by Commissioner Sommers, the Commission in three different periods during the 2000s addressed how DCMs should set minimum trade sizes for blocks. Although language was tweaked and enhanced over time, the theme remained the same. Block trade thresholds should be set at a level which, given liquidity for the trade, a trade would impact the price of the market. We believe this concept should remain the central guiding principle as it sets the right balance to promote transparency without unduly sacrificing liquidity. And we believe DCMs are best positioned to make this judgment.

We are also concerned that reporting times, particularly for our international equity index futures, not be set so that liquidity providers are unable to complete their hedges. And, also, they should not apply to unexecuted, not held orders; our global products involve 20 underlying markets worldwide; and that hedging activity needs follow the sun. Again, as Commissioner Sommers put it, we would not sacrifice liquidity at the altar of transparency.

MR. PESTONE: I am Wayne Pestone, Chief Regulatory Officer of FXall, a Thomson-Reuters Company. And I want to thank the Commission for inviting us to participate. We intend to develop and register SEFs and have devoted many resources over the past two and a half years towards this goal.

Thomson-Reuters is concerned about the regulatory arbitrage emerging between the futures and swaps markets as a result of implementing the Dodd Frank rules.

We note the disparate regulatory treatment between futures and swaps with regard to margin, block size, trade reporting, and the volume and thresholds that trigger swap dealer registration. In each of these cases, we think the right outcome is equal treatment for economically equivalent futures and swaps. Also, this equal treatment should occur at the same time. In other words, if a precedent exists in the futures market, the analogous swaps rule should be consistent with this precedent until and unless the Commission moves to change the precedent for both markets. For example, with regard to margin, we believe the margin for cleared swaps and futures should not be based on whether the instrument happens to be called a future or a swap.

We ask that the Commission revisit the margin requirements and make changes so that it's based on an economic analysis of risk and liquidity such that equivalent swaps and futures products have this equal margin treatment. For blocks, we believe that the block size determination should be equivalent for both swaps and futures. Since the precedent so far is that the DCMs can set their own block sizes, we think that the SEFs as SROs should also be given this equal authority. If after a year of the Commission analyzing market data, it believes that the sizes should be changed. That change should apply to both markets.

Thomson-Reuters views competition as a catalyst for bringing the best possible experience to all of our customers. We simply want the swaps markets to be permitted to compete thoroughly with the futures markets on appropriate playing fields. Regulatory arbitrage between markets, especially arbitrage caused by the unintended consequences of a regulator's efforts to improve one of those markets, doesn't create the appropriate playing field to compete.

MR. PESTONE: Rather than asserting the swap should simply have been traded exclusively on DCMs, Congress created SEFs as part of the Dodd-Frank rules as an alternative to the existing model. However, we are worried that the swaps markets for SEFs won't be viable by the time SEFs are ready to launch later this year.

We're asking the Commission to allow the SEF models to compete the SEF models to compete on an economic and customer service round first. Therefore, we request that the Commission delay the effectiveness of listing any swaps futures contracts on DCMs until the SEFs in each asset class are allowed to operate and can compete fairly.

Thank you.

MR. CAWLEY: Thank you once again for inviting me to participate on two panels this afternoon and this morning. My name is James Cawley. I am Chief Executive Officer of Javelin Capital Markets, an all-to-all trade execution venue. And, as I mentioned earlier, for interest rate swaps and credit fall swaps, it expects to register either as a SEF or DCM depending on which way the rules come.

To consider what should be an appropriate block trade rule for DCMs and for SEFs, we must first remind ourselves of such a rule's purpose. We must remind ourselves of the block rule where a market maker is given an extended period of time before the block trade is reported. It is designed to protect and encourage liquidity, not to hamper or lessen it. Block trade reporting delays encourage market makers to provide liquidity in large size without fear that other market players may abuse them as they hedge or trade out of such a large position completely.

The block trade threshold test should be objective and straightforward. For a given time delay, the question is, what is the liquidity available to the trader before he must report the block trade to the market and be exposed? Too little liquidity within such a time interval, and the trader does not have enough time to get out of her hedge or trade out of the position. She is exposed and could lose money. And because of this risk, the trader is loathe to quote such a large market next time.

Overall market liquidity is decreased as a result. And the opposite is also true. Too much liquidity within a given interval and the trader has too much time to set a hedge. And he can now use this price- moving information against the market. And, as a consequence, liquidity is also lessened. And market integrity suffers.

Thus, the block trade threshold should be exactly equal to the amount of liquidity available to the trader within the time interval or before she must report the trade. The threshold should not be too high, nor should it be too low. It should be just right.

Available liquidity, moreover, does not just include trades but also should include firm orders available at the current price. In fact, the concept of available liquidity goes further. It considers the liquidity of other related markets. For example, if I hedge interest rate swaps with Eurodollar strips, shouldn't I include the liquidity of that market in consideration of the liquidity and block trade thresholds for swaps? To be sure, the CFTC block trade rule for SEFs does set the interval at 15 minutes in the long run. And it does consider trade data in setting the block trade notion or threshold, but it does not yet consider price order data, nor does it consider liquidity from other economically equivalent markets. It should, and it would be a better measurement if it does.

But in order for this to work, the same block trade rule must extend to all trade venues, SEFs and DCMs alike, for instruments within a given class of economic equivalence to operate and function properly. For example, interest rate swap futures and their underlying swap instrument are economically equivalent. And, that is, they are equivalent in risk and trade relative to each other. And, as such, there should be one block rules that governs both. And such a rule should consider the available liquidity in both markets. Neither SEF nor DCM but the CFTC should set such a rule. And only then can the market be assured that the rule is objective, measured, and a realistic measure of the available liquidity. One trade venue must not be permitted to set its own rule while the other has it set for them. Such a scenario clearly raises the specter of a race to the bottom as market forces may gain such a rule mismatching attempt to force trades off market in a delayed reporting scenario or report them not at all.

In conclusion, we need to remember the block trade rules exist to encourage liquidity and transparency. There should be no such thing as block trade thresholds again that are too high or too low. And there should be objective thresholds based upon observable available liquidity in a given market that considers also the liquidity in other markets economically equivalent to it.

Moreover, such a rule would be set by the regulator and not be applied in a uniform manner to avoid any gaining or regulatory arbitrage but may manifest itself between such markets. But such a rule should be passed quickly along with other rules. And in the interim, the CFTC should place a freeze on all futures certifications on products that may be economically equivalent to products expected to be traded by SEFs so as not to create an unfair advantage. Such gaining can only lessen market integrity and drive up execution costs on the end user.

Thank you. And I look forward to your questions.

MR. LEE: Thank you and good afternoon. I appreciate this opportunity to come before you to share views and to contribute to the discussion of this very important topic.

As the Commission works diligently to finish its rules on swap execution facilities and block size thresholds, I think it is important and appropriate that the Commission take this time to acknowledge and also consider recent developments in the swaps and futures markets.

The topic of our discussion, you know, the futurization of swaps, has generated a number of commentaries that it had attempted to attribute reasons behind this movement. You know, some pundits have cited benign reasons, such as that this is a natural migration or a natural evolution of products. Other experts have cited less benign reasons, such as that this is borne out of concerns related to regulatory complexity or new regulatory burdens and costs associated with trading swaps. And others have also said that, you know, the primary driver is regulatory arbitrage or regulatory differences in the difference between swaps and futures. I think, irrespective of the reasons behind it, now that the topic of regulatory arbitrage is before us and it is known to the marketplace, it is known to the Commission, I think it is sensible to take appropriate steps to address and mitigate whatever potential there is for regulatory arbitrage, right?

I think there are two critical areas that have been identified by the Commission, you know, where basically regulatory differences could distort the competitive landscape and favor one market over another. And those, you know, the first of which is the setting of initial margins levels for futures versus swaps, has been addressed by the previous panel. So I will focus upon, you know, the block size threshold.

I think in order to address any potential for disparity in the treatment, I think a logical starting place would be to look at the proposed rules on setting block size thresholds for swaps. I think that is a natural starting place, given that, you know, reporting and SEF execution are new to the swaps marketplace.

When we actually look at the proposals for the methodologies for setting block size thresholds for swaps, I think if you were to look at the various comment letters that have been submitted, I think one underlying theme throughout is that there needs to be better calibration, right, for the particular swaps instruments in terms of setting the block size thresholds. All right?

And I think, just as an example, where we perceive some weakness in the proposed methodology is, you know, in the credit space just as a starting point. In the credit space, if you were to look at what is the most liquid instrument, you know, that right now is the five-year contract on the under-run series of the index. Right? Whenever there is a role, which occurs with every six months, the liquidity of what used to be the under- run series drops dramatically. And six months later on, it drops even further. However, the way that the methodologies treat these instruments is to actually lump them all together within the same maturity bucket. As such, you combine both liquid as well as illiquid swaps into the same bucket. And that has the effect of actually overstating the amount of liquidity for the less liquid products. And, therefore, the block size thresholds may be set inappropriately for the less liquid instruments.

And I think, similarly, in interest rate space, when you look at a ten-year fixed or floating swap, which is very liquid, and you pull it together with a six-year or seven-year, eight-year, or nine-year, which are less liquid, you have the same effect here.

And so I think a reasonable starting place when we actually look at and reevaluate the methodology, I think there should be a clear distinction between what is liquid versus illiquid, right, in order to, you know, satisfy the statutory mandate, which is to really take into account the impact of liquidity based upon public disclosure of information.

So, you know, if we were to start looking at how we would actually go about it, I think there needs to be perhaps more granular analysis of various contracts, I think a clear differentiation between illiquid and liquid products, maybe narrowing of the buckets so that you actually isolate liquid from illiquid products. And, you know, I think it's understandable, but for operation and administrative ease, some bucketing would be appropriate, right? But I think it is really trying to highlight that within a bucket, there are less liquid instruments and by conforming the block size thresholds to the more liquid instruments within that bucket, you will deprive the market of valuable liquidity in the less liquid instrument.

I think another aspect that I think has been alluded to by other panelists is the question about who actually determines ultimately the size of the block size thresholds. And I think that is a reasonable question, but I think what is more important to the marketplace is to figure out what are the common principles behind how that is actually determined. And I think there should be a common sense approach in terms of setting the basic guidelines. You know, for example, first and foremost, the block size thresholds for any particular instrument should really be reflective of its liquidity in the marketplace. You know, I think that is pretty obvious.

I think the second principle should be that less liquid instruments should have lower block size thresholds. And, once again, that is very common sense, but if you were to look at some of the proposed block size thresholds, in the proposal, it is counterintuitive if you were to look at it.

And I think a third principle, which I think is not very controversial, is that when you start grouping instruments into a maturity bucket, I think we really should look to the least liquid swaps instruments within that bucket to determine the block size threshold. Otherwise, I think you will overstate the liquidity for that illiquid instrument. And you would end up setting an inappropriately high block size threshold for that instrument.

And I think, you know, as everybody would agree, can agree on, I think you need to have a vibrant swaps market as well as a futures market. They essentially complement each other. And by having, you know, areas where there are potentials for regulatory arbitrage, you effectively, you know, have regulatory bias dictate where liquidity goes, rather than true market forces.

Thank you.

MR. THUM: So, again, I am Bill Thum from Vanguard. Just to remind the audience, Vanguard is on the buy side. We are a real money manager with over $2 billion under management and 9 million shareholders. We use swaps to carefully hedge portfolio risk, to lower transaction costs, and to achieve more favorable execution as we manage our portfolios. We have been very big supporters of the CFTC's rulemaking efforts, particularly with respect to non-public reporting, some of the margin rules, and as well the clearing of swaps and the enhanced customer protection for the margin that is held for cleared swaps, but we question whether the development of the swaps futures products suggests the CFTC's proposals are expected to negatively impact the swaps market overall liquidity.

With respect to swap futures, we, like other asset managers, are intrigued. The pros, of course, are lower initial margin levels and lower block sizes. However, we have questions with respect to liquidity in the product and also the ability to use the product to adequately tailor the hedges to match the risks presented by our portfolios.

The initial margin of two days of VaR is set by the clearinghouse based on its overall confidence with respect to pricing, hedging, and liquidation. And low block sizes are closely attuned to the trade size participants can hedge in 15-minute intervals. This is instructive as we evaluate the swaps regulations.

For the swaps initial margin under the current proposal for cleared product is a five-day VaR, and the clearinghouses have acknowledged in previous panels that a longer period is needed to have confidence with respect to pricing, hedging, and liquidity given the limitless variations on the swaps market. However, the disparity between a two-day VaR for swap futures and a five-day VaR for swaps, cleared swaps, is pushing participants toward increasingly considering swap futures.

Now, as a proposal to particularly focus on setting initial margin levels based on relative liquidity, one could consider an alternative approach where for the most liquid products, a two-day VaR would apply to swaps that were mandated for clearing, as opposed to swaps that are optionally cleared. A three-day VaR could apply to the swaps that would be optional clearing and a five-day VaR for uncleared swaps. In setting the VaR in this way, you recognize the relative liquidity presented by the products, and you also avoid the arbitrage between swaps futures and swaps.

As Vanguard hedges its portfolio, we look to hedge the overall risk presented by the portfolio. Swap futures, which will naturally hedge a more limited range of risk, may be attractive to us, but in executing a swap future, we will have to also focus on the risk at the tail and at the head as we consider it. So we want to make sure that we are driven by the proper considerations in constructing the hedge and not simply because of an arbitrage based on initial margin or lower block sizes.

In terms of the block thresholds, we have repeatedly come to the Commission and said, "The current proposals do not adequately reflect the relative liquidity nor the impact on liquidity that the block, the current proposals, could have." While we also think the current 30 to 15-minute public reporting delay is too short to actually hedge positions, we recommend a number of changes with respect to the block threshold approach.

First of all, treat all trades as blocks for the initial year while information can be gathered.

Secondly, study the data from the SDRs to determine both the categories based on differentiated liquidity buckets.

And, rather than run through examples, I will turn your attention to the May comment letters submitted by the ICI, by SIFMA AMG, and by ISDA, as well as our own letter from May that illustrates the many additional levels of granularity that we think should be applied in assessing blocks.

Fourthly, set relative block thresholds based on the volume that could be executed immediately without moving the market. In other words, we want to be able to put trades in that are not blocks where we can expect the dealer to hedge its position immediately without impacting the price that it charges to us.

Fifthly, refresh the block sizes quarterly. The current proposal simply has too long a period to refresh the assessment of the relative liquidity.

And, finally, report trades above the cap at the block level.

So, finally, when the CFTC sets more granular categories and establishes relatively appropriate block sizes, keep in mind that market participants such as Vanguard will still need to break trades into sizes that can be hedged in that 30 or 15-minute period to avoid pricing disruption. This may add significant costs to our execution, costs will, of course, be borne by our shareholders. The costs will include having to execute multiple small trades, which will increase transaction costs. And, indeed, as we execute subsequent trades, the price for the subsequent trades will be impacted by the trades we put on initially.

Vanguard's trading draws on the need to hedge across multiple portfolios. We aggregate the hedging needs and try to execute a single trade to cover the hedging across all the portfolios, then allocating the trades to distribute the hedging. If we have to break those trades up, we will obviously incur additional costs associated with that and possible pricing differences.

So thank you again for inviting me to speak and will be eager to answer any questions.

MR. HIRANI: Hi. I'm Sunil Hirani again of trueEX. Thank you very much for inviting me to participate in this roundtable to talk about some of the salient aspects of Dodd-Frank relating to swaps and futures.

TrueEX is the first regulated exchange approved as a designated contract market by the CFTC initially for the interest rate market. And trueEX's goal is to provide a safer, more efficient, open exchange, as outlined by Dodd-Frank mandates to create a transparent, competitive, regulated marketplace for standardized swaps and the clearing of those transactions, and also to provide consumers with a choice of clearing, which we have done.

And, you know, one of the reasons we created trueEX as a DCM regulated by the CFTC is of clearing, which we have done.

And, you know, one of the reasons we created trueEX as a DCM regulated by the CFTC is for the express purpose of listing both swaps and futures because our view is that consumers, like Bill, are going to choose over time which instruments they want to execute and where they get better liquidity and execution and cost.

So creating a DCM, we believe, is going to allow us to leverage the benefits that have long been enjoyed by the futures markets to be utilized by the $600 trillion interest rate swap market. We need a CFTC- regulated exchange, like trueEX, that provides all the benefits of futures to standardized swaps, including pre- trade transparency, trading on a regulated venue; i.e., DCM, post-rate transparency, true end-of-the-day close, anonymous execution with a fully cleared model.

So I'd like to make two primary points. And they dovetail very nicely with some of the comments. My first point relates to those classes of swaps that are very liquid, that are very standardized, that trade on a transparent exchange, that are cleared, that are very much futures-like. And so for those classes of swaps, not for every class of swaps, but for those classes of swaps, we would encourage the CFTC to craft a regulatory framework that treats a standardized swap, which is futures-like, similar to the framework that has existed and worked extremely well in a futures market for a long period of time, as long as the futures contract is equivalent in terms of risk, time for liquidation, volatility, pre-trade transparency, and clearing. But, as things stand today, even if a swap is traded on an exchange, on a DCM, with the full benefits of transparency and equivalent risk, time for liquidation and clearing, it is not equal to a futures contract and for an equivalent amount of product standardization because there has been some discussion in the previous panels. So I am not arguing that products that are not equivalent from a product standardization perspective should be treated similarly, but those contracts that are equivalent from a product standardization perspective, risk, liquidity and transparency, and hopefully regulatory oversight should be treated in a similar and consistent fashion.

My second point relates to those classes of swaps that are not liquid nor are standardized. And for those classes of instruments, it is necessary for market participants to trade them off the run or in a block fashion, you know, life cycle events that cannot be easily captured in a manner that I described the first class of transactions. Swap traders need to be able to terminate preexisting swaps. They need to be able to novate them and compact them. In looking at some of the recent SDR data and entry-level market information, you know, a majority of the clearable swaps of the reportable clearable swap transactions were done actually in off- the-run instruments that were either terminations, trading old series, novations, or unwinds. And for these classes of non-standardized swaps, we must allow swap market participants to execute them off the run, similar to how it happens in the futures markets on DCMs. And CFTC should ensure that these transactions can be executed on regulated DCMs in a manner similar to what is permitted for futures, such as blocks, exchange for physical, and exchange for risk transactions.

In the futures markets, new order types are permitted to execute less liquid or block transactions off facility. Once again, we would request nothing better but just similar treatment to futures on a DCM. As long as standardized swaps are traded on a DCM on a transparent, cleared, and anonymous basis with equivalent regulatory oversight, similar to futures, they should enjoy all the benefits as well as the obligations of a similarly traded futures contract on a DCM, which what matters is what is substantive about a financial instrument, not the name of the wrapper or the package in which it is delivered.

The objective of the act was to regulate swaps in a manner similar to what has worked extremely well in the futures markets for so many years. It is incumbent upon the regulators to ensure a vibrant, well- functioning, transparent, and regulated not only futures but swaps market as well for a lot of the reasons that Bill and others have talked about and to ensure consistency in regulation and treatment so people and firms that utilize these instruments for risk management, they are in the best position to choose which wrapper they would like their risk to be packaged in.

Thank you very much.

MR. EMMITT: As I said before, my name is Bill Emmitt and I'm president of PVM Oil Associates in the US. I appreciate the opportunity to share my views on the futurization of swaps and the role of voice brokers in the energy markets. PVM is an international voice broker specializing in over-the-counter and futures execution services in the energy arena.

We have been in business for over 40 years, serving a diverse institutional client base, including integrated oil companies, independent refiners and producers, physical traders, banks, hedge funds, proprietary traders and national oil companies. Our primary markets involve crude oil and refined products traded in futures, derivatives and physical markets. Many of these products are illiquid and do not trade actively on a central order book.

In addition, I'm also here representing a coalition of energy voice brokers who have come together to express their common interest in preserving their ability to serve our customer base in an every-changing regulatory environment. Although diverse in style and market specialization, we have many traits in common. We are small business enterprises, privately owned, entrepreneurial, experts in our chosen market segments, competitive and, most importantly, we all enjoy an extensive institutional customer base across all areas of the energy trading space.

As the CFTC implements new regulations under Dodd-Frank, we are facing new challenges to providing execution services to our clients; first, with SEF rules favoring large, public companies with sufficient capitalization to open their own SEFs, and then, with the unilateral migration of most of our OTC derivative products to futures market.

www.CapitalReportingCompany.com © 2013

First and most significantly, our customers have spoken and are supporting the trading and clearing of swap futures. We support this migration and urge the commission to allow the active participation of voice brokers in these markets. Going forward, the CFTC should not impose any barriers to using futures as a means to force market participants to use swaps.

The decision to trade in a particular contract should be based on the needs of the customer, not on the regulatory requirements imposed by the CFTC. To that end, we urge the continuation of current block sizes for futures and options. As outlined in the comment letter submitted by the Energy Voice Broker Coalition, we believe that the CFTC should monitor trading volumes on these converted OTC products, as well as related options contracts, to better judge the appropriateness of the assigned minimum block sizes.

The CFTC should analyze a significant volume of trade data accumulated over a long period of time, at least one year, from both DCMs and SEFs. This analysis should look at the size and frequency of trades, daily volumes and consistency of resting bids and offers to the extent that trading activity grows. Then the CFTC can monitor the growth the data provided.

A particular contract, futures, options or swaps, could be required to trade on the CLOB. Many of the swaps that were recently converted to futures by CME and ICE remain very illiquid and there is often no alternative mechanism for execution other than voice broker-arranged transactions that are then executed as block trades. If the minimum size for block trades for illiquid products is raised, there will be negative consequences for customers seeking to hedge or risk manage and for the markets in these products more generally.

As a result, our customers risk not being able to enter into customized block transactions and will not or cannot enter into transactions because on a screen because, one, there are no or few bids or offers on the screen and they will not want to expose or telegraph their trades, trading strategies or, two, standard products are not tailored to their specific risk management needs, such as structured products with multiple legs.

Many of these products have been illiquid for many years. Forcing them to a CLOB, if possible, will not create liquidity. These are thin markets with infrequent trades. Forcing end users to the CLOB will drive them elsewhere, which will reduce and ultimately eliminate any liquidity in these products.

We strongly believe that there must be consistent block rules for trades on SEFs and DCMs, which should be tailored to the features of the contract being traded, such as type of asset, class, liquidity and depth of market, and not the venue on which it trades.

Furthermore, a voice broker should be permitted to arrange block trades on SEFs as well as DCMs. In this regard, we urge the CFTC to confirm in the final SEF rules if voice brokers are permitted for transactions that are not available to trade. We believe that the CFTC, and not a SEF, should make the determination as to which swap should be made available to trade. Otherwise a SEF is as -- is incentivized to certify that a swap is available to trade, even if that swap is relatively illiquid and does not actively trade

 © 2013

on a SEF.

Finally, block trade sizes should not be determined by notional value. Instead, they should take into account the particular features of the contract. If a contract is not liquid and, therefore, is not actively traded on a screen, the block trade threshold should reflect those factors.

I appreciate the opportunity to participate today and I look forward to answering any questions.

MR. BRADY: Thanks. Neal Brady from Eris Exchange. You know, on this topic there's a lot of discussion, a lot of bandying about of the term, you know, level playing field. And as, you know, Professor Parsons in the opening session mentioned, I mean, while that's a tempting sort of slogan and framework with which to look at -- look at this -- an issue like this -- and some of the others were talking about today with this one in particular, the reality unfortunately -- or the reality, in fact, is just -- it's quite different.

I mean, Congress, you know, intentionally set up two very different frameworks and two very different playing fields, if you will, to oversee both swaps and futures. And there's -- you know, there's an underlying rationale for those very different playing fields. And we at Eris Exchange believe that's the framework with which to, you know, look at -- look at this issue of block thresholds.

So I'll talk just about one overlying concept related to that and then give two specific examples. In a -- in a swap framework, as I think we're all aware, the execution guidance allows for an extreme amount of flexibility. And there's a reason for that, given the nature of the customized nature of swaps.

In the DCM framework, there's very specific guidelines around how executions occur below the block threshold -- and I'll walk through some specific examples around that -- that, you know, do not apply to SEFs. And then in setting block thresholds, the commission has provided guidance around nine principles which the DCM should use for futures contracts and set those thresholds.

And notably, you know, one of those nine principles includes, you know, the block thresholds and comparable SEF products. So at Eris, you know, we're supporters of the -- of the rule and that proposed rule. We think it works and it's worked in practice and it works -- it will work going forward.

So two specific examples -- you know, a lot of the discussion focuses on what that block threshold is and what happens above that block threshold but it's worth just pausing for a moment to talk about and be very explicit and clear about what occurs below the block threshold and what's required below the block threshold.

You know, at Eris Exchange our other futures -- DCMs, we have a central limit order book. We have an anonymous central limit order book. We have stacked bids and offers that are fully transparent. Executions occur in, you know, a submillisecond timeframe and are reported instantly to the marketplace.

Importantly, RFQs for off the run -- or customized structures, those are -- those RFQs are seen by everybody on the platform. Anyone can participate in the response to that RFQ. Anyone can step inside of the best bid and offer and the matching occurs according to that price-time priority. So a very, very different framework than the framework that's been laid out for SEFs, whether that ends up being, you know, send it -- send it to five -- the RFQ to five people or send it to three.

We think there was -- even within Congress in setting up these frameworks was intentional about doing that. So just to us, to talk about equivalency and that the threshold should be identical in the two venues, it just doesn't make a lot of sense. Should it be one of the factors considered in, you know, in DCM setting block thresholds? Sure, and that's already in the DCM -- you know, the proposed guidance.

Second, you know, major sort of area to clarify is clearly Congress mandated for swaps and SEF execution multiple venues. I mean, there are -- there are multiple SEFs trading the same -- the same contracts. So to take that in practical terms, if a -- if a client were executing a $500 million interest rate swap, that could be cut up into five different RFQs on five different SEF platforms with, you know, five different sort of ways of operating or protocols that allow for, you know, purposely and intentionally a maximum amount of flexibility.

If you mapped that over into the futures example, that one $500 million trade in an interest rate swap future that would be occurring on a single venue would have a larger impact as a single trade moving the market. There's more flexibility in a SEF in a swap arena. Therefore, it seems quite logical to us and intentional that the, you know, that the thresholds could be -- could be higher because what's allowed under the threshold is a lot more flexible.

So I'm happy to answer questions and engage in a dialogue but, in conclusion, we just -- we support the framework that's been laid out by the commission and believe there's very strong Congressional intent on setting up two distinct frameworks.

MR. JESKE: Good afternoon and thank you for inviting us to speak here today. My name's Jerry Jeske, group chief compliance officer for Mercuria Energy Trading. We are an energy end user. Our operations span 50 countries and over 40 offices with facilities as well a general office space.

We invest in upstream assets. We manage

midstream operations. We ship, store, blend and transact in the physical commodities, including crude, refined products, fuel oil, coal, biofuels, emissions, natural gas, electricity and base metals. Along with this activity comes a need to manage price risks. In order to manager our commodities-related risks, we are dependent upon the standardized futures contracts, as well as the OTC Derivatives Markets. We are customers of both the exchanges and the broker community.

I'm representing our firm here today because we understand the needs of both the exchange community and the broker community. We strongly believe that the Commission should refrain from trying to fix something that is not broken. In other words, block trading is working. The marketplace and the exchanges have done an excellent job in administering the block limits and have struck the appropriate commercial and regulatory balance.

Block trading activity is cleared, reported, transparent, meeting the goals that were established by Congress through Dodd-Frank. Dodd-Frank's aim was to bring transactions in the OTC marketplace and that --

to regulated clearing houses, SEFs and DCMs. That's exactly what's happened in the energy market.

Migrating EFS to blocks in the past few months has been successful. As a result, the CFTC should embrace the success and declare victory. The existing futures regulatory regime provides firms like ours with legal certainty newly developed swap regime presently cannot offer.

It certainly defies logic to conclude that Congress intended for the CFTC, through rulemaking, to now force market participants from legally certain futures markets onto untested swap platforms, resulting in added commercial and legal risks, simply to become -- to avoid the cumbersome EFS mechanism, which has now been abandoned for the more streamlined block mechanism that's been administered.

For the CFTC to attempt to manage block thresholds with limited staff resource and over 1000 different contracts in various asset classes and try to fit a one-size-fits-all methodology, we fear will be disastrous, which would also lead to the possibility for companies like ours to seek venues outside of the

US.

As the commission knows, every market is different and the value of the core principles regimes allow registrants the ability to be flexible, tailor the rules to fit the characteristics of numerous markets. A particular example is the electricity markets, where the exchanges have worked with the industry to craft six different lot sizes for commercially appropriate reasons.

What we feel that has been overlooked is Section 3 of the Commodity Exchange Act. The very purpose of the CEA specifically states, "Transactions subject to the act are entered into regularly in interstate and international commerce and are affected with a national public interest by providing a means for managing and assuming risks."

Prior to the CFMA of 2000, the CFTC used to utilize an economic purposes test to determine if a futures contract should be listed. The economic purposes test assessed the contract's ability to transfer or hedge risk. We suggest that risk transference is paramount to the well functioning markets.

Price discovery is secondary and should not be the final outcome necessary to list futures contracts or to force arbitrarily high block levels. Thus, the utility for end users and ultimate commodity consumers would be in peril. Current block trading provides the essential ability of parties to transfer risks from ones that do not want to manage that risk to ones that are willing to take on such burdens.

We respectfully request that the CFTC guidance in this area should be strictly limited to an evaluation of whether a DCM evidences good faith efforts to support competitive, well functioning markets and allow commercial end users and other market participants access to clear their risk.

In sum, and to answer some of the staff questions that were presented earlier, any perceived differences between the futures and swap regulatory regimes are a red herring intended by parties to gain commercial interests for economic advantage. Block trading has been successfully administered by the exchanges from a commercial and regulatory perspective and should not be tampered with.

Proposed Rule 38.502(a) is a very bad idea. The so-called 85 Percent Rule should not come into force. Block limit sizes should be managed by those closest to the market participants needing to recognize that each commodity asset class is different and must be analyzed closely by market participants with their involvement.

Markets could easily vanish or move offshore if not treated appropriately. Thank you.

MR. WILSON: Thank you. I'm Don Wilson, founder and CEO of DRW. I'm here representing the FIA PTG. The members of FIA PTG are supportive of block thresholds, which are appropriately sized. There's ample evidence that blocks -- block thresholds which are too low harm the central limit order book and encourage internalization and payment for orderflow. On the other hand, block thresholds that are too high make it difficult for large market participants to efficiently consummate large transactions and move large amounts of risk efficiently.

FIA PTG also supports the notion that block thresholds may, in some circumstances, be different between swaps and futures. The reason for that is that the regulatory regime for swaps is very different than the regulatory regime for futures. Let me talk about some -- let me highlight some of the important differences.

Although the SEF rules have not yet been finalized, we know that SEFs will have very flexible transaction rules for RFQs, while DCMs do not. An RFQ on the SEF is a private interaction between a very limited number of market participants. Current -- the current rule proposes five. Some market participants have suggested that a one-to-one RFQ is appropriate. To be clear, a one-to-one RFQ is a block trade by a different name.

On the other hand, on DCMs and futures, an RFQ goes out to the entire marketplace, so that everybody can respond to the expression of interest to transact. Because of this very high degree of flexibility afforded to SEFs for transactions not considered blocks but also not consummated in the central limit order book, it is reasonable that SEFs are subject to relatively high block thresholds compared to futures.

Because identical swaps, including swaps which are cleared at the same clearing house, can be transacted on different venues, unlike futures, which are, of course, a vertical model, it is reasonable that the CFTC should be responsible for setting the block threshold for all swaps.

Furthermore, because a block is just a privately negotiated transaction and really isn't transacted on a platform, it is important that DCMs that list swaps are held to the same block threshold as the SEFs for the same swap. The de facto block threshold for a given fungible swap is equal to the lowest block threshold for that swap, regardless of venue.

So in summary, it's my belief that the CFTC is going down the right path in distinguishing the framework that's used to determine block thresholds. I also believe that the CFTC should stick with the historical approach of applying Core Principle 9 to -- as guidance to DCMs in setting block thresholds for futures, rather than applying a one-size-fits-all mechanism to the futures markets, which is simply unnecessary because of the vertical relationship between the DCM and DCO in the futures space. Thank you.

MR. SHILTS: Okay. Thank you all. Commissioner O'Malia, do you have -- do you have a question?

COMMISSIONER O'MALIA: I just want to ask one to start. And there was discussion about, you know, getting block sizes right, not too small, not too large, that there should be a function of liquidity, et cetera. And I -- the question is maybe to the exchanges but to anybody is that -- I guess myself and I think the staff had always kind of viewed blocks meaning large, you know, transactions that are large relative to something -- usually relative to trading on a centralized market.

And as you get -- as we've seen in some of the energy products, where blocks are, you know, very low, five, two, one, then it kind of -- I just, you know, wondered, what do people think of in terms of the relative to what? You know, it's large relative to what? If you -- particularly if you have a block that's only two or one, it's essentially the same as the contract size.

So in some sense, it seems as though the term "block" has another meaning, I mean, as illiquid or something and not really large. So I just -- I don't know if anybody's got any comments on that or thoughts on that.

MR. WILSON: Go ahead, Bryan. Yeah, I think it's a question of large compared to the size of the central limit order book in a given product. And the energy market is a very interesting example. I think that perhaps the block thresholds in the energy market right now are not sufficiently granular. Certainly in a front month product that's very liquid, it's entirely reasonable to set a block threshold that's higher than for a month that's difficult to price, that's very opaque, is difficult to source liquidity in and doesn't - - just doesn't exist on the screen.

MR. JESKE: Rick, maybe I can jump in since Don mentioned energy. Not to be cliche, size matters.

But the liquidity that people are speaking of, I think, is paramount. I use the example of electricity. You have megawatt hours. You have nodes that are being traded around this country. There are tremendous amount of illiquid potential products out there.

So how do you put a buyer and a seller together? Do you force them to go to the central limit order book for the sake of price discovery? I say not. I say you allow those counterparts to come together, whether it's through a voice broker or through an exchange, to have the ability to be able to make that transaction transparent.

But when you only have two people in the marketplace or three or four or five, they need to be able to seek one another out. And for the commission to actively set an arbitrary number is just -- will destroy the markets -- in the small markets, as well as those that could develop into larger markets. So when you -- when you get to the concept of size, I think that's secondary. I think you really have to look at the type of market.

MR. DURKIN: Having recently gone through this in, you know, great, laborious detail, I would agree with both of actually what Don and Jerry stated. I mean, you have to look at -- when you're talking about over 1000 products in the energy space that you're trying to respond to a marketplace that has obviously spoken loudly that there is a need for these risk management tools, and you look at the more liquid-type contracts that are bit more conducive to a CLOB-like environment, you will see a greater correlation of higher block thresholds associated with those particular products.

As you move into some of the other more esoteric products, and particularly, as you're dealing with options that are linked to a variety of other energy- related instruments, it becomes a bit more complex. And your -- you know, your realm of user base and the liquidity associated with that could be as low as what Jerry had just described. And so that predicates a lower threshold.

You know, when we went through this for the conversion of all of our products, we did do it in -- there was a semblance process that we went through. And we took all of the available market information data, liquidity elements, the uniqueness and structure of the product to come up with the levels that we chose.

Some of those that we came out with, the commission may recall, we got a resounding response from the marketplace that they were unusable. And this was particularly in the power segment. And when you go into power and you look at the complexity of how that power market is calculated, it resonates with you to understand why you have to have a much lower level, bases how that market trades and is priced.

So it is not a one-size-fits-all equation, you know, I assure you. And it's something that needs to take very much into consideration the risks associated with every one of those products in the market that you're trying to serve.

What's been very beneficial by all of this is the greater transparency behind the establishment of these block transactions, the reporting information and the ability now to be building up more historical data for us to benchmark and base our calibrations off going forward.

MR. HIRANI: Would it be possible to add something to that?

MR. SHILTS: Yeah, just if maybe one more. And I don't know if -- Commissioner O'Malia, are we -- do you have any questions? But, yeah, maybe this will be about it because we want to try to end this fairly soon. Because for our fourth panel, you know, some people have to leave and they may not be able to sit through the whole thing. So maybe just maybe one more comment and maybe one question. And then --

MR. HIRANI: Sure.

MR. SHILTS: -- we'll wrap it up.

MR. HIRANI: I very much agree with what Jerry and Bryan said. What you're hearing them say is the energy market is very complex and there's certain instruments that are very, very liquid, deep transparent that trade on a CLOB. But what they're also saying is that there's thousands of other instruments that are illiquid that don't lend themselves to a CLOB that require a lower block threshold.

And that's exactly the analysis and the

thought process that I would encourage you to look at for the interest rate swaps market. Because you have 2s, 5s, 10s, 30s that are very, very liquid that, I believe, are futures-like that should be traded on a DCM, on a CLOB.

But for all those other instruments, that Vanguard and other asset managers all over the world, including hedge funds, will be doing, allow those instruments to be traded exactly using the same analysis that Jerry and Bryan have outlined, to trade them using a block size -- a lower block size than you would for 2s, 5s, 10s, 30s, and allow those instruments to be traded -- exchanged for physical and exchanged for risk. Thank you.

MR. PULLEN: Rick, can I follow up with that? I had a question on that. So in follow-up -- and I've heard many comments along this same ilk, but I've heard no consideration of portfolio of risk, except by Mr. Thum from Vanguard, where he talked about his hedging of the risk on a portfolio basis.

But liquidity providers are also looking at risk in that same way. Whether those are liquidity providers on your exchanges or on your future SEFs, they're providing that liquidity based on a portfolio. So I have a hard time following the logic that a two-year and a two-year two-day should have different block sizes. If everyone would like to elaborate, that'd be great.

MR. CAWLEY: Yeah, let me see if I can help elaborate on that. The notion of parsing, certainly in the interest rate swap markets, the liquid points on a curve, 2s, 3s, 5s, 7s, 10s and so forth, what happens then when you take exactly a five-year, which is highly liquid and no one disputes to trade in block and whether trade on the central limit order books or what not, it's -- we all agree that it's more liquid than, say, a four- and-a-half year.

But then what happens with that swap is it rolls down the curve and it's no longer a five-year. What do you do with it then? So you're right George; you have to look directly at what market practitioners in the interest rates market do today and that is when -- you know, I get hit with 7.2-year swaps, I'm looking -- I'm going to look -- going to hedge that with a basket of 7s and 10s. I'm going to take my two most liquid points around that swap and hedge it.

So -- and if I'm going to do that, I should really consider -- or you should really consider -- or it should be considered the liquidity of both the 7-year and the 10-year swap around it. So don't only just consider the liquidity in the particular widget. Again, interest rate swaps -- and I'm not an expert on energy. But I'll tell you, interest rate swaps are traded on a portfolio basis.

We don't go out and hedge individual swaps piecemeal. It would be inefficient and impractical. So again, when you get hit with something between liquid curve points, you have to consider the -- if you're going to hedge using liquid curve points, you should consider the liquidity of those curve points than in your block trade threshold.

And, you know, one further just point on that. If I take two-year swaps or one-and-a-half-year swaps and hedge it with a Eurodollar strip, well, then shouldn't I also consider the liquidity in the strips -- in the Eurodollar market and -- as part of that calculation as well?

So, you know, the idea here is on one side you want to promote transparency. And I agree with Don in terms of, you know, you want to properly -- you want to have a -- you know, an orderly functioning market. And you don't want to penalize guys who want to make large markets. But also, you want to incentivize transparency within limit order books to the extent that you can.

So I would argue that -- exactly what you just alluded to, which is consider it on the portfolio basis.

MR. SHILTS: Any more comments about that?

MR. SRINIVASAN: Can I ask one question?

MR. SHILTS: Sure.

MR. SRINIVASAN: Thank you. So, you know, we were looking at the data for the energy complex. And there have been comments that we should be looking at the liquidity of the contracts to figure out the block thresholds. And we see that there are contracts which trade -- so in all over 10,000 contracts a day at least. It's a large number of contracts, which are pretty liquid.

But we do see that the majority of the trading activity of these energy contracts happening through blocks. So -- and earlier they were EFSs; now, it's happening through blocks. So the question is, you know, the futures industry, the same as it always has been, if you're doing over 5000 contracts a day, then it's a liquid market.

So we are -- we do see the data. There are a decent number of contracts -- energy contracts which are doing over 5000 contracts a day. But -- so the majority of the trading activity is happening through the blocks. And the block size -- and if you compare those with equal and non-energy contracts with similar volumes, those non- energy contracts have a much larger minimum block thresholds. It can be, like, 200 contracts for a non- energy contract. But for that energy contract, it would be 25 contracts or 5 or even 1.

So we're just trying to figure out, you know, how do we make sense? So we're looking at the liquidity, going by, you know -- if you just look at what's being printed on the exchange, it seems liquid, right? But if you looked at the block thresholds, they're really high. The block thresholds are low and the block activity is pretty high.

So, you know, what are we doing? Do we look at different sectors differently or do we just say -- go by the trading activity and say, "Okay. This is a liquid contract and this should be treated like any other liquid futures contract?"

MR. FARLEY: I'll just make a couple of quick comments, Bryan. The conversation, at least in ICE's case, from swaps to futures, we view it as a fairly fundamental event. And, you know, our kind of internal mantra was a version of the Hippocratic Oath, "Do no harm." And the market largely is traded as you described.

So in the -- whatever particular contract you're describing, 10,000 a day that does some high percentage of blocks, that's how it -- that market had evolved. And on ICE, we had always made a central limit order book available to customers alongside block trade -- block trading. And the market, for whatever reason, in that particular case had evolved in that way.

So as part of the conversion, our goal was to do no harm and provide the ability both the Friday prior to our conversation, as well as that Monday morning when we were a futures for the market to continue to behave as it always has. I would give it some time. This was just October.

MR. SHILTS: Right.

MR. FARLEY: These markets are now futures. My sense is that they will evolve. You probably will see more central limit order book trading. And I think it's probably a more interesting intellectual or academic conversation six months from now or a year from now, once the -- you know, that these markets as futures have had a chance to mature.

MR. JESKE: I would add to that comment, certainly from a user's perspective, what you're talking about is electronic screen-based trading versus voice broker trading. And I think, as Bill mentioned, you've got the broker community out there that's trying to provide that liquidity. Call it an EFS. Call it a block. It's irrelevant.

Those transactions have grown up in the voice broker community. You can't flip a switch overnight and make it different. You can't make people behind their desks start trading on a screen immediately. That's -- the point Tom made about give there some time is absolutely correct. People aren't going to change their customer practice overnight.

The change between EFS and block has been a very constructive one because it's streamlined. You don't have two swaps anymore. You have one transaction. It's a lot less clunky. The market likes it. It works. As it relates to the broker community, if everything's forced into a central limit order book, you're forcing the brokers out of business to a large extent. And I don't think that's good for anybody.

Certainly in the physical world, you have to have brokers communicating. Again, there's not enough counterparties out there. And, you know, we strongly believe that the commission should do nothing to chase away counterparties in a nutshell.

MR. THUM: If I could just --

MR. SHILTS: All right. Yeah, maybe one last comment. Because we don't want to lose our panelists for the next panel.

MR. THUM: Sure. Real -- just real quick. In our letter from May, we quoted a study from ISDA that showed the average daily trading volume for all interest rates derivatives is 6800 trades, of which 2500 are new price-forming trades. The most popular, the US dollar ten-year swap, trades on average of 200 times a day.

So while the breadth of the market is huge, the depth of the market is actually pretty shallow. So when you think about the current proposal, which has extremely large block sizes in the proposal, it's really out of whack, given the actual liquidity that's presented by these products. So if those proposals continue on, it will really disrupt the available liquidity, the products and certainly the price that we, as users, get for trading those products, given the depth is so small.

MR. SHILTS: Well, thank you all for your participation on the panel. It's -- I think we'll take, like, a five-minute break. Maybe at 3:10 we'll start back. Thank you.

(WHEREUPON, the meeting went off record from 3:02 p.m. to 3:10 p.m.)

MR. SHILTS: If everyone wants to take their seats so we can get started on the last panel? Thank you.

MS. GUTMAN: Thank you all for being here. I'm sorry it's running a little late. Panel 4 will focus on the effect of the conversion of swaps to futures on end users specifically and any issues or changes regarding consistency between swaps and futures regulations to existing regulations or to future Dodd-Frank rulemakings to address these effects.

Please elaborate on how this affects your trading and hedging strategies as end users in deciding whether to use swaps or futures. Before we begin this discussion, I'd like to go around the table and have everyone introduce themselves and identify who they represent.

MR. ALLISON: I'm Jim Allison. I'm the global risk manager for ConocoPhillips.

www.CapitalReportingCompany.com © 2013

MR. REYL: Charles Reyl, CEO, Parity Energy.

MS. INGBERG: Sally Ingberg. I work at Forest City Enterprises, a real estate company.

MR. CAMPBELL: Lael Campbell, Exelon, where I'm responsible for the energy trading compliance program.

MR. DEAS: I'm Tom Deas, vice president and treasurer of FMC Corporation. And I'm chairman of the National Association of Corporate Treasurers.

MR. KOTSCHWAR: I'm Lance Kotschwar with Gavilon here on behalf of the Commodity Markets Council.

MR. ZUBROD: Luke Zubrod with Chatham Financial, a risk management advisory firm.

MR. FRENK: David Frenk, the research director of Better Markets.

MR. CAMPBELL: I'm Paul Campbell with Deloitte and run our energy regulator and risk practice. I'm not representing any clients here. I'm just on behalf of Deloitte.

MS. GUTMAN: Okay. Thank you. To quickly review the format, we will have each panelist provide their prepared remarks for four minutes or less. Once we hear the panelists' prepared remarks, we will then start an open discussion. So that we can hear from everyone, please hold your follow-up comments until either your remarks or until after all panelists have had the opportunity to make their prepared remarks.

And we will start with you, Jim Allison.

MR. ALLISON: Thank you. And I appreciate the opportunity to be here for this roundtable to discuss these implementation issues. As I said, I'm Jim Allison. I'm the manager of global risk for ConocoPhillips. ConocoPhillips is the largest North American-based, independent exploration and production company, based on production and reserves.

We're headquartered in Houston, Texas. We have operations and activities in 30 countries and about 17,000 employees. Because we're a producer of crude oil and natural gas, we're also a marketer of those vital energy commodities. And we use energy derivatives in connection with those marketing activities.

Derivatives, both futures and swaps, are tools, not ends of themselves. For these to work well, two things must be true. The tool must be well suited to the task and we have to know how to use the tool. From that perspective, the futurization of swaps is a good thing mostly. I'll come to my caveat at the end of the presentation.

For transactions that are standardized and appropriately cleared, futures are well suited to the task. The development of cleared swaps over the last decade was a useful innovation at the time but the distinction between a cleared swap and a future may no longer be useful. Preserving a distinction that is not useful adds unnecessary complexity for market participants and for regulators. In short, it appears to me that cleared swaps is now a redundant distinction in the marketplace.

Futures do what we need those transactions to do. Futures markets have evolved to facilitate the breadth of transactions we need. Therefore, it's important that futures regulation continue to evolve with the markets to continue to enhance the efficiency of the markets, which was, of course, one of the original goals of Dodd-Frank.

One particular way in which regulation should evolve is with respect to how these positions get created. I'm referring here to block transactions, which has been the topic of much discussion in the previous panels. So let me just echo a few of the themes that resonated with me from the previous discussion.

Much of the liquidity in the energy derivatives is now on the electronic platforms and that creates much better transparency than anybody could ever have imagined in the days of the trading pits. But the trades that are blocked in are still an important supplement to those.

From our perspective, the DCMs ought to retain the flexibility to manage the block limits, as we heard discussed in the previous panel. Block size should be related to liquidity, with lower liquidity, meaning lower thresholds for block sizes. So to the previous question of how big is a block, big should be judged in my view relative to the trading activity in that particular instrument.

And as was noted, we are evolving from a previous world into this world of a pure futures transaction. We're not fully evolved in that space yet. So you see some things in the data that may not look completely normal to you. But the evolution is continuing.

We also need to recognize the role that the voice brokers or other facilitators have played in the market. They play an important role in the physical market. They have played a role in the EFS market and now in the block market. And in particular, they also play a role in the market for bespoke swaps. So whatever it is we do from a regulatory perspective, we need to preserve the role of those facilitators, such as the voice brokers.

We've also heard a lot of discussion about the need for a level playing field, setting aside Mr. Parson's concerns about how level is level. From my perspective, if we accept that futures and cleared

www.CapitalReportingCompany.com © 2013

swaps are functionally equivalent, that the category we call cleared swaps is, in that sense, redundant, then there is no potential for regulatory arbitrage because there is only a single regulatory structure appropriate -- that is the structure for futures.

All in all, so far as cleared swaps are concerned, my complaint is that futurization may not yet have gone far enough -- again, specifically these concerns about block sizes. But as I said, there is a maybe. There are other swaps to consider. While I'm comfortable regarding cleared swaps as futures, we must also assure that the market deals properly with transactions that are not appropriate for clearing.

There are at least two reasons why a swap would not be appropriate for clearing. First, the swap might be bespoke, so that it doesn't fit easily into the clearing framework. Second, the swap might be a hedge and clearing might have the perverse effect of increasing the risk the hedge was intended to reduce. The case of bespoke swaps has, I think, been adequately covered. The impact of clearing on the performance of hedge perhaps has not.

There was discussion earlier that risk doesn't go away; it is simply transformed. This is an example of clearing transforming counterparty risk into liquidity risk. So the issue arises because clearing requires daily margining. As a result of the margining, the daily and monthly cash flows from the derivative are very different from the cash flows generated by the asset hedge.

An entity that was hedging for the purpose of smoothing cash flow would discover that clearing would result in cash flow that was more volatile than it would have been without the hedge. So it is essential that hedges be exempted from the clearing mandates. And of course, the statute does that.

My concern then is to assure that the trend toward futurization does not drive these transaction types, which must remain swaps, out of the market. These non-cleared swaps may require more bilateral discussion before a transaction can be consummated, either to customize terms or to arrange credit support other than clearing. Electronic transaction platforms by themselves do not handle that sort of negotiation well.

In the current state, voice brokers play an important role in bringing the ultimate counterparties together. And it's important that role continue. Fortunately, if, as I was recommending earlier, the regulations continue to allow easy access to block futures, I'd expect that activity to help assure the continued role of the voice brokers.

Thank you and I'll answer questions later.

MR. REYL: Thank you very much for the opportunity to participate in this roundtable. I am Charles Reyl, CEO of Parity Energy. We are an exempt commercial market and a broker for commodities. My goal today is to share with you my experience on the ground in the energy markets, more specifically, the energy options markets, which have been directly impacted by the futures to swaps transition.

In 2008, Parity Energy launched the Parity Energy Platform, or PEP, as an exempt commercial market for cleared energy options. And right from the start, PEP incorporated many of the futures that a proposed SEF rule would later require of swap execution facilities.

Since 2008, Parity has offered many -- to many an electronic order book, firm bids and offers, requests for quotes, pre- and post-trade transparency, as well as a very robust voice brokerage service. Now, over, you know, 175 institutions have access to PEP, including end users, energy producers and marketers, banks and hedge funds. These institutions have come to rely on Parity for price discovery and trade execution services.

Now, prior to the swaps to futures transition, Parity was on track to become a SEF. And given the overwhelming rejection of swaps by the energy trading community, we now don't see the point anymore. Whether to apply for SEF status or not will depend on the final rules for DCM Core Principle 9, minimum block thresholds and SEFs.

So before October 14, 2012, energy swaps included everything that did not trade on a central limit order book or open outcry. So most of this market traded through inter-dealer voice brokers. So again, for instance, in energy options, swaps represented about 80 percent of the overall trading volume -- so in terms of volume.

So since then, all market participants -- or nearly all market participants have moved from swaps to futures. And I think, as Tom Farley of ICE earlier mentioned, customers just love it. And rather than migrating to central limit order books, most of these energy swaps continue to be negotiated off exchange, through voice brokers before being posted as futures blocks.

So I think this is important because what it means is that customers did not switch to -- because of greater liquidity or convenience, but mainly because they wanted to avoid stiffer swap regulations. So by definition, off exchange trading activity on the DCM should be the exception rather than the norm. But any effort to address this issue in the absence of a strong, viable swaps alternative is likely to cause the market to die from lack of liquidity information.

And this would severely hurt end users and any other market participants who rely on such derivatives for their risk management. So for Parity specifically, the futurization of the energy markets has reduced the value proposition of its electronic services. So Parity now functions through its futures entity in order to broker block trading of futures contracts on various DCMs.

Because those DCMs prohibit the use of transparent, electronic off exchange matching, PEP now functions as a white board, showing only indications of interest. So all transactions we facilitate today must be consummated by voice and with help from the market until they are reported to the DCM. This is a step backward compared with Parity's original transparent electronic matching as an ECM.

Namely before the futurization, over-the-counter derivatives were electronically traded on PEP with full pre- and post-trade transparency for all participants. And now, ironically, after the futurization, all trades are exclusively voice brokered and the real time transparency Parity used to offer is prohibited.

So as a result, I respectfully ask the Commission to determine whether it is in the interest of end users and other market participants for DCMs to have rules which prevent the facilitation of block trades on a system that's accessible to multiple participants and that allows for electronic matching.

Also, I think we should really make swaps a genuine alternative to futures blocks. And if the commission regulates end users who trade swaps and swap dealers more strictly than any futures market participant, then maybe it should make swaps more flexible in return, which I think is the idea.

For instance, in terms of, you know, minimum block size or by allowing a variety of trade execution mechanisms for swaps, including the RFQ, auction, voice, as long as appropriate minimum levels of pre-trade transparency are achieved.

But in any case, we feel that the minimum block thresholds for futures should not be raised until either central limit order book trading takes off or a viable swaps alternative is made available.

On behalf of Parity, I thank you very much for the opportunity to share our thoughts and I look forward to answering any questions.

MS. INGBERG: Hi. Thank you for allowing me to speak today about the futurization of swaps. My name is Sally Ingberg and I'm vice president of debt management at Forest City Enterprises, which is a national real estate company headquartered in Cleveland, Ohio.

One of my main responsibilities is to coordinate our derivative risk management strategies on behalf of the company. These derivatives are simply used to mitigate interest rate risk on our mortgage and corporate debt financings. This is done to minimize our -- the exposure to our largest single expense, interest expense.

Derivatives have been an extremely useful tool for Forest City over the past 25 years. In the over-the-counter market we're able to effectively protect the cash flows of the property as over-the-counter products allow for us to match the resets of our loans.

Additionally, over-the-counter products allowed for us to have notionals on the hedge match the anticipated loan balance for the loan. This is especially important for real estate companies because our construction deals normally accrete while our stabilized properties normally have amortization.

Last, of upmost importance, many times the collateral on the derivative in the over-the-counter market is secured by the property rather than cash. Because the only cash flow on the property are rental income streams, which is received over time, we do not have excess cash available at any point in time to sit in margin accounts.

In the event the borrower ceases to be able to - - be able to make its payments on the loan, the lender would be able to recoup its losses on both the loan and the swap through the value of the property. To the extent the building value had diminished so substantially that it ceases to be able to cover the lender's losses on the loan and swap, the lender's losses would be no more than the losses that they would have incurred on a comparable fixed rate financing.

How do we ensure that we get the most efficient pricing in the over-the-counter markets? Many times, in order to get the best price and maintain transparency, we conduct competitive auctions amongst a group of swap dealer counterparties who are all important bank relationships. This is important to note because we look at the overall cost of our capital and the overall lending liquidity -- lender liquidity pool of which derivatives are only one component.

To avoid surprises after the trade is completed, both parties agree on key transaction terms pre-trade using pre-trade transaction term sheets. However, actual trade documentation is not completed until post-trade and only with the winning bank, a sequence that maximizes bank participation in auctions by minimizing the pre-trade documentation burden.

While many Dodd-Frank rules have yet to take effect, I would be remiss if I didn't point out that certain documentation rules that have been discussed could discourage competition in transparency by increasing the burden of participation for bidding banks. Anticipatory compliance with such rules has resulted in higher costs to us and, in some cases, has created difficulty in finding counterparties willing to trade with us, problems we anticipate will increase once swap documentation rules become effective.

Given the situation, many of you might suggest that we simply move into the futures market since the market is more transparent and straightforward. However, given the nature of our business, our derivatives available in the future market would not fit in with the structure of our financings, creating basis risk, accounting problems and liquidity issues.

There are four main reasons for this. First, the inability to use property as capital on exchanges. For the vast majority of our interest rate swaps, the swap is secured by the real estate, just as the loan is. Exchanges cannot accommodate real estate assets as collateral. And, most importantly, our lenders have requirements within their documents that we are not allowed to have any other kind of subordinated financing, such as posting cash, taking any -- something out of, you know, the lender's ability to get their money back on the -- their swap and the real estate, should something happen to either.

Second, futures require initial margins, something we do not post today. Assuming there was a 3 percent initial margin requirement in lieu of the structure that exists today and has been grandfathered in by using real estate, this could have resulted in collateral posting of $48 million as of our most recent quarter of hedges that were outstanding.

Third, exchanges in central clearing require variation margins. As of our most recent quarter end, if all of our swaps were -- sorry -- required to post cash, it would have resulted of us posting an additional $180 million, which would bring the total amount of cash required to be posted to be almost $230 million. This would have been an extraordinary use of our cash, since as of last quarter, we only had $214 million available on our credit facilities that is used to fund the entire operations of the company.

To be clear, as a real estate company, our core area of business is the management, ownership, development of real estate. Hedges are not the main component. And therefore, we can't have our cash availability potentially tied to a non-core need.

Last, the futures markets do not accommodate the customization needs required to perfectly address our risks. So taking these factors into consideration, the question is, whether the over-the-counter markets are no longer cost effective or if there are not enough counterparties who are willing to participate, will a company like Forest City end up leaving the over-the-counter market and move into the futures market?

This is unlikely for the reasons that I've cited today. What this ultimately means for a borrower like Forest City is to go into higher cost fixed-rate financing or leave our floating rate debt unhedged. This results in a loss of transparency, loss of flexibility and increased risk to non-financial end users like us.

I, therefore, urge you to take into account the need of end users when designing requirements like capital and margin requirements that could -- that could already adversely affect and impact our end user ability to utilitize the over-the-counter derivative market.

I thank you again for allowing me to speak on behalf of non-financial end users who are simply using derivatives to mitigate fluctuations to risk.

MR. CAMPBELL: Well, thank you. And I want to thank the Commission for the opportunity to be here today to discuss this important topic that impacts energy markets and energy companies like Exelon. Exelon is one of the leading companies in the physical commodities space. Exelon is the number one competitive power generator in the nation and owns nearly 35,000 megawatts of generation assets.

Exelon, through its Constellation brand, serves physical commodity needs of approximately 100,000 business and public sector companies and customers, including two-thirds of the Fortune 100. Exelon also serves approximately one million residential customers, their electricity and natural gas needs.

As an end user, Exelon actively participates in the futures and swaps markets to hedge and manage risks related to this physical portfolio. The substantial majority of the company's hedging activity is conducted in cleared markets, in particular, on ICE and on NYMEX and often originated through voice brokers.

Prior to 2012, these hedging activities were mostly in swaps. But starting with the ICE transition in October, these hedging activities are now conducted mostly in futures. The switch to futures has been relatively seamless from Exelon's standpoint as an end user. For the most part, little has changed in day-to-day hedging operations.

The transition to futures, however, has had one material insignificant impact on our business and that is in the area of compliance. Exelon is committed to having a reputation for excellence in compliance and compliance is a critical component of every business decision the company makes.

In the energy sector, and in particular, in the context of Dodd-Frank, many of the standards for compliance are subjective, qualitative and oftentimes confusing. However, the transition to futures has provided a refreshing source of compliance clarity. Rules relating to futures are mature. They're well understood and developed and, therefore, present minimal incremental hurdles to navigate.

This clarity is invaluable to those transacting in the market, for company leadership trying to make long-term decisions and for people like me, who are responsible for providing legal and regulatory advice to these stakeholders.

Furthermore, the benefit of compliance clarity that futurization brings has come with minimal costs to energy market participants, while also satisfying many of the key goals of financial reform. Futures markets have longstanding and robust oversight by this Commission. Futures markets are centrally cleared.

And from a transparency standpoint, including pre-trade transparency, and in particular with energy markets, where -- and power markets in particular, where many products are thinly-traded, futures markets arguably provide more and certainly not less transparency than if they were transacted as swaps.

Liquidity is the key element to transparency. And one needs to ask, at least from the context of energy markets, many of which are thinly traded, whether futurization has broken anything that needs to be fixed. It is difficult to regulate liquidity into a market but it is very easy for regulation to take liquidity out of the market. Thank you.

MR. DEAS: Thank you. I am Tom Deas, Vice President and Treasurer of FMC Corporation. We are a global chemical company. We are on the ground in two dozen countries making and producing a broad range of agricultural specialty and industrial chemicals.

One of those product lines is soda ash, the principal ingredient in glass manufacturing -- and for other uses. We are the world's largest producer of natural soda ash, and we'd like to think we're a real export success story. We operate in Southwestern Wyoming where we are one of that state's largest employers.

We can make soda ash, ship it to South Asia, and bump Chinese synthetically produced product back into China with a higher quality and lower cost product.

We do this in part because of our ability to predict and control our cost, and to do that at this facility in Southwestern Wyoming, we use flexible, over-the-counter derivatives to hedge natural gas exposure.

We do not use futures contracts, and I'll describe in a minute the advantages we see from over-the-counter derivative use and how we'd like the commission to continue advocacy of that as an alternative that's available to end users like FMC.

We use calendar year strips to hedge our natural gas exposure. We are going out two years, and sometimes farther. We average in -- not trying to time or guess the market -- but by layering in a series of calendar year strips for the future on a periodic basis.

We are able to do this between the underlying exposure on the main index and with basis swaps, with a few dozen over-the-counter derivative trades. They are all done under ISDA master agreements with one of the syndicates of banks that are also providing us in total with a billion and a half dollars of committed credit. And there is a legal right of offset that helps us manage the credit exposure that we have on the derivative trade with the amounts that we've borrowed from these banks under this credit agreement.

We're an "A" rated company. We have no credit support annex or other commitment requirement to pay margin. We are doing uncleared, over-the-counter derivatives, just like we always did, and we hope we are going to do those in the future.

We support the Commission's interpretation of the margining requirement under Dodd-Frank and we would absolutely urge you to continue your efforts to resolve this big uncertainty for end users with the prudential regulators and try to assure that we can continue to use this flexible product to manage our costs.

One of the advantages we get from using over-the-counter derivatives is that the futures market -- because of the way transactions need to be stacked in that market instead of being negotiated on a strip basis with an over-the-counter derivative -- would cause us to enter into at least 12 times more transactions to hedge a year's exposure.

Moreover, because of the margining requirement under a futures contract, we'd have, let's say, another 250 transactions. When you multiply that transaction flow out you get -- here's numbers to contrast -- in over-the-counter derivatives, we can complete the hedging program through the execution of about 100 transactions, and with the futures equivalent, it would be 144,000 transactions.

And so, as an end user, not involved in the energy space, other than to hedge this component of our input costs, of our productions costs -- we are not operating a trading room, and we don't have the back room facilities to be able to handle that huge -- more than a thousand fold increase in the transaction volume that a move to the futures market would require of us.

So, just to summarize, over-the-courter derivatives for us provide significantly lower transaction intensity than the futures equivalent. There is much greater liquidity by trading an entire calendar year strip for us than the futures alternative in some months that may be out at the end of time horizon of our hedging program.

We have a much greater ability with over-the-counter derivatives to make adjustments. One of the reasons that the over-the-counter derivatives market grew to be the largest financial market in the world was its ability to customize and allow end users like us exactly to match the underlying exposure with a derivative attuned to that exposure in terms of amount, currency, tenure -- all of the other components -- and that's not available to us in all instances in the sometimes one size fits all futures market.

So, again, I would just appreciate the Commission's effort to do everything you can to maintain over-the-counter derivatives as a viable alternative, not to burden them with margin requirements or other impediments that would take this alternative away from us.

Thank you.

MR. KOTSCHWAR: Good afternoon. I'm Lance Kotschwar with Gavilon. I'm here on behalf of the Commodity Markets Council. Thank you for the opportunity.

I want to specifically address the two questions that you had us consider today, Abigail, but before I do that I wanted to just talk a little generally about Dodd- Frank.

We agree with the primary goals of Dodd-Frank, which is to reduce the systemic risks through centralized clearing, increasing transparency through reporting and trading unregulated platforms where applicable.

And we also agree with Congress that futures and swaps should be regulated appropriately and that regulation for swaps should be different than futures because they are different things.

Not all swaps must be traded on exchanges or cleared, because commercial should be able to enter into swaps but not futures, over-the-counter, as they do today to hedge risks.

As commercial end users and other market participants, we need the most efficient and effective markets to manage our risks, including both listed futures and over-the-counter products. Our businesses depend on the price discovery and the liquidity of futures markets, and we also rely on the ability to use customized swaps as well.

So we don't think it's quite accurate to say that there's disparate regulatory treatment between futures over swaps. We think there are underlying reasons for that that are legitimate and make sense.

Many of the new swap regulations are similar to the regulations that have historically been imposed on futures markets, but they also reflect key differences and two primary factors drive that, I think.

There are different risk characteristics between futures and swaps, and then there is just a different trading manner. Futures traditionally are standardized. They trade centrally on DCM's. Swaps have historically been more customized and traded bilaterally in over-the-counter dealer markets.

The margin requirements for futures and swaps are another example of traditional expectation regarding the relative standardization of products held in futures portfolios versus the more customized nature of products held in swap portfolios.

And also, another example is flexibility and execution afforded to swaps via SEFs versus customized products because they don't lend themselves well to trading in centralized markets.

As market participants, we will continue to consider whether a customized or standard product will serve our needs best. Regulatory treatment of futures versus swaps will be a part of that calculation, and the fact that firms are making these trading decisions based on this kind of assessment does not mean that swap markets have been unfairly disadvantaged. We will continue to use them both to serve our risk management needs the best way we can. Innovation and competition and customer choice among well regulated markets is important to us.

I want to get specifically to the two questions that we were directed to today. Question #1: "In light of ICE's and CME's listing of energy swap contracts as futures contracts, which coincided with the October 20, '12 effective date of the swaps rules, what issues or challenges would you like to bring to the attention of the Commission?"

We do not have any issues or challenges we would like to bring to your attention other than to say that we appreciate the Exchange's responsiveness to the requests of their customers.

We would, however, like to make an observation that from our perspective the big driver of what ICE and CME did in October was really the result of one thing, regulatory certainty, something that Lael said earlier.

On October 12th, many Dodd-Frank rules began to go into effect. The problem is that there was then, and still remains, a tremendous amount of uncertainty around the swap regulation regime. And futures regulation is something we all are familiar with and comfortable with, and certainly in the short term it provides our compliance staff with significantly more comfort. Again, that's something that Lael said.

The second question: "Are there any issues or challenges that should be addressed regarding consistency between swaps and futures regulations, whether in one of the remaining rulemakings, or something that has already been put out?"

As I've discussed, I think there are legitimate reasons for treating swaps and futures differently, owing to the differences between the instruments. We believe that futures instruments have been, and are currently being regulated in an appropriate manner.

However, with respect to the regulation of swaps, I think it is a fair question to ask whether all of the recently promulgated rules, and still pending rules applicable to swaps and swap dealers, are appropriate.

But just to wind up here, from our perspective - - you know, the thesis of the derivative title of Dodd- Frank was the appropriate regulation of swaps, not regulatory parity between swaps and futures, whatever parity means in that context.

And lastly, I know you tried to keep block trading confined to one panel, but in keeping with everybody wanting to throw in a gratuitous remark about block trading, I just wanted to bring one more perspective to it.

It's been said, but I just want to say it in maybe a different way. You know, Dodd-Frank envisioned a structure where swaps can trade across multiple trading venues, unlike futures where a futures contract is generally a proprietary to the exchange where it's traded.

So with this distinction it makes some sense that some entity other than the trading platform, whether it's a SEF or a DCM, would aggregate the liquidity of the instrument across trading venues and set it in an appropriate block threshold. And there's no individual trading venue that's going to have a full view of all that liquidity.

But that is not how it works on the DCM because you've got all of the liquidity right there in one place, so we think in that sense it makes sense for the DCM to continue to be able to evaluate and determine block levels at that level. And again, in keeping with my theme here, "if it ain't broke, don't fix it," and it seems like the DCM approach to this is working very well.

Thank you.

MR. ZUBROD: Good afternoon, and thank you for the opportunity to offer an end user perspective on futurization. My name is Luke Zubrod and I am Director of Risk and Regulatory Advisory Services at Chatham Financial. Having introduced Chatham on a prior panel, I will transition directly to my comments.

On the last panel I focused my comments on concerns relevant to financial entity hedgers. On this panel I'll focus on those concerns applicable to non-financial end users.

The topic of futurization is an important one for end users. End users specifically, and hedgers more broadly, have long valued over-the-counter derivatives because of the ability to customize them, to perfectly mitigate a company's idiosyncratic risks, and because of the ability to bilaterally negotiate margin arrangements with swap dealer counterparties.

Regulatory actions that create an incentive for end users to clear their trades or use futures would have at least three adverse consequences, two of which I mentioned on the prior panel.

Basis risk is one of those. Regulatory incentives that encourage futures would cause companies to take on basis risk, that is, mismatches between the hedge and the risk that hedge is designed to address.

Basis risk poses a threat of loss for end users, and that's especially true in times of market stress.

Basis risk also leads to the second adverse consequence, which is accounting and effectiveness. Basis risk is reflected in financial statements as accounting and effectiveness and because accounting and effectiveness, and the income statement volatility it creates, it's difficult or impossible to control. Public companies often avoid hedging strategies that might result in effectiveness.

The third issue -- and this is particularly pertinent to non financial end users -- is liquidity risk. End users appreciate uncleared, over-the-counter derivatives, because they afford the ability to transact in a manner that does not require the posting of initial or variation margin.

Cleared swaps and futures trades, on the other hand, are fully margined. Because margin requirements create an unwelcome liquidity risk for end users, many end users will accept higher costs on uncleared, over-the-counter derivatives, in order to avoid the liquidity burden created by fully margined products.

I would like to identify two areas in which regulators can ensure its proposals do not adversely impact end users by driving up costs or by introducing new risks.

One, initial margin. Although non-financial end users are not directly subject to initial margin requirements in the CFTC's proposed margin rule, their swap dealer counterparties are subject to such rules. Because dealers typically offset their positions to end users, the dealer must post initial margin on positions used to offset end user hedges.

Because these initial margins are incurred solely to facilitate the end users trades, the swap dealer will increase the transaction price paid by the end user to compensate it for what would otherwise be an unproductive use of its funds.

The higher transaction price that results creates a regulatory incentive for end users to consider using futures, an incentive that brings with it the aforementioned adverse consequences of basis risk accounting and effectiveness and liquidity risk.

Capital requirements. Similar to initial margin requirements, capital requirements applicable to swap dealers against trades executed with end users will cause dealers to increase end user transaction prices for uncleared swaps.

Higher pricing on uncleared swaps will create regulatory incentives for end users to consider clearing, even though they are technically eligible for the end user exception.

Margin differences between cleared swaps and futures will further cause end users to consider using futures, however, because of countervailing business incentives created by basis risk, accounting and effectiveness and liquidity risk, many end users will opt not to use cleared swaps and futures.

The net result for such end users will be higher costs that could deter some users from hedging, or make hedging more expensive.

Limiting or eliminating initial margin and capital requirements applied to swap dealers when their transactions are executed in connection with end user hedging transactions would serve to lower end user costs and avoid a deterrent to hedging. Regulators should consider such relief because end user hedging activity does not meaningfully contribute to systemic risk.

On this basis, Congress established an end user exemption. Please don't take that exemption away by making uncleared, over-the-counter derivatives, too expensive to use.

Thank you.

MR. FRENK: Thanks. I'm David Frenk, the Research Director at Better Markets. We are a 501(c)(3) nonprofit. I think you are all familiar with us. We aim to represent the public interest in the capital and commodity markets.

Most of us, myself included, used to work in finance -- don't anymore -- which gives us the unique opportunity to be on the one hand informed and on the other hand impartial.

We appreciate the opportunity to come here today and talk about futurization, although perhaps it would be better titled, "Re-futurization," since for a century or so, if you were an end users looking to hedge, futures were your option.

We had a brief experiment with the over-the-counter markets. You could say a 30-year experiment, or if you time it from CFMA, about an eight year experiment, which was kind of a miserable failure given that we nearly blew up the world, but then Congress decided to go back to the drawing board and see if we could sort of capture the best of both worlds.

They said, "Well, should we throw out OTC swaps entirely?" No, the end user still wants some degree of customization.

Okay. So how can we fit that into a structure that's not going to run the same risk that we had with pure OTC? They said, "Okay, you can keep customization, but you're going to have to execute these things on a SEF. You're going to have to clear them, unless you are somehow insulating this from the financial sector as a whole; i.e. by doing it end-user to end-user that would give you an end-user exemption."

Similarly, if there is something that is so exotic that doing it through clearing and trading would cause a systemic problem within the primary market, you can also do that on the side so it doesn't blow everything up.

Okay. Great. So then you've got the IDBs, and they say, "Fantastic. We'll become SEFs. We have a three hundred trillion dollar pie here that's been, you know, baked up the dealers and now served up by Congress and we want a slice, except now we have a problem because the pie seems to be getting smaller, since, you now, a lot of it is starting to be served chez ICE and chez CME."

And so the question I think we've got to be asking here from the public interest perspective, from a regulatory perspective, is why is the pie shrinking? Is it simply because there is some sort of regulatory loophole when it comes to futures? And sure enough, I think plenty of people have identified the fertile areas to be looking in that regard -- block trades, core principle 9.

You know, is it simply the case that yes, the futures -- the DCM's have been in this game for a long time, but the game has now changed, and so what once worked, letting these guys decide a lot of their own rules, may no longer be appropriate now that the stakes have become so much higher. These are issues that the Commission needs to be looking into.

On the flip side though, there are clearly other things going on here and I would say that re-futurization is actually clear evidence that end users had other reasons for trading on the OTC markets beyond the availability of customization.

So what could those reasons be? Well, if I'm and end user using OTC, other than customization, what were the perceived advantages I may have had?

Number one, no margin. You know, you wonder, what are the biggest charities in the world? You might think Oxfam, Action 8, and so on. Apparently, it's actually Goldman Sachs, J.P. Morgan, because if you believe the figures, they gave out about a trillion dollars of free hedges to the end user community by not charging a margin, which is very generous.

Of course, we know that -- and I should just say that I don't necessarily agree with the trillion dollar figure, right -- maybe the Bank of England, $200 billion, is more appropriate -- but whatever figure you want to put on it, we all know that that wasn't given away for free.

You know, credit charges were imbedded in the prices of swaps and so -- okay, maybe I didn't have to pay margin and maybe I had cash freed up in some way as a result of that, but you know, that cash was probably not just being given to me for free, it was costing me in other areas -- in the price of my swaps, in other words.

Okay. So that's one thing, there's the no margin issue, and then the other thing -- well, I had opacity. Okay. So that gave me a lot more flexibility when it came to my balance sheet. You might say too much flexibility. We all know some pretty good examples of end users who were doing some pretty terrible things with that flexibility.

Either way you look at it though, Dodd-Frank came in and said, "Okay, sorry, those two advantages, they don't exist anymore. We're not going to have improper risk management. We're not going to have opacity anymore."

That's part of the law now that that doesn't exist, so you've lost a couple of things as an end user. You've lost the ability to cook your books by using OTC derivatives. You've lost the privilege of funding Lloyd Blankfein's bonus by paying him better credit charges than your swaps.

But on the other hand, you know, you've gained quite a lot of things, right? I mean, you've basically gained competitive pricing and more transparency.

You do have the best of both worlds, and in fact that was exactly what was intended and exactly what the Commission is trying to put into place here. You can still customize, you just have to pay the appropriate prices and, you know, from our perspective -- from the public interest perspective, and I think realistically from the end user perspective, that's a pretty good tradeoff.

MR. CAMPBELL: I want to thank you again for the opportunity to speak on two panels, and I'll try to take a different tact on the points I'm going to address today.

I think a number of the technical issues have already been addressed by the folks to my right. You know, the appeal of a free hedge. It makes me think of a free lunch. I didn't have to pay for lunch today, but somehow or another I'll pay for it in the end, I'm sure, so I don't think that ever exists.

The perspective maybe I can try to bring is this. I've been with Deloitte for almost fifteen years - - and it's part of the same practice -- and so I have some sense of trends that have moved through the energy markets as they've deregulated, as they've been actively traded, thinly traded, both on the large trading, large operators, all the way down to small operators -- small, even special entities.

And some of the trends that have come through -- and maybe that'll help maybe to point towards some of the issues I think that the Commission could be addressing here.

If I look at Title VII, and just the Title VII aspects of Dodd-Frank, it feels very similar -- and I use the analogy a lot when I'm working with clients on solving problems -- if you're familiar with the hedge accounting rules that came out of the early part of the 2000 -- so it's really around FAS 133 and how those evolved into ASC 815.

The hedge accounting rule actually feels a lot like this where we went through this period of we had -- you know, what I've described as maybe rules were written for large financial entities and then they made their way down to the end users, to energy companies -- and it was a number of years before we got to good interpretation and guidance in terms of how those should be implemented.

It feels very similar to that in terms of the time it's taking to work through this, as well as the -- I would say lack of preparation, or readiness, on behalf of the energy companies -- they struggled with that for a number of years.

We saw that from Deloitte's perspective, both as an auditor as well as a consultant, and I'll say that the same issues and the things I'm going to talk about feel very similar to that.

So, the perspective we're bringing in is we're on the ground with a wide range of clients across North America trying to implement these rules, and as it gets to specifically the swaps and futurization -- you know, the thoughts we have are, do we have to build a new system for this? Do we have to build a new process? Do we have to build a customized tool? Can we get this done in Excel? How do we do this -- and, you know, to come back to what Lael said -- how do we make sure companies and complying and help them do that? And how do we do that as efficiently as possible?

And so the move from swaps to futures I would say has been incredibly efficient. In terms of a compliance requirement, it's been very beneficial to most energy companies.

I'll try to talk about some of the exceptions as well as maybe some of the unintended consequences that I could see potentially coming out of that. I would refer back to, again, as I think about the broad market, and not just talking about the market as a whole, but really the segmentation within that.

So not the swap dealers and how they'll all be effected by this, and maybe not even the large trading companies that are kind of these -- the tweeners -- nor the companies that have just now, I'd say, moved away from anything to do with swaps whatsoever, but the companies that fall into that other category. And this, I'd say, solely hits the end users, mid-size utilities, anybody in the energy space that hedges in a variety of different ways, but sometimes intermittently.

And I think the first thing to do is look at the period of time we're dealing with, and from an economic standpoint, you know, we're dealing with incredibly low gas prices on a historic level, volatility is as low as it's been in a while, and so as we think about these issues and the problems they may be creating for people by not having liquidity in a cleared market -- or an uncleared market -- were thinking about that because people actually aren't hedging very actively right now.

If we were having this conversation four years ago when gas prices were moving at eight and nine dollars -- the call that it's going to put on liquidity -- what that would do to margin, and frankly, just people to be willing to enter the market -- it would be a very different story.

I don't know when gas prices are going back up. You know, we could poll maybe some of the other people on the panel. They certainly probably have a view on when they will or when they'd like them to go -- probably sooner rather than later -- but I'm quite sure they are going to go back up, and I would expect commodity prices, besides what we've seen in the ag space, on the power side, also to ramp up.

It's a normal, mean reverting process, and so I'd expect to see a return to high gas prices, high power prices, at some point in the future.

And then you're going to have these companies that have been sitting on the sidelines, not having to actively hedge, reenter the market. And it's when they reenter the market that that's when we tend to see, I would say, discontinuity in their ability to actively manage their risk.

And so as I think about the unintended consequences of this, it's the people that are making those markets for them and going away and moving to a cleared environment, and then not being able to provide products to people, I think that's a real risk that maybe we're overlooking right now.

And so maybe that's two years down the line, maybe that's three years down the line, maybe it's this summer if we get a big hurricane going through the Gulf. It's hard to predict when these things are going to happen, but I feel relatively comfortable in saying that it likely will happen again.

And so -- I think it was Tom Farley, on the previous panel, who said, you know, give this some time to think how it's going to move through, to understand really what all of the changes are going to be before maybe passing further rules.

I think providing the opportunity to keep an uncleared swap market out there, as well as the participants in that -- from the brokers all the way down -- I think is a vital piece of that because when you are dealing with people that have operational risks that are tied to, you know, their liquids production -- their liquids processing -- there's a very limited number of people that can actually participate in that market.

And the people that are willing to provide very tailored, small lot products to end users -- there aren't a lot of people that can step into that -- and so if the market for that goes away in the uncleared swap business, I think you could actually have some, again -- the unintended consequences of people not being able to manage their risk. I really view that as a significant concern.

The other one is -- because there has not been a lot of pressure to hedge because commodity prices have been low -- if you look at the state commissions, they have not been pushing the utilities that are still regulated to put in hedging plans around their gas purchases -- I would say most companies actually don't have a lot of experience in managing liquidity, and managing liquidity risk, and so they'll be fairly comfortable entering a futures market now -- or a future swap market now -- because it's not putting a lot of burden on them.

But if you move back to where volatility is moving at 50% or 100% in a gas or power market, and suddenly they have to start managing it, most of them don't have the adequate processes or systems in place to manage that.

And so again, that's an issue that isn't going to -- I'll say -- pop up today, but something that's going to pop up in a year or two, and then I would say again, create that issue for the people that are actually just trying to manage their risk.

I think those are really -- probably, you know - - really serious things. They're not going to happen next month, but I could see them coming up in a year or two, and I'd be fairly concerned with that.

You know, the last -- and I think Luke touched on it -- we were talking at the break about this -- as it comes to providing more guidance to them, for the larger companies, they are sophisticated enough that they have the resources to put in implementation plans in to ensure in compliance.

For the smaller ones, they're -- I'll say -- very much struggling with this, both from awareness standpoint, as well as just having the tools to do it. I was telling Luke, you know, we built kind of a quick start methodology -- it's almost a Dodd-Frank in a box to give to smaller clients -- so they could do it on an affordable basis.

To the extent you can provide more clarity, specifically around the swaps and futures in what's in and what's not, and how the they'll manage the uncleared environment, I think that would be very helpful to see from the Commission.

Thank you.

MR. SHILTS: Okay. Thank you all. I don't, myself, have any questions. Does anyone else here have any questions you want to ask? I think the issues and concerns were expressed pretty clearly, and it's been a long day.

Commissioner O'Malia? Chairman Gensler? Do you have any questions you want to ask of the panel before we adjourn?

All right. Does anyone else have any further comments they want to make before we adjourn for the day? Any of the panelists?

All right. With that, then I want to thank everyone. I appreciate you sticking with us for an extra hour as we went over, but the discussions were very interesting, and it's always nice to have a lot of people wanting to participate and then having a lot to say, and it's been very productive.

So, again, thanks everyone, and with that, I think we will conclude the roundtable for today.

(Whereupon, at approximately 3:59 pm, the above- referenced meeting of the Commodity Future Trading Commission was adjourned.)

CERTIFICATE OF TRANSCRIBER

I, AnnMarie Wasko, do hereby certify that this transcript was prepared from audio to the best of my ability.

I am neither counsel for, nor party to this action nor am I interested in the outcome of this action.

____
AnnMarie Wasko

CERTIFICATE OF TRANSCRIBER

I, SARAH VEACH, do hereby certify that this transcript was prepared from audio to the best of my ability.

I am neither counsel for, nor party to this action nor am I interested in the outcome of this action.

____
SARAH VEACH

CERTIFICATE OF TRANSCRIBER

I, DEBORAH ARBOGAST, do hereby certify that this transcript was prepared from audio to the best of my ability.

I am neither counsel for, nor party to this action nor am I interested in the outcome of this action.

____
DEBORAH ARBOGAST

CERTIFICATE OF TRANSCRIBER

I, CAROL ROBERTS, do hereby certify that this transcript was prepared from audio to the best of my ability.

I am neither counsel for, nor party to this action nor am I interested in the outcome of this action.

____
CAROL ROBERTS

CERTIFICATE OF TRANSCRIBER

I, MIRANDA PENNACHI, do hereby certify that this transcript was prepared from audio to the best of my ability.

I am neither counsel for, nor party to this action nor am I interested in the outcome of this action.

____
MIRANDA PENNACHI

CERTIFICATE OF TRANSCRIBER

I, MARY JO MITCHELL, do hereby certify that this transcript was prepared from audio to the best of my ability.

I am neither counsel for, nor party to this action nor am I interested in the outcome of this action.

____

MARY JO MITCHELL

www.CapitalReportingCompany.com © 2013

CERTIFICATE OF COURT REPORTER

I, ANDREW KNOUS, the Court Reporter before whom the foregoing proceeding was taken, do hereby certify that the proceeding was recorded by me; that the proceeding was thereafter reduced to typewriting under my direction; that said transcript is a true and accurate record of the proceeding; that I am neither related to nor employed by any of the parties to this proceeding; and, further, that I have no financial interest in this proceeding.

____
ANDREW KNOUS
Digital Court Reporter