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1 COMMODITY FUTURES TRADING COMMISSION

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6 OPEN COMMISSION MEETING

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10 10:00 a.m.

11 Monday, January 30, 2020

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19 CFTC Headquarters Lobby-level Conference Room

20 1155 21st Street, NW, Washington, D.C. 20581

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1 COMMISSION MEMBERS

2 Chairman Heath P. Tarbert

3 Commissioner Brian D. Quintenz

4 Commissioner Rostin Behnam

5 Commissioner Dawn DeBerry Stump

6 Commissioner Dan M. Berkovitz

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Adjournment

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P R O C E E D I N G S

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(9:03 a.m.)

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CHAIRMAN TARBERT: Good morning. This

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meeting will come to order. This is a public meeting

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of the Commodity Futures Trading Commission. I'd like

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to welcome members of the public and market

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participants as well as those on the phone or watching

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via webcast. I'd also like to welcome my fellow

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Commissioners, Commissioner Quintenz, Commissioner

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Behnam, Commissioner Stump, and Commissioner Berkovitz.

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As always, we'll begin with the Pledge of

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Allegiance. Anyone is welcome to join. We are honored

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today to have John Einstman lead us in the pledge.

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John is the CFTC's Deputy General Counsel for General

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Law and a Veteran of the U.S. Army where he served as a

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Captain in the JAG Corps. He is a member of the CFTC's

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recently-formed Veteran's Affinity Group. Thank you,

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John. Please step forward. (Pledge of Allegiance.)

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CHAIRMAN TARBERT: Thank you.

20

Before proceeding to our substantive agenda,

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I want to announce that today the Agency approved the

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interagency rule revising the Volcker rules covered

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1 funds provisions. Commissioner statements on the rule
2 will be posted on the Commission's website this
3 afternoon along with a voting draft. That is something
4 we will try to do for all of our rules going forward.
5 The same day that we vote on something, post it as part
6 of the press release.

7 Today, we'll be discussing two very important
8 agenda items. This morning, we'll consider a long
9 awaited proposed rule on Speculative Position Limits.
10 Then this afternoon, we'll consider a proposed rule
11 codifying certain no-action relief related to Swap
12 Execution Facilities.

13 For each of these items, we'll proceed as
14 follows: Commissioners will make opening statements, if
15 any, in order of seniority. Commissioners are free to
16 reserve their time to make a longer closing statement
17 if they wish. Staff will then make a presentation to
18 the Commission. Commissioners will have the
19 opportunity to ask questions and make comments. The
20 Commission will vote on the proposal. Commissioners
21 will then make closing statements, if any, on that same
22 item.

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1 All final votes conducted will be recorded
2 votes. The results of the votes approving the issuance
3 of rulemaking documents will be included with those
4 documents in the Federal Register. To facilitate the
5 preparation of approved documents for publication in
6 the Federal Register, I now ask the Commission to grant
7 unanimous consent for staff to make the necessary
8 technical corrections prior to submitting them to the
9 Federal Register.

10 COMMISSIONER QUINTENZ: So moved.

11 COMMISSIONER BEHNAM: Second.

12 CHAIRMAN TARBERT: Without objection so
13 ordered.

14 We will now consider the proposed rule on
15 speculative position limits. I'd now like to open the
16 floor for any statements in order of seniority. As
17 Chairman, I'll go ahead and start with my statement.

18 I'm pleased to present a proposed rule today
19 setting Speculative Position Limits. This proposal is,
20 I sincerely believe, the closing chapter of a long
21 saga. Since 2010, the Agency has issued four separate
22 proposed rules on position limits. As many know, only

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1 one of those proposals was adopted but that rule was
2 struck down by the Courts.

3 Position limits, which sounds like a simple
4 concept, is a complicated endeavor. If there were a
5 perfect solution, I have no doubt we would have already
6 found it. The Commission and staff have worked
7 tirelessly over the last decade improving the rule.
8 With each iteration, the proposal gets better and
9 better. To the past Chairman and Commissioners who sat
10 in our seats before us, I'm truly grateful for all the
11 work you did to make today possible.

12 To the Commission staff, I want to extend a
13 heartfelt thank you. This project exemplifies the
14 Agency core values of team work and commitment. To my
15 fellow Commissioners, thank you for the invaluable
16 feedback over the past six weeks. And I think we all
17 have a common goal that this rule be a practical
18 solution that works for the American people.

19 And to the end-users of our derivatives
20 markets, you lived with uncertainty over how this rule
21 would impact businesses and you have given us ten years
22 of comments, feedback, and suggestions.

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1 To our market participants, and particularly
2 American agriculture, I want to say your feedback is
3 appreciated. It has been heard. And today it is being
4 acted on.

5 When I came to the Commission last summer, I
6 set out several strategic goals. Among those goals is
7 to regulate our derivatives market so they promote
8 the interest of all Americans. Another goal is to
9 improve the regulatory experience. Markets need rules
10 but those rules should be clear and practical. The
11 rules should also cause no more burden than necessary
12 on the users of our markets.

13 On that first goal, position limits are a way
14 to make sure our futures markets work for American
15 businesses. The markets we are talking about today are
16 vital to farmers and ranchers, to electric utilities,
17 and to all manner of businesses that produce or use
18 agricultural and petroleum products. These are the
19 business that keep food on the shelves and keep the
20 lights on. Futures markets are how those businesses
21 protect themselves from volatile prices.

22 Today's proposal will help protect from some

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1 of the most nefarious schemes in our derivatives
2 markets. Capping speculative positions in these
3 markets will help prevent cornering and squeezing.
4 Limiting speculative positions can also cut down on
5 chaotic price swings caused by speculative
6 gamesmanship. In effect, position limits should help
7 ensure that prices in our markets reflect actual supply
8 and demand.

9 Also, the proposal would revoke the so-called
10 risk management exemptions used by banks and hedge
11 funds to exceed federal limits. A decade ago
12 Congress changed the statute to make clear that banks
13 shouldn't get the same treatment as real hedging
14 producers. And now, today, our proposal will implement
15 that change and make sure that our markets are for
16 businesses in the real economy.

17 Now let's focus on how the proposal meets the
18 goal of improving the regulatory experience. That
19 comes out first and foremost with how the proposal
20 impacts hedgers. We can't overstate that these limits
21 are on speculative activity. Congress never intended
22 people with real hedging needs to be subject to these

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1 rules. As a result, position limits is the rare rule
2 where the exception is just as important as the rule
3 itself.

4 The greatest risk in this rule is that
5 hedgers are caught in limits aimed at speculators. If
6 a farmer can't hedge the prices on next year's crop, if
7 a refiner can't offset a risk on crude oil for a new
8 plant, or if a wholesaler can't offset risk on
9 inventory it's buying, those businesses will not expand
10 their operations and the American economy would suffer.
11 Any position limits must be written with these hedging
12 needs in mind. Congress and the American people expect
13 nothing less.

14 We've also expanded the definition to include
15 hedging strategies that are common in the energy
16 markets. We can't inadvertently undermine producers,
17 refiners, pipeline operators, and utilities that keep
18 this country running.

19 On the second point, we've built a practical
20 and efficient way for hedgers to use the bona fide
21 hedging exemption. A lot of red tape could mean lost
22 businesses and opportunities for these people to

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1 actually hedge their risk. If your hedging needs fits
2 within the enumerated list you're automatically exempt,
3 and we've made that enumerated list much longer. We
4 would also discontinue forms, reporting forms, 204s,
5 and the cash position forms on 304s. These are forms that
6 we've had for decades.

7 So not only are we thinking about putting new
8 position limits on commodities, but we've looked back
9 and said our current federal position limits, are there
10 ways to improve the process there?

11 If you don't fall within the enumerated list,
12 you can still request an exemption from the exchanges.
13 If the exchange agrees with your position, that it
14 constitutes a bona fide hedge, it will notify us and
15 unless the Commission votes within 10 days to overturn
16 that decision, your exchange exemption counts as a
17 federal exemption. And with the expanded list of
18 enumerated hedges, I think it would be a rare case
19 where there is actually a bona fide hedging need that
20 isn't already covered.

21 Finally, I want to touch on something a bit
22 esoteric, but I think it's fundamental and a welcome

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1 shift in how this agency approaches position limits.
2 Previously the Commission read our statute to require
3 federal limits on every futures contract on a physical
4 commodity. This would have required the Commission to
5 set limits on 1,200 individual contracts. I don't
6 think this is the best way to read the actual words of
7 the statute but I do believe it's a reasonable way to
8 read the statute, which I think most if not everyone
9 agrees, is somewhat muddled.

10 But that reading comes out of a philosophy of
11 regulation that I fundamentally disagree with.

12 Position limits are like medicine. They can help cure
13 a symptom but they can also have undesirable side
14 effects. And like any medicine, position limits should
15 be prescribed only when necessary.

16 A necessity finding like the one we are
17 proposing today will put more work on the Commission.
18 We will need to evaluate whether a position limit would
19 have a role to play in a particular market. If nothing
20 else, it requires the Commission to think carefully
21 before it acts. But compare that to the burden of this
22 rule which would be on American people and businesses

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1 that rely on our markets. If the choice is between
2 burdening a government agency with doing a more
3 thorough job or putting the initial burden on private
4 enterprise and our citizens, then I think the right
5 choice is clear. The right thing to do is to put the
6 initial burden on the government to justify its actions
7 and that is what today's proposal does.

8 Thank you very much. I'll now turn to
9 Commissioner Quintenz.

10 COMMISSIONER QUINTENZ: Thank you, Mr.
11 Chairman and let me just start by thanking you for your
12 leadership on this very important but very difficult
13 issue. You went through the history very well.

14 I think it's reasonable to think that we have
15 all reached our position limit on position limits and
16 maybe that is certainly true with the staff as well
17 with all the hard work that they have done over the
18 last number of months, but maybe no one more so than
19 all of the end-users, the farmers and ranchers, the
20 energy producers, the transporters, the merchandisers,
21 anyone that has exposure to physical goods in our
22 marketplace that has had to live through iteration

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1 after iteration and punitive interpretation and in my
2 view, poor policy that could affect their ability to
3 risk manage their business.

4 And I am hopeful that today is the beginning
5 of providing them with certainty and flexibility but
6 most importantly, in my view, market integrity. And
7 while all of us up here may take different views in
8 terms of an ambiguously-constructed statute, I think
9 the most important thing is to listen to the end-user
10 community after we publish this proposal and hear their
11 feedback and hopefully hear what we have got right,
12 what we've improved upon, and if there is more room to
13 do that.

14 I don't think that anyone out there cares
15 about us bickering over legal interpretations. They
16 want to see policy to help them manage their risk and I
17 compliment all the staff here today that I think put a
18 proposal in front of us that does that. Thank you.

19 CHAIRMAN TARBERT: Thank you very much.
20 Commissioner Behnam.

21 COMMISSIONER BEHNAM: Thanks Mr. Chairman and
22 good morning to everyone. It's good to see a crowded

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1 room here at the CFTC.

2 Mr. Chairman, first I'd like to echo
3 Commissioner Quintenz's comments and thank you for your
4 leadership on this. I'm certainly happy to be here
5 after many years. I'm going to reserve most of my
6 comments for later but I do want to spend a minute here
7 thanking all the staff before us. We have a big table,
8 which is fantastic, but that should be a clear
9 indication to everyone in the room and who might be
10 watching on the webcast how many people had to
11 participate in this effort.

12 It was a big one and a lot of very smart
13 hardworking people put forward a really fantastic
14 document that I think reflects the CFTC's hard work.
15 So thank you to OCE, thanks to the Chief Economist,
16 thanks to the Division of Market Oversight, and of
17 course, the General Counsel's Office.

18 And I'd also like to take a couple of seconds
19 to thank my staff as was reflected by the two previous
20 speakers, this is a pretty significant document and
21 it's not one that is read easily. So I want to thank
22 Will Baxley, who's a legal intern in my office, David

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1 Gillers, who is my Chief, John Dunfee for his advice as
2 always, and of course, Laura Gardy for her hard work
3 and creativity and her discipline.

4 So I couldn't have done it without them and
5 look forward to today's discussion.

6 CHAIRMAN TARBERT: Thank you so much
7 Commissioner Behnam. Commissioner Stump.

8 COMMISSIONER STUMP: Thank you and good
9 morning. Having looked at position limits and various
10 iterations of this rule over the course of the past 10
11 years, I struggle with what metric by which to evaluate
12 the proposal. So I came up with three criteria: Is it
13 reasonable in design? Is it balanced in approach? And is it
14 workable for both the market participants and the
15 Commission?

16 Overall, I believe the answer to each of
17 those questions is, yes, so I'm very proud to support
18 advancing the proposal for public comment. There is
19 one question that I did not ask, is it perfect? The
20 answer is, no. But I would like to acknowledge that it
21 is by no lack of effort by the people who are sitting
22 at the table in front of us. I know this has been

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1 painful for you all. I know that you have attempted to
2 address the concerns of various competing interests and
3 while it's not perfect, I have to acknowledge that you
4 all -- I spent time with various teams since I have
5 been here at the Commission on various rules, but I
6 spent no more time with any team than those people who
7 are sitting at this table.

8 And I have to acknowledge that I'm somewhat
9 of a perfectionist myself. But also recognizing that
10 this rule must advance, I'm going to focus on two areas
11 that I believe can be improved. The list of enumerated
12 hedge transactions and the process for reviewing
13 hedging transactions outside of that list.

14 I continue to believe that there is more work
15 to be done here. But I want to recognize the
16 tremendous improvements that have been made in this
17 regard and I'm particularly pleased that at my request,
18 the proposal recognizes anticipatory merchandising as an
19 enumerated bona fide hedge.

20 While I remain committed to continue to
21 refine the list of enumerated hedging transactions as
22 well as the appropriate practice for reviewing non-

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1 enumerated transactions, given our desire to finalize
2 the rule in short order, and provide the marketplace
3 with a legal certainty it deserves, I would have very
4 much preferred a formalized process to consider such
5 improvements in these two areas of the proposal. And
6 I'm disappointed that we are unable to agree to such
7 today.

8 Nonetheless, I'm committed to advancing the
9 rule such that perfect is not the enemy of the good.
10 In reality, how could a position limit proposal ever
11 achieve perfection? Congress has given the Commission
12 the remarkable task of adopting position limits that
13 first, it finds necessary to diminish, eliminate or
14 prevent excessive speculation in derivatives. Second,
15 that deter and prevent market manipulations, squeezes
16 and corners. Third, that ensures sufficient market
17 liquidity for bona fide hedgers. Fourth, that ensures
18 the price discovery function of the underlying market
19 is not disrupted. Fifth, that do not cause price
20 discovery to shift to trading on foreign boards of
21 trade. And sixth, that include economically equivalent
22 swaps.

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1 In many instances these statutory objectives
2 are in tension with one another. As a result, it's not
3 surprising that each of us will have a different view
4 of the perfect position limit framework. Perfection
5 simply cannot be the standard by which we measure this
6 proposal. I would like to briefly elaborate on the two
7 specific concerns and issues that I raised and I
8 mentioned that I think could be refined prior to
9 finalization.

10 With respect to bona fide hedging, the
11 Commission's Rule 1.3(z) identifies certain enumerated
12 hedging practices that the Commission recognizes as
13 bona fide and therefore not subject to speculative
14 position limits. Other non-enumerated hedging
15 practices can still be recognized as bona fide but only
16 after a Commission review process.

17 I'm delighted that the proposal recognizes an
18 expanded list of enumerated bona fide hedging
19 practices. This is entirely appropriate. Hedging
20 by companies that produce, process, trade, and use
21 agricultural, energy and metals commodities has become
22 far more sophisticated, complex, and global than when

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1 the Commission last considered Rule 1.3(z).

2 Not to mention, we're expanding the federal
3 limits to commodity contracts not previously subjected
4 to federal limits, and must consider common hedging
5 practices applied in those markets for inclusion in the
6 list of enumerated hedging transactions.

7 A disappointment to me, however, is that the
8 proposal doesn't go far enough in this regard. In
9 commenting on prior proposals, market participants in
10 the energy and metals space, that will now be subject to
11 federal limits for the first time, have provided the
12 Commission with reams of documentation detailing the
13 types of hedging activities in which they engage.
14 Nevertheless, it's once more unto the breach, I'm
15 afraid.

16 I encourage all interested market
17 participants, especially in the energy and metals space,
18 and including the exchanges, to comment, yet again, so
19 that we can appropriately identify further enumerated
20 bona fide hedging practices when we proceed with the
21 final position limit rule.

22 Even if the hedge is enumerated, though, the

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1 trader must still receive approval from the exchange to
2 exceed exchange limits. This, too, is entirely
3 appropriate. The exchanges know their markets and how
4 to best protect them from excessive speculation and
5 manipulative conduct. They are also familiar with the
6 current hedging practices in agricultural, energy, and
7 metals commodities and thus, are well-suited to apply
8 the enumerated bona fide hedges in real-time.

9 A second disappointment to me, relates to
10 what the proposal refers to as a streamlined process for
11 recognizing non-enumerated bona fide hedging practices.
12 Under the proposal, if an exchange recognizes a non-
13 enumerated practice as a bona fide hedge, that
14 recognition would apply to the federal limits as well
15 unless the Commission notifies the exchange and market
16 participants otherwise.

17 The Commission would have 10 business days
18 for an initial application, or two business days in the
19 case of a sudden or unforeseen increase in the
20 applicant's bona fide hedging needs, to approve or
21 reject the exchange's determination.

22 I do not believe that this 10-day, two-day

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1 rule is workable because it is both too long and too
2 short. It is too long to be workable for market
3 participants that may need to take a hedging position
4 quickly. And it is too short for the Commission to
5 meaningfully review the relevant circumstances and make
6 a reasoned determination whether the hedge should be
7 recognized as bona fide.

8 I welcome public comment on the proposal's
9 legal discussion of delegation of the agency's
10 decision-making authority as relevant to this question
11 and how the proposed 10-day, two day rule might be
12 improved in a final rulemaking. There are many other
13 aspects of the rule that merit adoption.

14 I know the team will be discussing those in
15 detail and I will submit a longer statement outlining
16 them. Thank you.

17 CHAIRMAN TARBERT: Thank you very much
18 Commissioner Stump. Commissioner Berkovitz.

19 COMMISSIONER BERKOVITZ: Thank you Mr.
20 Chairman and I'd like to echo the comments of my fellow
21 Commissioners thanking the staff very much for their
22 work with me and my office on this. We had a number of

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1 meetings encompassing hours of time going over the
2 proposal with DMO, OGC, Office of Chief Economist and I
3 really appreciate the dialogue back-and-forth.
4 The document has been improved from its earlier drafts
5 and we've had productive process in that regard. I
6 thank the staff and I thank the Chairman and my
7 colleagues as well.

8 We've had a number of conversations and
9 they've been productive. Unfortunately, I still think
10 there are some fundamental disagreements about the
11 document and where we are today. We'll discuss
12 those, and as I think one of my colleagues, Commissioner
13 Quintenz, mentioned in an earlier meeting, we may
14 disagree but not disagreeably.

15 So there are some fundamental disagreements
16 which I'll talk about more, a little bit here but more
17 in my questions.

18 Mr. Chairman, I was also inspired by your
19 approach to one of our recent rulemakings. I think the
20 last rulemaking on cross-border, where you brought us
21 up a level and explained how the philosophy you were guided by
22 in that rulemaking was Kant's categorical

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1 imperative, a great 18th century enlightenment
2 philosopher, that if everybody acted this way, would it
3 be appropriate?

4 So I took inspiration from philosophy and
5 thought of appropriate philosophy that really could
6 guide us in this rulemaking. I have in mind the
7 works of a mid-to-late 20th century philosopher I
8 studied in my youth. I'm not sure they studied him at
9 Oxford though. He could be considered a playwright.
10 Like Shakespeare, he's written tragedies, comedies, and
11 histories.

12 I'm thinking of Eastwood and his middle works
13 involving themes of law and order in an age of terror
14 and man's relationship to the state. In the second of
15 these middle works, called Magnum Force, Eastwood
16 speaks wise, immortal, timeless words as Lieutenant
17 Briggs drives away and then blows up in an exploding
18 car. At that point, Eastwood's Inspector Callahan says,
19 "a man's got to know his limitations."

20 And so, as Congress has directed to the CFTC,
21 market participants have got to know their limitations.
22 We need effective limitations on speculation.

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1 Commercial market participants need certainty and
2 transparency regarding bona fide hedge exceptions and
3 we need a solid, rational, reasonable legal basis for
4 today's and future rulemakings on this subject.

5 Unfortunately, the proposal does not meet
6 Eastwood's maxim or Congress's directive. The proposal
7 provides for large increases in spot month limits for
8 all commodities and non-spot month limits for
9 agricultural commodities. It does not provide the
10 Commission with the ability to phase in or
11 monitor the effect of these increases and adjust the
12 increases to avoid disruptions to market integrity or
13 the price discovery process, should they arise.

14 The proposal does not provide adequate
15 justification for the absence of numerical limits on
16 energy commodity contracts. The proposal creates an
17 unworkable, opaque and uncertain process for the
18 recognition of non-enumerated bona fide hedges. It
19 demotes the Commission from its traditional role as
20 head coach in determining what is a hedge exemption to
21 the role of Monday morning quarterback second-guessing
22 the exchanges.

1 The legal analysis in the document reverses
2 decades of Commission and judicial holdings as to the
3 interpretation of the Congressional directive in the
4 Commodity Exchange Act since 1936 -- 84 years -- to the
5 Commission to establish position limits to prevent the
6 undue burdens of interstate commerce from excessive
7 speculation. For the first time, it would require the
8 Commission to make a predicate finding that position
9 limits are necessary for each particular commodity
10 subject to those limits.

11 Incredibly, the Commission interprets the
12 Dodd-Frank Act's directive to impose position limits to
13 make it more difficult to impose position limits on
14 energy, metal, and agricultural commodities. In the
15 aftermath of the price spike of oil to \$147 a barrel,
16 the collapse and disruption to the natural gas market
17 from excessive speculation of the Amaranth hedge fund
18 in the midst of the financial crisis where the
19 financial system plunged this country and the world
20 into a recession, to think in that legislation Congress
21 tied the Commission's hands and made it more difficult
22 and reversed 80 years of legal interpretation and made

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1 it more difficult to impose position limits, is truly
2 revisionist history.

3 In another
4 rulemaking that we recently did, the exempt DCO
5 rulemaking, in that rulemaking the Commission proposed
6 to have unlicensed clearing organizations, no
7 bankruptcy protection for customers, and prohibited U.S
8 FCMS from clearing for U.S. customers trading on
9 these exempt DCOs. At that time I thought I was in
10 Bizarro World. Today, we are back in Bizarro World
11 where the Dodd-Frank Act is being interpreted to make
12 it more difficult to put limits on speculative
13 activity.

14 I look forward to the discussion with the
15 staff on this and other issues. Thank you, Mr.
16 Chairman.

17 CHAIRMAN TARBERT: Thank you very much
18 Commissioner Berkovitz.

19 Okay. At this the time, Commission staff
20 will make a presentation on the speculative position
21 limits proposal. We'll have two rounds of Commissioner
22 questions after that presentation preceding in order of

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1 seniority.

2 We have a very big table today, a long table.

3 So we have individuals from the Division of Market

4 Oversight, the Office of General Counsel, and the

5 Office of Chief Economist. So I'd like to welcome all

6 the following individuals from left to right: Dan

7 Davis, Rob Schwartz, Vince McGonagle, Dorothy DeWitt,

8 Aaron Brodsky, Steven Haidar, Lillian Cardona,

9 Jeanette Curtis, Steven Benton, Scott Mixon, Stephen

10 Kane, and Harold Hild.

11 Ms. DeWitt, the floor is yours.

12 MS. DeWITT: Thank you, Mr. Chairman and

13 thank you Commissioners for the opportunity to present

14 here and for the comments and insights and analysis of

15 you and your staff in helping us make this a better

16 rule.

17 Today the presentation will consist of

18 presentation by Aaron Brodsky, Senior Counsel to the

19 Division Director of the Division of Market Oversight,

20 who will give an introduction and overview and talk

21 about limit levels. Next to him is a Special Counsel in

22 the Chief Counsel's unit of DMO, Steven Haidar. And he

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1 will talk about the proposed universe of contracts that
2 are subject to position limits.

3 Next to him is Jeanette Curtis, also Special
4 Counsel in the DMO Chief Counsel's unit. She will talk
5 about the process and types of exemption that can be
6 requested. We also have Lillian Cardona, who is also
7 Special Counsel at the DMOs Chief Counsel unit who will
8 talk about the standards for granting exemptions.

9 We also have Harold Hild and Steven Benton
10 from the Market Intelligence and Product Review branches of the
Division of

11 Market Oversight who will be available to answer
12 questions.

13 MR. BRODSKY: Good morning, Mr. Chairman and
14 Commissioners. Today, staff is recommending that the
15 Commission approve for publication in the Federal
16 Register a notice of proposed rulemaking concerning
17 speculative position limits.

18 This document reflects the hard work of
19 many team members and colleagues across the Commission.
20 On behalf of the large group presenting here today, we
21 would also like to thank the many colleagues who have
22 contributed to this project, including colleagues in

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1 the Division of Market Oversight's Market Intelligence,
2 Product Review, Market Review, Compliance, and Chief
3 Counsel branches.

4 We would also like to thank staff in DMO, who
5 until yesterday, did not realize they were going to be
6 helping out on the position limits rule but who stepped
7 in at the last moment to help proofread the 500-page
8 document.

9 We would also like to thank our colleagues in
10 the Office of General Counsel and Office of Chief
11 Economist. And finally, we would like to thank the
12 staff of Chairman Tarbert and Commissioners
13 Quintenz, Berkovitz, Stump, and Behnam for their
14 comments and questions which have helped us immensely
15 in analyzing and improving the proposal.

16 The proposal before you today is intended to
17 achieve statutory directives and policy goals while
18 minimizing burdens on the farmers, ranchers, and
19 product end-users that CFTC regulated markets are meant
20 to serve. By way of background, the Commission has
21 long used position limits to protect futures markets
22 and bona fide hedgers from excessive speculation that

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1 can cause unreasonable or unwanted price fluctuations.

2 In 1938 the Commission's predecessor, the
3 Commodity Exchange Commission, first promulgated
4 position limits for grains. Since then, the Commission
5 has continued to establish and enforce speculative
6 position limits for futures contracts and options on
7 futures contracts on various agricultural commodities
8 as authorized by the CEA.

9 The Commission's existing position limit
10 regulations include three components: the levels of the
11 limits, which currently apply to nine agricultural
12 commodity derivative contracts, exemptions from the
13 limits, and regulations to determine which accounts and
14 positions a person must aggregate. The existing
15 federal position limits function in parallel with
16 exchange set limits required by the designated contract
17 market core principles.

18 The Commission has decades of experience
19 applying federal position limits. The Commission
20 recognizes however, that federal position limits are
21 not the only tool for protecting markets. Other tools
22 such as surveillance by Commission and exchange staff,

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1 exchange set position limits, exchange set position
2 accountability, Commission rule enforcement reviews,
3 and robust enforcement are also effective.

4 To that end, the proposal contemplates a
5 narrowly-tailored position limits framework that
6 recognizes differences across commodities, that focuses
7 on derivatives contracts for which an antecedent necessity
8 finding has been made due to the contract's role in the
9 price discovery and physical delivery process, that
10 focuses on a narrow subset of swaps that are truly
11 economically equivalent, and that reduces duplication
12 and inefficiency by leveraging existing expertise and
13 processes at the exchange level.

14 We have split up today's presentation into
15 four components. First, the contracts covered by the
16 proposal. Second, the proposed limit levels. Third,
17 the proposed standards for granting exemptions and
18 fourth the proposed process for granting exemptions.
19 We will walk through each component in turn.

20 I'll now turn over the presentation to Steve
21 who will provide an overview of the contracts covered
22 by the proposal.

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1 MR. HAIDAR: Thank you, Aaron. And thank
2 you, Mr. Chairman and thank you to the Commissioners
3 for this opportunity to speak.

4 The proposal creates a new defined term,
5 referenced contract. This term comprises the universe
6 of contracts subject to the proposed federal position
7 limits, simply, anything that is a referenced contract
8 would be subject to federal position limits. While
9 contracts not falling within the definition, would not.

10 The proposal defines a referenced contract to
11 include three categories of contracts. The first
12 category includes core referenced futures contracts.
13 Itself a new defined term. We will refer to core
14 referenced futures contracts as CRFCs. CRFCs consist
15 of 25 of the most liquid, physically-settled exchange-
16 traded futures. The second referenced contract
17 category includes other futures and options related to
18 the 25 CRFCs, including certain cash-settled futures.
19 The third category includes the new-defined term,
20 economically equivalent swap, which would cover a
21 subset of swaps.

22 As noted, the first referenced contract

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1 category consists of CRFCs, which includes 25 of
2 generally the most liquid, physically-settled futures.
3 These 25 futures include the existing nine legacy
4 agricultural futures currently subject to federal
5 position limits, as well as 16 new futures. These 16
6 new futures include seven additional agricultural
7 futures, five metals futures, and four energy futures.

8 The second referenced contract category
9 consists of futures and options thereon, that are
10 directly or indirectly linked to the price of either a
11 particular CRFC or to the same commodity underlying the
12 CRFC. This category generally consists of for example,
13 cash-settled look-a-like futures. However, referenced
14 contracts, specifically exclude the following four
15 types of contracts: one, location basis contracts.
16 Two, commodity index contracts. Three, swap
17 guarantees. And four, certain trade options.

18 Staff believes that generally speaking,
19 linked cash-settled and physically-settled exchange-
20 traded contracts form one market and thus should be
21 subject to federal position limits. Specifically,
22 staff has observed that it's common for the same market

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1 participant to arbitrage linked cash-settled and
2 physically-settled contracts. Staff has also observed
3 instances where linked cash-settled and physically-
4 settled contracts have been used together as part of a
5 manipulation.

6 The third referenced contract category
7 includes economically-equivalent swaps. The Commodity
8 Exchange Act requires the Commission to establish
9 limits for economically-equivalent swaps
10 simultaneously, as appropriate, with position limits on
11 futures. Since the CEA does not define economically-
12 equivalent, staff has applied its expertise in
13 construing this term. A swap would qualify as
14 economically-equivalent, so long as the swap shares
15 identical, material, contractual specifications, terms,
16 and conditions with a referenced contract.

17 Disregarding differences with respect to any
18 of the following three things: one, lot size or
19 notional amount. Two, post-trade risk management
20 arrangements and three, delivery dates for physically-
21 settled swaps as long as these delivery dates diverge
22 by less than one calendar day from the referenced

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1 contract's delivery date.

2 However, there is an exception for natural
3 gas swaps. Natural gas swaps qualify as economically
4 equivalent if a swap's delivery date diverges by less
5 than two calendar days rather than one calendar day.
6 This exception captures penultimate natural gas
7 physically-settled swaps.

8 Compared to other futures markets, the
9 natural gas market includes relatively active cash-
10 settled and penultimate futures. Therefore, the
11 economically-equivalent definition is slightly expanded
12 to include natural gas penultimate swaps.

13 Staff observes that there is a difference
14 between swaps traded over-the-counter, or OTC, and
15 exchange-traded futures. OTC swaps are bilaterally
16 negotiated and customizable. As a result, it is
17 necessary to have a relatively narrow economically-
18 equivalent definition to prevent market participants
19 from inappropriately netting down their CRFC positions
20 against bespoke swaps that may not necessarily offer
21 identical economic exposure to the CRFC. Further, CEA
22 Section 4a(a)(2), requires the Commission to strive to

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1 ensure that federal position limits will not cause
2 price discovery to shift to foreign venues.

3 Accordingly, the proposed economically-
4 equivalent swap definition is cognizant of the
5 corresponding EU definition. While the definitions are
6 similar, the EU's definition requires only identical
7 terms rather than identical material terms. While our
8 proposed definition is relatively broader than the
9 EU's, since ours explicitly covers swaps with different
10 non-material terms, staff believes that this will deter
11 market participants from inappropriately avoiding
12 position limits merely by changing an immaterial term
13 of a swap that otherwise offers identical economic
14 exposure to a CRFC, while the proposed definition
15 remains mindful of the EU's definition as required by
16 the CEA.

17 I'll now turn over the presentation to Aaron
18 who will provide an overview of the proposed federal
19 position limits.

20 MR. BRODSKY: With respect to the proposed
21 levels, contracts that physically settle can in certain
22 circumstances during a spot month be at risk of corners

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1 and squeezes. These corners and squeezes could distort
2 pricing and resource allocation, make it more costly to
3 implement hedge strategies and could harm the
4 underlying cash market.

5 The proposal thus includes federal spot month
6 limits for referenced contracts on all 25 core
7 referenced futures contracts. The proposed spot month
8 levels are set at or below 25 percent of deliverable
9 supply as estimated for each commodity using recent
10 data provided by DCMs and verified by Commission staff.
11 The Commission and exchanges have long used 25 percent
12 of the deliverable supply when calculating spot month
13 levels. The application of the 25 percent ceiling to
14 data for each commodity results in levels that account
15 for differences across markets and that are low enough
16 to prevent excessive speculation and to protect price
17 discovery, yet high enough to ensure sufficient
18 liquidity for bona fide hedgers.

19 The proposed spot month levels are generally
20 higher than the existing federal and exchange set spot
21 month levels, but only when warranted by increases in
22 deliverable supply. In some cases, the proposed spot

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1 month levels are unchanged or lower than existing
2 levels. Outside of the spot month, federal position
3 limits would only apply to referenced contracts based
4 on nine legacy agricultural contracts that are
5 currently subject to federal limits. Contracts on the
6 other 16 commodities would be subject to federal
7 position limits only during the spot month and would be
8 subject to exchange set position limits -- or exchange
9 set position accountability outside of the spot month.

10 Such exchange set position limits or position
11 accountability would be mandatory. It would be subject
12 to Commission oversight and standards established by
13 the Commission, including that the levels be necessary
14 and appropriate to reduce the potential threat of
15 market manipulation for price distortion of the
16 contract or underlying commodities, price, or index.

17 Exchange accountability is a particularly
18 flexible and effective tool because it provides
19 exchanges with the opportunity to intervene once a
20 position hits a relatively low level, while still
21 affording traders the flexibility to establish a large
22 position when warranted by the nature of the position

0043

1 and by the conditions in the market. The Commission
2 has decades of experience overseeing accountability
3 levels implemented by the exchanges, including for the
4 16 commodities that would be subject to exchange set
5 position limits or exchange set position accountability
6 outside of the spot month.

7 The proposed federal non-spot levels are set
8 at 10 percent of open interest for the first 50,000
9 contracts, with an incremental increases of 2.5 percent
10 of open interest thereafter. This formula reflects a
11 limited change from the existing formula which applies
12 the 2.5 percent incremental increase at 25,000 contracts
13 rather than 50,000. The proposed change is intended to
14 help account for significant increases in overall open
15 interest which has roughly doubled since federal non-
16 spot month limits were first set on these markets.

17 The proposed non-spot levels are based on the
18 application of the modified 10, 2.5 percent formula to
19 recent open interest data. The proposed position
20 limits are generally higher than the existing levels
21 but in some cases unchanged when changes were
22 unwarranted based on the open interest data.

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1 Next, Lillian will provide an overview of the
2 proposed standards for granting exemptions from federal
3 position limits.

4 MS. CARDONA: Thank you Aaron. Good morning
5 Mr. Chairman and Commissioners. My name is Lillian
6 Cardona, I'm a Special Counsel in DMO's Office of Chief
7 Counsel.

8 As Aaron indicated, the proposal provides for
9 several exemptions that subject to certain conditions
10 would permit a trader to exceed the applicable federal
11 position limit. In addition to exempting bona fide
12 hedges from position limits, which I'll get back to
13 shortly.

14 The proposal also includes exemptions for the
15 following types of positions: first, spreads. As those
16 positions will be defined in the proposed spread
17 transactions definition. Second, certain financial
18 distress positions. Third, certain natural gas
19 positions held during the spot month and fourth,
20 certain pre-enactment and transition period swaps also
21 as those terms are defined in the proposal.

22 Now focusing on the exemption for bona fide

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1 hedges, the proposal recognizes hedging transactions or
2 positions may continue to exceed federal limits if they
3 satisfy all three elements of the general bona fide
4 hedging transactions or position's definition. So
5 specifically, when we talk about the general elements,
6 those requirements refer to the fact that the hedge
7 represents a substitute for transactions made or to be
8 made or positions taken or to be taken at a later time
9 in a physical marketing channel, commonly referred to
10 as the temporary substitute test.

11 The hedge is economically-appropriate to the
12 reduction of price risk and the conduct and management
13 of a commercial enterprise, commonly referred to as the
14 economically-appropriate test. It's a very appropriate
15 name for that element. And the hedge arises from the
16 potential change in value of actual or anticipated
17 assets, liabilities or services. This is commonly
18 referred to as the change in value requirement.

19 So the current bona fide hedging definition
20 lists or enumerates certain hedges that the Commission
21 determines qualify as bona fide hedges. The proposal
22 before you today expands that current list of bona fide

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1 hedges that are enumerated to cover additional hedging
2 practices, including hedges of anticipated
3 merchandising.

4 Speaking more broadly, the proposal also
5 provides guidance on whether and when market
6 participants may measure risk on a gross basis rather
7 than on a net basis to provide market participants with
8 greater flexibility on how to manage their own business
9 risk.

10 And finally, the proposal will modify that
11 temporary substitute test to require that a bona
12 fide hedging transaction or position in a physical
13 commodity, must always and not just normally, be
14 connected to the production, sale, or use of a physical
15 cash market commodity.

16 So in connection with this change to the
17 temporary substitute test, a market participant would
18 generally no longer be allowed to treat positions
19 entered into -- what are referred to for risk
20 management purposes as a bona fide hedge, unless that
21 position otherwise meets the bona fide hedging
22 definition or it qualifies for one of the pass-through

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1 swap provisions that are included in the proposed bona
2 fide hedging definition.

3 Now under that swap pass-through provision,
4 generally, the bona fides of the bona fide hedging swap
5 counterparty pass-through to a counterparty that is not
6 itself a bona fide hedger. So for example, that could
7 be the case where you have a swap dealer who is
8 entering into a hedge to provide liquidity to a bona
9 fide hedger.

10 Now next, my colleague Jeanette, will provide
11 an overview of exactly just how we've proposed the
12 process for granting exemptions.

13 MS. CURTIS: Thank you, Lillian. Good
14 morning Mr. Chairman and Commissioners. My name is
15 Jeanette Curtis, I'm Special Counsel within the
16 Division of Market Oversight's Chief Counsel's office.

17 As Lillian just discussed this proposal
18 outlines the different types of exemptions from federal
19 position limits. The proposal also sets forth
20 processes for market participants to request such
21 exemptions from federal limits. I will first address
22 the proposed processes for granting bona fide hedge

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1 exemptions and then I'll discuss the processes for
2 obtaining the various other types of exemptions that
3 are available under the proposal.

4 So first with respect to bona fide hedging
5 positions that are enumerated, the proposal continues
6 to allow such enumerated bona fide hedges to be self-
7 effectuating for the purposes of federal position
8 limits. So this means that a market participant would
9 not be required to request the Commission's approval of
10 the enumerated bona fide hedge before exceeding federal
11 position limits. Rather, the market participant would
12 only be required to request the enumerated bona fide
13 hedge exemption from the relevant exchange for purposes
14 of the exchange's set limits.

15 This approach is similar to the existing
16 process the Commission has used for many years to
17 recognize certain bona fide hedges and it's an approach
18 that all market participants that are currently trading
19 on designated contract markets, are subject to and very
20 familiar with.

21 So next, with respect to bona fide hedging
22 positions that do not fit within the proposed

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1 enumerated hedges, these positions may be considered
2 non-enumerated bona fide hedges that would not be self-
3 effectuating. So this means that a market participant
4 would be required to obtain the Commission's approval
5 and under this proposal that we are setting forth here
6 today, there are two different options available for
7 obtaining a non-enumerated bona fide hedging exemption.

8 So under the first option, a person could
9 apply directly to the Commission under the new proposed
10 process in section 150.3b for an approval of their non-
11 enumerated bona fide hedge. After the person receives
12 the Commission's approval, they would then be required
13 to separately apply to the relevant exchange for an
14 exemption from the exchange's position limits. This
15 option is based on and similar to the Commission's
16 existing approach under existing regulations 1.47 and
17 1.48. And many market participants are already very
18 familiar with this particular process.

19 However, as we were preparing this proposal,
20 we recognized that requiring market participants to
21 comply with different federal and exchange-level
22 processes, creates certain inefficiencies in the

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1 application process. As such, the Commission is
2 proposing a new streamlined approach, which is the
3 second option for obtaining a non-enumerated bona fide
4 hedging exemption.

5 This second option leverages existing
6 exchange processes which many bona fide hedgers are
7 currently familiar with. So under the second option, a
8 person could submit one application directly to an
9 exchange to obtain a non-enumerated bona fide hedging
10 exemption and that exemption would be valid for the
11 purposes of both federal and exchange-set limits.

12 Under this new streamlined process, if an
13 exchange approves a non-enumerated bona fide hedging
14 exemption for purposes of its exchange set limit, the
15 exchange would then notify the Commission and the
16 applicant simultaneously and the non-enumerated bona
17 fide hedge would be deemed approved for the purposes of
18 exceeding federal position limits so long as the
19 Commission does not intervene with a limited 10-day
20 review period or it would be a two-day review period in
21 cases where applications are filed for the purposes of
22 sudden and unforeseen bona fide hedging needs.

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1 It's important to emphasize that this
2 response where the Commission may intervene would be a
3 full Commission action. It wouldn't be a staff-
4 delegated action.

5 So those are the processes that we are
6 proposing for handling enumerated bona fide hedges and
7 non-enumerated bona fide hedges and I just want to note
8 that for either case, whether it's enumerated or not
9 enumerated, market participants would no longer be
10 required to file the Form 204 on a monthly basis to
11 demonstrate their cash market position justifying limit
12 overages. Instead, under the proposal the Commission
13 would have access to cash market information that
14 market participants submit to exchanges as part of
15 their application to exchanges from the exchange set
16 limits.

17 So, in addition to the processes we have in
18 place for achieving enumerated and non-enumerated bona
19 fide hedging positions, the Commission is also
20 proposing processes for market participants to rely on
21 the other types of exemptions that are available under
22 this proposal.

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1 First, for spread exemptions, spread
2 positions that are covered in the new proposed spread
3 transactions definition would be self-effectuating. So
4 similar to how we are handling the enumerated bona fide
5 hedges, a person would only be required to apply to the
6 relevant exchange to request a spread exemption for the
7 purposes of the exchange set limits.

8 However, if there is a spread position that
9 does not fit within the defined list of spread
10 transactions as proposed in 150.1, then the person
11 would have to apply directly to the Commission under
12 Section 150.3b to obtain the spread exemption first.

13 Similarly, we are offering a conditional spot
14 month limit for natural gas, as well as an exemption
15 for certain pre-enactment and transition-period swaps
16 and both of these exemptions will be self-effectuating
17 for the purposes of federal limits.

18 And finally, for requests for financial
19 distress exemptions, these will be granted on a case-
20 by-case basis in response to requests market
21 participants submit to the Commission staff under the
22 Commission's existing regulations in Section 140.99.

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1 So those are the processes that we are
2 outlining for market participants who obtain exemptions
3 from federal position limits. And now I will turn over
4 the presentation to our colleagues in the Office of
5 General Counsel to discuss the legal authority
6 supporting the proposal. Thank you.

7 MR. SCHWARTZ: Good morning, Mr. Chairman and
8 members of the Commission. I am Rob Schwartz from the
9 Office of General Counsel and I have been working on
10 this for eight years.

11 (Laughter.)

12 MR. SCHWARTZ: Mr. Chairman, I'm going to
13 spend a few minutes elaborating on the legal issue you
14 identified in your opening remarks and that is whether
15 the Dodd-Frank Act requires position limits for all
16 physical commodities or only when the Commission finds
17 them necessary.

18 Before Dodd-Frank, the CEA required the
19 Commission to establish limits from time-to-time as it
20 finds are necessary. In Dodd-Frank, Congress said the
21 Commission shall establish limits in accordance with
22 the standards applicable under the existing authority.

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1 So the question became whether necessity is
2 among the standards the Commission must follow.

3 In 2011, the Commission said, no, it's not
4 and it believed that the Dodd-Frank Act contained an
5 unambiguous mandate to establish position limits
6 across-the-board. We got sued. In the ISDA v. CFTC
7 case, the Court said the CFTC got it wrong and in fact,
8 Dodd-Frank is ambiguous as to whether the Commission
9 has to make a necessity finding. So the court remanded
10 the rule to the CFTC with the following instruction: to
11 resolve the ambiguity, the Commission must apply its
12 experience and expertise in light of the competing
13 interests at stake.

14 In administrative law that's called a Chevron
15 Step 2 Analysis, where the agency can select a
16 permissible interpretation including for policy reasons
17 so long as its explanation is reasonable.

18 The proposal today resolves that ambiguity
19 and recommends requiring a necessity finding. That's
20 based on several factors. The proposal contains a
21 detailed discussion of indications in the statutory
22 text that necessity is in fact among the standards

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1 that apply. Policy discussion is also detailed but the
2 overarching concept is this: the CFTC can better carry
3 out the purposes of Section 4a if it makes a necessity
4 finding before it establishes the limits.

5 I think a helpful way to look at this is to
6 think about the Commission's experience considering
7 costs and benefits under Section 15(a) of the Act, and
8 most people think that leads to better rules, and we
9 typically are required to do that. But not always.
10 When Congress issues a clear directive, we cannot
11 reconsider the costs and benefits because Congress made
12 those judgments.

13 In the same way if there were an across-the-
14 board mandate for position limits, we wouldn't take it
15 upon ourselves to determine if that was necessary. But
16 here the statute is ambiguous. We don't know with
17 certainty what judgment Congress made. So the proposal
18 explains it is better policy to consider the facts and
19 circumstances including costs and burdens and benefits,
20 to determine when position limits are necessary.
21 Sometimes they are not.

22 The purpose of Section 4a, to paraphrase,

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1 is to address excessive speculation in derivatives
2 that can disrupt cash market prices. But markets
3 vary in terms of whether that is a realistic risk
4 because some derivatives play little or no role in
5 price discovery for the underlying commodity. Position
6 limits for those derivatives would generate little-to-
7 no benefit.

8 On the other hand, there are always costs
9 associated with position limits and they vary in
10 magnitude. The public benefits when the Commission
11 considers all relevant facts and circumstances before
12 acting. Based on that, and again, discussed in much
13 greater detail in the proposal, we recommend the
14 Commission apply the statute by making a necessity
15 finding before it sets a position limit.

16 So the proposal contains that necessity
17 finding and it too is an extensive discussion. The
18 statute itself does not give direct criteria for making
19 a necessity finding. So the proposal takes an approach
20 that is rooted back in the 2011 rule. In 2011 the
21 Commission did not make a necessity finding but it
22 selected 28 contracts to prioritize based on two

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1 things; the contracts either had high levels of open
2 interest and notional value or they served as a
3 reference price for many cash market transactions.

4 The factors in the proposal are similar,
5 primarily considering the importance of futures and
6 swaps to price discovery in a given commodity including
7 whether there is physical delivery. And in some
8 instances, it considers the importance of the commodity
9 to the national economy to gauge the seriousness of
10 what could result from price disruptions. In
11 conjunction with the proposal's cost benefit
12 consideration, those factors identify the 25 core
13 referenced futures contracts and those overlap
14 considerably with the 28 the Commission prioritized in
15 2011.

16 So that is more in line with the past
17 practice than may meet the eye. But the Commission has
18 not previously explained its thought process so
19 thoroughly, the factors that it has considered may be
20 more similar than you might think.

21 So on behalf of the panel, we look forward to
22 your questions.

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1 CHAIRMAN TARBERT: Thank you very much.

2 We'll go ahead and open it up for questions now and
3 we'll do so in order of seniority. I will go first.

4 Let's just start off -- I see a lot of people
5 in the room today and there is probably hundreds of
6 others if not thousands maybe watching this throughout
7 the country. So I thought it might be helpful before
8 we get mired in details for maybe Mr. Mixon to give us
9 a quick overview on how position limits actually work.
10 What are they? What activity are they meant to
11 address?

12 MR. MIXON: Thank you Mr. Chairman.

13 At a very high level, farmers and ranchers
14 and energy producers and other real economy firms rely
15 on derivatives markets to manage their risk and all of
16 them expect and deserve a well-functioning derivatives
17 markets. That means, for example, if a farmer has a
18 corn crop in the field and he goes short a futures
19 contract as a hedge to manage his risk, he expects the
20 futures price to reflect those supply and demand
21 fundamentals the same way potentially that the value of
22 his cash crop is impacted by those supply fundamentals

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1 and demand fundamentals.

2 However, if the futures contract is
3 distorted, if the price is distorted or manipulated by
4 a large trader engaged in scheme to corner the market
5 near expiration, simply put the price is wrong. The
6 farmer's hedge will not work as expected. His business
7 will be disrupted and he is likely to lose money
8 through no fault of his own. And Congress has long
9 recognized the harm to commerce caused by these price
10 changes that are unwarranted by these real-economy and
11 fundamental supply and demand effects.

12 And since 1936, Congress has directed the
13 Commission and its predecessor agencies through the
14 Commodity Exchange Act to diminish or proactively
15 prevent such distortions from occurring. And one of
16 the tools available to the Commission as a preventative
17 measure against these erratic price fluctuations is
18 position limits. And federal limits have been in place
19 for various commodities since 1938.

20 So by limiting the quantity of futures
21 contracts that a trader can hold in the delivery month,
22 near expiration, the Commission is attempting to lower

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1 the likelihood that a corner or a squeeze for example,
2 could distort the price away from its proper level.
3 However, Congress also directed the Commission to
4 ensure that hedgers have ample liquidity to transact
5 their legitimate business needs. Congress exempted
6 these bona fide hedging transactions my colleagues
7 talked about, from any such position limits. So
8 therefore, the goal of the position limits rule is to
9 reduce this likelihood of unwarranted price changes,
10 not reflecting supply and demand, that will cause harm, and
11 now on the other hand, not constraining the
12 ability of hedgers to use the derivatives markets to
13 manage their risk the way they intend to do so.

14 CHAIRMAN TARBERT: Great. Thank you very
15 much. I think that is really helpful to sort of set
16 the scene.

17 So now on to the position limits themselves.
18 I guess I have a question for Mr. Benton. The proposal
19 covers 25 core referenced contracts plus the contracts
20 that are directly or indirectly linked to those
21 contracts. So on the whole, how many futures contracts
22 are we actually talking about here that are covered by

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1 these position limits?

2 MR. BENTON: Thank you, Mr. Chairman. We
3 have created a staff workbook that list approximately
4 428 contracts that we have discovered that we believe
5 are reference contracts. It's not -- we do not claim
6 it is a all-inclusive list. I believe in the proposal
7 we ask questions as to what other contracts should be
8 included and whether the exchanges should list these
9 reference contracts and core reference contracts on
10 their exchanges' website for easy access.

11 CHAIRMAN TARBERT: So we're not just not
12 sticking our toe in the water. We are talking about
13 hundreds of contracts, well over 400 that at least at
14 this point we are pretty sure are included and if
15 someone comes up with a new contract down the line, for
16 example, that will be automatically included? We won't
17 have to go through a rule making to reference that?

18 MR. BENTON: That is correct.

19 CHAIRMAN TARBERT: Okay, and out of those
20 sort of 400 plus contracts, what percentage of the
21 market for physical commodities is actually covered?

22 MR. BENTON: That's --

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1 CHAIRMAN TARBERT: A ballpark figure --

2 MR. BENTON: But generally, the 25 core
3 reference contracts and the associated reference
4 contracts cover the vast majority of trading open
5 interest and volume among the Ag contracts and the
6 exempt commodities.

7 CHAIRMAN TARBERT: Okay, so vast majority.
8 And that includes the big energy contracts as well,
9 right?

10 MR. BENTON: Correct.

11 CHAIRMAN TARBERT: So it's crude oil, it's
12 gasoline, it's heating oil, and natural gas?

13 MR. BENTON: Correct.

14 CHAIRMAN TARBERT: And all the relevant
15 contracts with them.

16 MR. BENTON: All the options, all the look-a-
17 likes, the minis, jumbo size and the different
18 varieties.

19 CHAIRMAN TARBERT: As well as if someone
20 wanted to replicate it through a swap?

21 MR. BENTON: Correct. That's covered, too.

22 CHAIRMAN TARBERT: Great. So in your view,

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1 it's pretty broad?

2 MR. BENTON: Yes.

3 CHAIRMAN TARBERT: Okay. Thank you.

4 I want to talk a little bit about the impact
5 on farmers because I think one of the things that is a
6 common theme over the last decade is concerns from our
7 Ag community that there wasn't sufficient room to
8 account for bona fide hedging. So, I guess at a high
9 level, Mr. Brodsky, could you give us sort of -- what
10 is the difference between this rule and let's say our
11 current -- or this proposal and our former proposals
12 when it comes to the point of view, for example, of a
13 grain producer or processor?

14 MR. BRODSKY: Thank you, Mr. Chairman. To
15 the extent that the proposed limit levels will be
16 higher than existing levels, market participants such
17 as those in the grain space may be less likely to need
18 to request an exemption. Additionally, with an
19 expanded list of enumerated hedges, a greater variety
20 of common commercial hedging practices will be
21 available for self-effectuating exemptions at the
22 federal level.

0064

1 There is another important change here which
2 is a proposal to streamline the process for requesting
3 exemptions. Under current regulations, a market
4 participant is required to submit cash market information
5 to the exchange, typically during an annual process,
6 and then separately to the Commission, typically during
7 a monthly process on the Form 204.

8 As we mentioned earlier, the proposal would
9 eliminate that Form 204, which would allow market
10 participants to simply file cash market information
11 with the exchange during the annual application process
12 and then the Commission would leverage that information
13 rather than laying on top of that an additional
14 duplicative requirement.

15 CHAIRMAN TARBERT: Thank you. Sticking on the grain
16 topic, I guess Ms. Cardona, how will this proposal
17 impact grain merchandisers? You mentioned the
18 anticipatory merchandising. Is that going to sort of
19 provide the relief needed?

20 MS. CARDONA: Yes, thank you, Mr. Chairman.
21 I think generally under this proposal, a grain
22 merchandiser or a market participant whose business

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1 performs a merchandising function in our physical
2 commodity markets, depending on the facts and
3 circumstances of course, they may qualify for several
4 of the enumerated bona fide hedge exemptions but in
5 particular, as you mentioned, yes, the proposal
6 includes an enumerated bona fide hedge exemption for
7 anticipated merchandising.

8 So assuming the grain merchandiser positions
9 qualify for the enumerated hedge, then the federal
10 position limits would not apply to those enumerated
11 bona fide hedges that she uses to mitigate her risk.

12 CHAIRMAN TARBERT: Right. And at the same
13 time, you know, this has nonetheless been
14 controversial. So one of my concerns is, we don't want
15 hedge funds and banks coming in and saying, "Hey! I'm
16 merchandising."

17 I guess Mr. Brodsky, are there guardrails on
18 this so when we actually -- could you explain the
19 guardrails we put in so this sort -- this doesn't
20 become a loophole. That it actually is used for
21 legitimate merchandising.

22 MR. BRODSKY: Sure. So the proposal includes

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1 two key guardrails with respect to the anticipated
2 merchandising enumerated exemption. The first is that
3 the market participant must be engaged in the business
4 of merchandising. The position must be in connection
5 with that business and the participant must have a
6 demonstrated history of engaging in that business. And
7 as you mentioned, this is really intended to limit the
8 scope of the entities that would be eligible for this
9 particular exemption.

10 The second guardrail is a limitation to one
11 year worth of anticipated purchase or sale
12 requirements. We think this will help prevent misuse
13 of the exemption by entering into large positions
14 several years before an actual need to purchase or sell
15 the underlying commodity arises.

16 And there is a third critically important
17 guardrail which applies to this enumerated hedge, but
18 really to all. And this is that the enumerated hedges
19 included in the proposal are only self-effectuating for
20 the purposes of federal position limits. So to the
21 extent a market participant has a position that fits in
22 one of those categories, they would still have to

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1 request an exemption from the exchange and the exchange
2 would then make a circumstances determination using its
3 expertise and applying the standards established by the
4 Commission.

5 CHAIRMAN TARBERT: Great. And more
6 generally, for the new or non-legacy contracts that we
7 are adding federal position limits for the first time.
8 Or I should say, if the proposal is finalized and if
9 it's challenged, upheld, et cetera, it will be a
10 regulation for the first time. We don't -- we focus on
11 the spot months. We don't focus on the outer months.
12 But the proposal does - would require exchanges to set
13 either limits, hard limits, or accountability levels.

14 I guess, what is the check on that to make
15 sure the exchanges don't just wave their hands and not
16 actually impose limits or accountability levels? I do
17 think that's an important question.

18 MR. BRODSKY: Sure. So the first check is
19 that in order to establish or amend either of those
20 position limit or accountability levels, the exchange
21 would have to make a Part 40 filing to the Commission.
22 So the Commission and staff would have a chance to

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1 review that filing.

2 Second, the limit levels or the position
3 accountability levels would have to meet standards
4 established by the Commission. So for example, the
5 proposal includes the definition of position
6 accountability, which would require the exchange to
7 have the authority to request additional information
8 from their market participants, to require a
9 participant to cease increasing its position or even to
10 require market participant to reduce its position.

11 So, the key here is that the exchanges, even
12 though they are establishing their own levels, whether
13 it be position limits or position accountability, the
14 levels have to be in accordance with standards from the
15 Commission and would be reviewed by the Commission once
16 they are established and also any time they are
17 amended.

18 CHAIRMAN TARBERT: Great. Thank you.

19 I want to focus now on the non-enumerated
20 hedges and the process for that. And in fact, I
21 appreciate comments by both Commissioner Stump and
22 Commissioner Berkovitz, which to some extent, appear to

0069

1 at least on their face sort of conflict. I think
2 Commissioner Berkovitz has said, Look, we're playing
3 Monday morning quarterback under this rule. We are
4 having the exchanges do the first cut.

5 And then Commissioner Stump's view is maybe
6 we are doing too much. Why isn't the exchange playing
7 a bigger role?

8 So I think there is tension here from a
9 policy standpoint and then also a legal issue. So
10 first from a policy perspective. I guess, are there
11 advantages to having for non-enumerated hedges, and
12 anyone can answer this question and I really ask this
13 for the Division of Market Oversight, do you think it's
14 better or is it more helpful to have the exchanges take
15 the first cut at reviewing it and then is there a
16 benefit to then reviewing their analysis? Some people
17 have said they are closer to the market and they
18 understand it. Or are there benefits to not having
19 that, and having it go directly to us?

20 MS. CARDONA: Thank you, Mr. Chairman. So,
21 we think that there are benefits to being able to have
22 exchanges take the first cut at reviewing the non-

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1 enumerated bona fide hedging applications. We think it
2 is helpful for the Commission to be able to leverage,
3 exchange resources, and exchange expertise as they are
4 closest to the market participants and they are most
5 familiar with the particular market for which the
6 applications are being submitted.

7 So we think that there are significant
8 benefits for the Commission to be able to leverage the
9 exchange's initial take on whether a particular
10 position qualifies as a non-enumerated bona fide
11 hedging position.

12 CHAIRMAN TARBERT: Okay. And then this is
13 more of a legal issue. I guess I would ask Mr. Davis,
14 our General Counsel. Could we actually just have the
15 exchanges do the whole thing? The non-enumerated and
16 then checkup on them as we do our exams down the line?

17 MR. DAVIS: There is definitely some doubt,
18 legally, as to whether the Commission could do that.
19 We outlined that in the proposed rule. There is a
20 doctrine called the Sub-Delegation Doctrine, that is
21 enumerated in cases such as U.S. Telecom v. FCC, which
22 is a 2004 case from the DC Circuit. That case outlines

0071

1 the general notion that an agency may sub-delegate
2 authority to people within the agency but usually when
3 you delegate authority outside of the agency, you
4 usually need affirmative evidence of Congressional
5 authority to do so.

6 As we explained in the proposed rule, there
7 is some doubt as to whether such statutory authority
8 exists to grant plenary authority to the exchanges to
9 make these determinations. They can make an initial
10 determination and then bring it to us for review. The
11 authority for that is clear. But there is some doubt
12 as to whether that authority can be given wholesale to
13 the exchanges.

14 CHAIRMAN TARBERT: And so I guess the best
15 way to characterize this is we tried to fulfill our
16 legal obligations but at the same time, make use of the
17 exchanges and their expertise?

18 MR. DAVIS: Yes. Legally that is correct and
19 obviously this is a proposal so we obviously look
20 forward to any comments regarding this question.

21 CHAIRMAN TARBERT: And I want to make that
22 clear that we ask questions regarding this as the 10-

0072

1 day, two-day, what is the right length of time? So I
2 think we are open. Again, this is a proposal. We want
3 to get it right but we are balancing a couple of things
4 here.

5 Final question is also sort of the final
6 legal question, which is going back to the necessity
7 mandate. I guess, you know, sort of my view on this is
8 -- I get it. I get that we took an initial position.
9 Congress, the statute is what it is, and I get there is
10 a difference between what Congress says it will do and
11 sometimes what it actually does. What we have to do is
12 look at the law and what it says. There may be
13 differences there but my concern is, is we took the
14 earlier interpretation. We do have a traditional
15 opinion. And I guess I am guided by, in this respect,
16 by Clint Eastwood. And I'm reminded by that perennial
17 question. "You feeling lucky, punk?"

18 (Laughter.)

19 CHAIRMAN TARBERT: And so, when I look at
20 this opinion from the District Court, it says, you can
21 take -- it's ambiguous, you can take both but there is
22 language in here that says, the CFTC's interpretation

0073

1 renders other parts of Section 6a mere surplusage,
2 significantly it fails to give any meaning and full
3 effect to the very first cause of the section which
4 requires the necessity finding and my concern, just to
5 be frank, I was a law clerk on the DC Circuit for a
6 year. This District Court -- did we appeal this case?

7 MR. SCHWARTZ: We appealed and then withdrew
8 the appeal at the time we proposed the rule in 2013,
9 thinking that would be a more efficient way --

10 CHAIRMAN TARBERT: Right.

11 MR. SCHWARTZ: -- to finalize position
12 limits.

13 CHAIRMAN TARBERT: Right. One of my concerns
14 is sitting here and thinking about number 1, getting
15 position limits done and getting it done right. I
16 prefer the necessity finding because I think based
17 under this, from a legal standpoint, that
18 interpretation of the statute I think that the Court
19 didn't -- sort of reflect on that and say that is
20 impermissible to the extent they expressed concerns, it
21 was on our original reading and I'm also concerned that
22 if we go back and then we end up before the DC Circuit,

0074

1 it is entirely possible.

2 I guess, I'd like to ask both of you, both
3 Mr. Schwartz and Mr. Davis, is it possible that the DC
4 Circuit, for example, could go Chevron Step 1 and say,
5 no, we do think it's plain on its face and it cuts the
6 other way?

7 MR. SCHWARTZ: I think yes, it is possible
8 it's a risk.

9 CHAIRMAN TARBERT: Okay. So I definitely
10 understand the differences in views among its
11 Commissioners on this particular provision, but I
12 pledged to get this rule done to focus in on what
13 matters most and I guess, you know, I'm being perfectly
14 frank and honest as the chief executive of the agency,
15 is that I don't want to take on that additional legal
16 risk. That's the legal standpoint and as I mentioned
17 before, the policy goals in my view, if we have to go
18 through an extra step, I'm willing to do it.

19 With that, I will turn to Commissioner
20 Quintenz.

21 Actually, my apologies. I'm going to read
22 -- just to make sure that the rulemaking works: To

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1 formerly continue the Commission's consideration of
2 these rulemakings, I will now entertain a motion to
3 adopt the proposed rule on speculative position limits.

4 COMMISSIONER QUINTENZ: So moved.

5 COMMISSIONER BEHNAM: Second.

6 CHAIRMAN TARBERT: Thank you. Okay, so
7 Commissioner Quintenz.

8 COMMISSIONER QUINTENZ: Thank you, Mr.
9 Chairman. I think I'm going to start exactly where you
10 left off with the necessity finding. I think we are
11 all just going to agree to disagree about the
12 interpretation. But I think that is part of this
13 process and that it was validated by the District Court,
14 that it is open to interpretation. It is not clearly a
15 mandate, although I could understand that some people
16 may read it that way. That is not how I read it.

17 The language that Dodd-Frank added to Section
18 4 of the CEA specifically in paragraph two, that called
19 for the consideration of new limits on energy, metals,
20 and other physical commodities, starts off with: in
21 accordance with the standards set forth in paragraph 1.

22 Mr. Davis, a lot of the language in paragraph

0076

1 1 first appeared in the 1936 statute. Is that correct?

2 Or Mr. Schwartz.

3 MR. SCHWARTZ: Yeah, I'll field that one.

4 That is correct.

5 COMMISSIONER QUINTENZ: Okay. And at that
6 point, Congress specifically interpreted that language,
7 specifically the Commission shall from time-to-time
8 proclaim and fix such limits in the amounts of trading
9 which may be done or positions which may be held as a
10 Commission finds are necessary.

11 Congress specifically interpreted that to
12 require that position to be premised on a finding of
13 necessity. Is that correct?

14 MR. SCHWARTZ: The way I would put it is the
15 Commission did proceed to make a number of necessity
16 findings over the years and Congress has amended it
17 from time-to-time. So it's fair to say that Congress
18 did adopt that interpretation.

19 COMMISSIONER QUINTENZ: Okay, so in 1935, and
20 this is actually reading from the opinion in the case,
21 it says, "In 1935 Congress provided unambiguous
22 interpretation of the phrase, 'as the Commission finds

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1 are necessary,'" in the explanation of the bill where
2 it said, "Section 4a of the CEA gives the Commodity
3 Exchange Commission, the CEC, the precursor of our
4 agency, the power after due notice and opportunity for
5 a hearing and a finding of a burden on interstate
6 commerce caused by such speculation to fix and proclaim
7 limits on futures trading." That is from HR Report
8 74421.

9 And it goes on to say -- this is not in
10 quotes. This text clearly indicates that Congress
11 intended for the CFTC to make a "finding of burden on
12 interstate commerce caused by such speculation prior to
13 enacting position limits."

14 It seems to me there are two possible
15 scenarios here. There may be more. But either
16 Congress intended Dodd-Frank to mandate that the agency
17 have no discretion and apply position limits across all
18 physical commodities, but then wrote that language as
19 confusingly and opaquely as possible while referring
20 back to paragraph one that contains specific
21 flexibility for the Commission and a historic finding
22 of necessity.

0078

1 Or another option, is that Congress intended
2 to focus the Commission's attention on whether or not
3 to review its position limits regime and establish new
4 positions as necessary and appropriate.

5 It seems to me like the second possibility is
6 the more logical interpretation of the text that we
7 have in front of us. And the consideration that the
8 folks that wrote it made deliberate word choices.

9 I want to move on to the concept of
10 deliverable supply. I think we are all aware of the
11 debate around the effectiveness of position limits
12 generally. Mr. Schwartz you described them as
13 unambiguously having costs.

14 Some people don't believe that there is any
15 evidence that excessive speculation currently exists.
16 Others believe that large and sudden price fluctuations
17 can be caused by a number of things and it's hard to
18 determine whether or not it is excess speculation.
19 Some others believe that outside speculative positions
20 can aggravate price volatility. And then taking those
21 different views into account and the different studies
22 that have been produced, the 2013 proposal correctly

0079

1 stated that there is a demonstrable lack of consensus
2 in the academic studies as to the effectiveness of
3 position limits.

4 I think if you combine that concept in terms
5 of the skepticism of when and how they work, especially
6 if they were to exist in a mandated form along with the
7 language that Dodd-Frank did add to the statute, which
8 adds the provisions that Commissioner Stump mentioned,
9 that are in tension with each other, that create a
10 mandated focus that position limits be applied on
11 liquidity, on price discovery and on preventing corners
12 and squeezes; it seems to me there is a confluence of
13 all of those things in terms of where position limits
14 could have the most benefit, because they automatically
15 impose costs, and where we can satisfy the balance of
16 all of those tensions, is in the spot month of
17 physically-delivered contracts to protect the integrity
18 of the delivery process and promote convergence between
19 cash and futures contracts.

20 So for the Division of Market Oversight. Let
21 me ask quickly, why do you believe that deliverable
22 supply is the best source for calibrating a position

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1 limit in the spot month?

2 MR. BENTON: Thank you Commissioner.

3 Deliverable supplies long have been used by the
4 Commission in trying to determine what an appropriate
5 spot month limit is or should be. It's the first step.
6 You get the idea of how much of a commodity is located
7 at the delivery points, specified by the contract at
8 quantities that the contract specifies.

9 In the absence of other factors, 25 percent
10 level -- it would be difficult for a market participant
11 to corner or squeeze a market when it doesn't hold more
12 than 25 percent of the limit.

13 We've had comments in the past where it
14 should be higher, it should be lower. But no one has
15 been able to give us an actual scientific measure as to
16 what would be more appropriate.

17 COMMISSIONER QUINTENZ: But that concept, 25
18 percent of deliverables supply, relates directly to the
19 idea of preventing corners and squeezes --

20 MR. BENTON: Yes.

21 COMMISSIONER QUINTENZ: -- which is in the
22 statute.

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1 MR. BENTON: Yes.

2 COMMISSIONER QUINTENZ: Could someone --
3 Harry and I talked about this. I don't know who the
4 best person to answer it is.

5 How are deliverable supply numbers
6 calculated? It's not just putting your finger in the
7 air. There is a deliberate process for doing this with
8 a lot of adjustments and --

9 MR. BENTON: I can take that sir.

10 COMMISSIONER QUINTENZ: Great.

11 MR. BENTON: Effectively what we have done in
12 the past is the contracts, when it's certified these
13 days or in old days, when it had to come in to be
14 approved to be listed before it could be listed for
15 trading, the exchanges would provide background on the
16 underlying market, including deliverable supply
17 estimates for the underlying commodity.

18 Again, locations as specified in the
19 contract, quantities as specified in the contract, and
20 would propose a spot month limit level. Sometimes that
21 level was at 25 percent of estimated deliverable
22 supply. Many times it would be less, based on the

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1 exchanges recommended --and expertise recommendation
2 from their expertise.

3 COMMISSIONER QUINTENZ: Steven, I wasn't
4 necessarily talking about how the position limits
5 themselves are calibrated. I was trying to get to the
6 estimates of deliverable supply themselves.

7 For instance, the contracts list a number of
8 delivery locations and there has to be some concept of
9 what can be delivered to those delivery locations. So
10 it's not the case that all oil produced in the United
11 States is deliverable supply.

12 MR. BENTON: Correct. It has to be -- the
13 commodity that is available at the location specified
14 in the contract.

15 COMMISSIONER QUINTENZ: And that can
16 fluctuate over time?

17 MR. BENTON: Yes. And exchanges have the
18 liberty to expand the number of locations that delivery
19 can take place as well and as it happens over time.

20 COMMISSIONER QUINTENZ: And for the purposes
21 of federally set spot month limits, when was the last
22 time we updated our deliverable supply numbers?

0083

1 MR. BENTON: To my knowledge the last time we
2 did this was back in 1999.

3 COMMISSIONER QUINTENZ: Okay, 20 years?

4 MR. BENTON: Yes.

5 COMMISSIONER QUINTENZ: So would it be fair
6 to say there has been some changes in deliverable
7 supply since then?

8 MR. BENTON: Yes, sir.

9 COMMISSIONER QUINTENZ: And would you mind
10 giving me an example or two of a contract that has seen
11 some type of change?

12 MR. BENTON: Sure. I do not have access to
13 what the deliverable supplies were for 1999 but I can
14 tell you from 2016 when we last did this approach.
15 Corn, in particular, went from -- and these are in
16 number of contracts to try to keep it simple rather
17 than in number of bushels or pounds or bails or
18 whatever.

19 Deliverable supply was estimated to be
20 roughly 3,324 contracts back in 2016. Since that time,
21 CBOT added the delivery points for the corn contracts
22 and as well as increases in the actual corn supply.

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1 That grew nearly estimated deliverables by up to 13,020
2 contracts. Again for wheat, 2016, we had 9,422
3 contracts estimated deliverable supply. In 2018, it
4 was 12,990. No additional locations added for that
5 contract.

6 So there is a natural growth to the commodity
7 over time. Efficiencies that come from growing the
8 underlying commodity and harvesting. COMMISSIONER

9 QUINTENZ: Okay, thank you.

10 MR. BENTON: Sure.

11 COMMISSIONER QUINTENZ: Maybe this would be
12 another good question for you but anyone else feel free
13 to answer.

14 Could you give an example of a company that
15 would need to hedge more than some of these numbers in
16 terms of deliverable supply? I mean, it would seem to
17 me like there are national and international companies
18 that could hedge a large amount of their production
19 using some of these major contracts but yet the
20 deliverable supply for these major contracts isn't
21 anywhere near the size that they may need to hedge.

22 MR. BENTON: Yes, sir. A good example would

0085

1 be an oil company with global resources where they're
2 obtaining the actual commodity all around the world and
3 having the ability to hedge the processing of that oil
4 once they've brought it into refineries. Justifying
5 them having positions above a speculative position
6 because of the bona fide necessity of obtaining large
7 amounts of the oil, refining it and then selling it in
8 it's refined products would justify them having a limit
9 above the spot month, federal spot month limit.

10 COMMISSIONER QUINTENZ: Thank you very much.

11 I'd like to move on to the enumerated hedges
12 and how the proposal has expanded some flexibility
13 there, specifically for un-sold anticipated production
14 and offsetting on fixed price cash commodity sales and
15 purchases. Could someone explain to me how we have
16 increased flexibility there over prior proposals?

17 MS. CARDONA: Certainly. So in regards to
18 the three particular enumerated hedges that you are
19 mentioning, I think the proposals we are -- excuse me,
20 the amendments we are proposing to those existing
21 enumerated hedges really get at the fact that there are
22 unique characteristics of running a physical commodity

0086

1 business so taking the first hedge that you mentioned,
2 hedges of unsold anticipated production, this proposal
3 -- under the existing rules, a market participant
4 limited to hedging only 12 months of the anticipated
5 production. And this proposal would remove --
6 eliminate that limit -- that 12 month limitation.

7 And then in regards to hedges for offsetting
8 unfixed price cash commodity sales and purchases, the
9 proposal would allow a commercial enterprise to enter
10 into derivatives to reduce the risks that arise from
11 either -- or both, location differentials or time
12 differentials, which is common in the commodity
13 business, what we were just discussing. The location
14 of a commodity is sort of a unique characteristics to
15 our markets and it makes an impact on pricing and
16 other aspects that inform running a physical commodity
17 business.

18 And then finally, in the enumerated cross
19 commodity hedge, the proposal would allow that a cross
20 commodity hedge could be used in conjunction with other
21 enumerated hedges. So for example, you would use the
22 unsold anticipated production hedge or the pass-through

0087

1 slot provisions to exceed the limits of a certain
2 commodity. So say, coffee. In order to hedge the
3 exposure that you are facing in another commodity for
4 which there might not be a futures contract available.
5 So say, tea.

6 One thing that is important in this
7 particular cross commodity hedge is that we do require
8 -- would require for these two commodities that are
9 part of the cross commodity hedge to be substantially
10 related. And that really would achieve the derivative
11 position and the cash market position that are sort of
12 offsetting in that cross commodity hedge would be
13 different commodities but they would still have to have
14 a reasonable commercial relationship.

15 So you sort of can't hedge a particular
16 physical commodity with a very unrelated financial
17 contract that does not have a reasonable commercial
18 relationship.

19 COMMISSIONER QUINTENZ: And I think it's an
20 important point that we kind of reiterated a principle
21 approach to that. Because I recall in the 2013
22 proposal, the quantitative test that was proposed where

0088

1 you could only qualify for a cross commodity hedge if
2 the spot prices had an 8.8 percent correlation or
3 higher over a period of 36 months, which would have
4 eliminated longstanding hedging practices in the energy
5 market to hedge electricity prices, for instance, with
6 nat gas.

7 So I'm really pleased that we didn't adopt
8 that arbitrary and ill-informed policy. And feel free
9 to agree with those interpretations -- but that we went
10 beyond that and created, I think, good policy by
11 expanding the applicability of that hedge.

12 Quickly I'd like to just touch on the
13 exchange adjudication of bona fide hedges and their own
14 limits in the 5-day rule. This may be best asked to
15 Dorothy or to Vince. But does DMO believe that
16 futures exchanges are incentivized to set position
17 limits and grant hedge exemptions in a manner that
18 prevents corners and squeezes on their markets?

19 MR. MCGONAGLE: That's right, Commissioner.

20 COMMISSIONER QUINTENZ: Does DMO believe that
21 futures exchanges aren't incentivized to adjudicate
22 holding bona fide hedges into the spot month to prevent

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1 corners and squeezes?

2 MR. MCGONAGLE: That's right, Commissioner.

3 Although there is a proposal or there is a discussion
4 around the application of the 5-day rule that we could
5 talk about.

6

7 COMMISSIONER QUINTENZ: It seems to me that
8 exchanges, while trying to balance creating liquidity,
9 have an interest in maintaining markets that have
10 integrity and I don't think any of them wants to see
11 corners and squeezes occur in their marketplaces. And
12 I think a lot of the flexibility that is in this
13 proposal that allows them to adjudicate these processes
14 reflect directly on their interests in preventing those
15 corners and squeezes from occurring. Do I have that
16 right?

17 MR. MCGONAGLE: That's completely accurate.
18 The exchanges are self-regulatory organizations. They
19 have obligations with respect to ensuring integrity and
20 the ability of the exchange to follow the rules that it
21 sets as well as the obligation to comply with the
22 Commodity Exchange Act and the regulations including

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1 the bona fide hedge provisions that we discussed
2 earlier.

3 COMMISSIONER QUINTENZ: Thank you. And just
4 one last point on the non-enumerated hedge review
5 process.

6 It's my understanding that during the time
7 period of 10-days following the exchanges approval of a
8 non-enumerated bona fide hedge, that the market
9 participant can use that conditional approval to take a
10 position and should the Commission subsequently vote to
11 revoke that approval, there is a commercially-
12 reasonable amount of time to get out of that, and the
13 market participant will not be held liable for
14 violating position limits? Is that correct?

15 MS. CURTIS: Thank you Commissioner. So
16 under the proposal, we would require that the market
17 participant wait until the Commission, until the 10-day
18 review period has lapsed and after that 10-day review
19 period, the market participant could rely on the non-
20 enumerated bona fide hedge for the purposes of
21 exceeding federal position limits.

22 COMMISSIONER QUINTENZ: Okay, so can you

0091

1 describe to me when the hold harmless provision in the
2 proposal applies?

3 MS. CURTIS: Correct. So if there is a
4 sudden or unforeseen need in the market participant's
5 bona fide hedging needs and they need to exceed federal
6 position limits prior to actually receiving approval,
7 then this proposal would allow the market participant
8 to do that, so long as they submit an application
9 within five days of exceeding federal position limits.

10 COMMISSIONER QUINTENZ: Great. Thank you.
11 Thank you Mr. Chairman. And thank you to all the staff
12 for your hard work in answering all these detailed
13 questions and your engagement.

14 CHAIRMAN TARBERT: Thank you very much.
15 Commissioner Behnam.

16 COMMISSIONER BEHNAM: Thanks, Mr. Chairman.
17 I want to focus on -- a big-picture question first. A
18 lot of conversation about corners and squeezes. A lot
19 of conversation about legal interpretation, which there
20 are a lot of very, very smart lawyers both at the table
21 and in this room who have been puzzled by the statutory
22 language for a number of years. But to the extent when

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1 we parse words too much I think we end up going down
2 rabbit holes in trying to figure out what Congress
3 intended. But in many ways, if you think about where
4 the act was prior to 2010 and then the inclusion of the
5 word "shall," and what we have done historically,
6 coupled with -- and I'll lay out this point and I'd
7 like to have a little bit of discussion about it.

8 Commissioner Berkovitz mentioned earlier in
9 the opening about what really led up to the amendments
10 to this statute and it was the sort of price bubble
11 that we experienced in 2008, the price of oil hitting
12 \$145 and other commodities at all-time highs. And
13 excessive speculation is in the statute. And I'd like
14 to understand from an exchange perspective, how do we
15 marry the responsibility to prevent corners and
16 squeezes with what in my mind, was the core primary
17 responsibility that was laid out by Congress to this
18 agency about preventing excessive speculation?

19 And granted, in the statute we also have the
20 responsibility to prevent corners and squeezes but as
21 I'll talk about this a little bit later with our
22 deference to the exchanges, are we confident that given

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1 historically what the exchanges are responsible for and
2 what their mandate is and what their incentives are and
3 what they do best, that they are going to be able to
4 prevent -- given our sort of taking a step back,
5 excessive speculation and what Congress intentionally
6 asked us to do.

7 I don't know who -- that might be for you,
8 Vince.

9 MR. MCGONAGLE: Thank you Commissioner.

10 You know, looking at the term of the statute
11 and you're right. The Commission itself takes on a
12 discretionary evaluation in looking at the
13 determination for either putting in trading levels,
14 which we went away from years ago, or making
15 determinations about the level of position limits, the
16 things that Commission -- in its discretion are
17 required to consider, is whether the activity to the
18 maximum extent possible is helping prevent against
19 unwarranted or unnecessary speculation which could
20 result in sudden or inappropriate price changes,
21 corners and squeezes, and at the same time, also
22 considering that we have market participants that need

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1 to access and utilize liquidity in our markets as well
2 as certain market participants, particularly hedgers,
3 who also need to be able to also for risk management
4 purposes or other reasons, to execute the transactions
5 and use the markets for the way that its intended.

6 So you know, we look at the discretion of the
7 Commission and we look to evaluate, all right, so what
8 is appropriate? Where can we and where do we set the
9 standards? And so, in the Agricultural Legacy 9, of
10 course, we do have position limits that are set and
11 established in the spot and non-spot month limits.
12 We're not walking into a clean page with respect to the
13 energy products, the metal products, and then the
14 agricultural commodities that are not otherwise subject
15 to the federal position limits.

16 So, I think the proposal, in the first
17 instance, this is recognizing the real-world scenario
18 that we're in, which is the markets are already
19 reacting to and trading in a way that is consistent
20 with the exchange imposed limits and accountability
21 levels. But we recognize, and I think we have
22 recognized consistently over time, particularly as it

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1 relates to corners and squeezes, which is different
2 than the excessive speculation point, but corners and
3 squeezes and in particular where you're looking at
4 activity that may be concentrated in strong hands that
5 can effect the price significantly in the spot month
6 that concern around potential price manipulation in the
7 spot month would be an appropriate place or a
8 reasonable place for the Commission to apply a position
9 limit standard.

10 And then in the course of the time, consider
11 or reconsider, whether it is appropriate to adjust the
12 levels or limits with respect to any of the commodities
13 that have been determined as OGC articulated before as
14 being -- having a necessity component whereas limits
15 would need to be implemented also making that
16 determination as to whether those commodities that
17 don't currently have a federal limit in the non-spot
18 month, should be evaluated and it should be changed.

19 COMMISSIONER BEHNAM: Thanks. And I
20 appreciate that. And I guess one thing that is good to
21 hear is that we are going to be, at least my take from
22 your statement, is that we are going to be actively

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1 monitoring whatever rule is finalized, hopefully sooner
2 than later, but not considering the proposal of a
3 static interpretation of what's necessary or not
4 necessary.

5 Because I do think as we have all
6 experienced, even since 2010, the markets have all grown
7 rapidly much faster than we can keep up with, and given
8 the role of speculators in the market, the reason that
9 we're here today and the differences in my mind between
10 preventing and monitoring excessive speculation and
11 preventing the sort of age-old responsibility of this
12 agency and the exchanges regarding corners and
13 squeezes. We have to be vigilant and make sure that at
14 the very least, regardless of how you interpret the
15 statute, the mandate, the "shall" or the "time-to-time",
16 that we are focusing very specifically on excessive
17 speculation in making sure that we are doing what we
18 need to do as an agency and working with the exchanges.

19 I want to pivot to a little bit of a related
20 issue, it's a reference to 4a(a)(6) and aggregate
21 position limits. And without belaboring the topic of
22 the spot versus non-spot month limits, which as the

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1 team has articulated for those who are listening, that
2 the proposal does not require the CFTC to set non-spot
3 month limits on the 25 contracts. The exchanges will
4 either set limits or accountability levels.

5 Reading 4a(a)(6), and the aggregate position
6 limits, and I'll try to articulate this in a very
7 generic way so that folks understand, in the post-Dodd-Frank
8 world where this agency is overseeing swaps, you're
9 going to have a reference contract, which Steven, you
10 spoke about extensively.

11 If we are not overseeing non-spot month
12 contracts and relying on the exchanges to do that,
13 based on our legal interpretation and our necessity
14 finding, how are we going to be able to fulfill the
15 mandate of having this macro view of a participant's
16 positions and holdings and how the entire position
17 could potentially affect the market and how it relates
18 to excessive speculation and corners and squeezes.

19 We have multiple exchanges. We as an agency,
20 as a regulator like our sister agencies across this
21 city, have a unique perspective of being able to
22 collect data, analyze data, and inform the market of

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1 what we are seeing through surveillance and enforcement
2 or otherwise. An individual DCM is not going to be
3 able to analyze a participant or a client's position
4 across exchanges or arguably across products as well as
5 we are. And I'm a little worried and I would welcome
6 this response and engage here.

7 How are we going to circle the 4a(a)(6)
8 aggregate position limit requirements when we are
9 abdicating our responsibilities in the non-spot month
10 contracts?

11 MR. HAIDAR: Thank you, Mr. Commissioner.
12 Just to be clear, is your question focusing on swaps
13 specifically or contracts in general?

14 COMMISSIONER BEHNAM: Well, help me
15 understand that better and -- I think writ large, there
16 are going to be economically-equivalent swaps that have
17 futures reference, contracts.

18 So I think one element of the question should
19 certainly focus on both swaps and futures but to the
20 extent that you have, you want to focus on futures
21 only. That's fine. I don't think this question needs
22 to be answered with specificity. It's a larger policy

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1 question I'm concerned about of how we are going to
2 aggregate positions when we are not looking at the
3 curve and only focusing on spot month contracts and
4 relying on the exchanges who don't have access to this
5 information.

6 MR. HAIDAR: Sure, and thank you for that
7 question.

8 So the reason I asked to distinguish swaps
9 specifically is because I think you raised a good
10 point. The exchanges do not necessarily have the
11 aggregate swap's data as we know the swaps market
12 traditionally has been OTC and therefore selecting more
13 opaque than the exchange traded futures. And so, we
14 make that point in the preamble and we do explicitly
15 make clear that to the extent we're implementing
16 position limits on economically-equivalent swaps, we
17 recognize that exchanges don't have that aggregate
18 swaps data and therefore the impetus is on the
19 Commission -- the onus is on the Commission. We're not
20 expecting exchanges to be looking at swaps because as
21 you said, they don't necessarily have that data.

22 And I think ever since the enactment of Dodd-

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1 Frank, the Commission -- specifically, OTC swap data,
2 has been getting better and better. And every day and
3 every year, the Commission's insight into the swaps
4 markets gets better.

5 But until that point where we can come up
6 with a system where exchanges can have access to that
7 aggregate swaps data, they will not be -- they're not
8 expected to be looking at aggregate swaps data. That
9 will be -- the onus will be on the Commission.

10 COMMISSIONER BEHNAM: Thanks Steven.

11 MS. CARDONA: Commissioner Behnam, if I could
12 just quickly follow-up on that point. Just something,
13 I guess, a point to think about in terms of the current
14 world reality is, we do not impose federal limits on 16
15 of the commodities that today we are proposing.

16 So today, there are no non-spot federal
17 requirements in our surveillance unit within the
18 Division of Enforcement, does have oversight over that
19 trading activity. To some degree, that would still
20 continue to be the real-world experience. In the
21 macro-view.

22 COMMISSIONER BEHNAM: I appreciate that. And

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1 recognize the hard work of both our Surveillance folks
2 and the Enforcement Division. But nevertheless, we are
3 now 10 years past the law being passed and we need to
4 implement this rule. And our interpretations will
5 differ, but as far as I'm concerned, and I want to move
6 past this question, but it's fairly clear in the
7 statute recognizing the requirement to aggregate limits
8 to look at not only the spot month but each month
9 across DCMs and I raise concern with the way we are
10 proposing this rule and what the statute says.

11 Moving on. I want to talk a little bit about
12 the hedge exemptions. I think Jeanette, you might be
13 the person to answer these questions.

14 Both, first on the enumerated side and the
15 non-enumerated side. I think it's pretty clear at this
16 point that the bucket of enumerated hedges is growing.
17 Just as a matter of context, I know that number of
18 hedges has been identified but can you actually tell us
19 and the audience how many new hedges are being included
20 in the enumerated bucket?

21 MS. CURTIS: So there would be five
22 additional enumerated hedges included in this proposal.

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1 COMMISSIONER BEHNAM: And as we've decided
2 and I think this is the number one responsibility of
3 the agency, this has been a back-and-forth with our
4 market participants and sort of as the market adapts,
5 this is what they are telling us the markets evolving,
6 the way the hedge is evolving and this is what they
7 need and what we should be sort of considering.

8 Are these hedges very black and white? And I
9 want to pivot to the self-effectuating process. And
10 ultimately, I'm going to get to a few questions and if
11 you just want to get ahead of me, that's fine. But I'd
12 like to learn more about, now that we are going to have
13 a larger bucket of self-effectuated and enumerated
14 hedges and you mentioned as a matter of streamlining,
15 what role are we going to play? What data or
16 information is the CFTC going to receive?

17 And as a matter of market integrity and
18 discipline and us performing our responsibilities, by
19 both increasing the number of enumerateds and allowing
20 the self-effectuating system to run on its own without
21 our interference, do we run the risk as a regulator,
22 through surveillance or enforcement or otherwise, not

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1 being able to monitor the market as we should?

2 MS. CURTIS: Understood. Thank you,
3 Commissioner.

4 So first I would like to point out that
5 currently under our existing regulations, we have this
6 approach or construct where certain enumerated bona
7 fide hedges are self-effectuating. So just because an
8 enumerated hedge is self-effectuating which means the
9 Commission said we've determined this is a bona fide
10 hedge. Just because it is self-effectuating doesn't
11 mean the Commission is not looking at what exchanges
12 are doing or looking at what positions are out there.

13 So under our proposed Section 150.5, we would
14 be requiring exchanges to file a monthly report with
15 the Commission that outlines all of the exemptions that
16 they are granting each month, whether the exemptions
17 are for non-enumerated bona fide hedges, enumerated
18 bona fide hedges, spread exemptions. So the Commission
19 will be getting a month-to-month look at what exchanges
20 are granting.

21 And so, that would effectively give us some
22 resources to at least start asking questions if, for

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1 example, the Surveillance team sees a very large
2 position in the market. They could turn to that
3 monthly report but then separately, the Surveillance
4 team, as it always has had, has authority to go to
5 traders or go to exchanges and ask questions about what
6 is going on.

7 So the process of having enumerated hedges be
8 self-effectuating, even though that list of commodities
9 is expanding and the list of enumerated hedges is
10 expanding has not necessarily diminished the
11 Commission's responsibility to surveil the market.

12 COMMISSIONER BEHNAM: Thanks. So let's talk
13 about Form 204. And I think you mentioned in your
14 presentation, we are -- at least through the proposal
15 getting rid of Form 204.

16 Anything specific that is worth noting why
17 204 was -- is the proposal and the policy idea a matter
18 of pure efficiency or did the market tell us this is
19 onerous, unnecessary, and not helpful?

20 MS. CURTIS: Well, I think over the years of
21 experience of us receiving the Form 204, and also as a
22 part of us talking to market participants in

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1 preparation for this proposal and all the past
2 proposals, what we have realized is that the Form 204
3 is fairly duplicative of the data that exchanges
4 receive directly from market participants when the
5 market participant is applying to the exchange for the
6 purposes of exemptions from the exchange set limits.

7 So in order to create better efficiency
8 within the application processes, and lessen the burden
9 from market participants in that regard, the Commission
10 or the staff has decided that we would have access to
11 sufficient cash market data via the information that
12 exchanges collect directly from the market
13 participants.

14 COMMISSIONER BEHNAM: Thanks.

15 MR. MCGONAGLE: Can I -- just to follow on
16 for a second. To think about the surveillance approach
17 without giving away surveillance processes. But
18 certainly, if there is a trader that is identified in
19 the market that we're interested at -- for whatever
20 variety of reasons; the size, position, and the manner
21 in which they are trading, surveillance might typically
22 look to see whether that trader has an exemption and

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1 whether they are otherwise entitled to an exemption or
2 if they're making a determination about whether they
3 should receive an exemption.

4 So looking at the 204, something that's in-
5 house, sort of furthers the surveillance mission to
6 just get an understanding about potentially who
7 that trader is. So that information now to the extent
8 that market participants are seeking a hedge and it's
9 going to be self-effectuating or otherwise, the
10 exchanges will be sending in a report on a monthly
11 basis. So we're going to be getting the information
12 that we need for the surveillance perspective in order
13 to do the job without potentially having the traders
14 just send in additional papers.

15 But I think there are questions about this.
16 Certainly to the extent that the market wants to
17 comment on the utility or interest in continuing to
18 submit information to the Commission, we definitely
19 want to hear that.

20 COMMISSIONER BEHNAM: Thanks Vince. I
21 appreciate that and I've articulated and advocated for
22 years now about engaging with the market and ensuring

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1 efficiency and making sure we are doing our jobs as
2 best we can with the goal of, obviously, transparent
3 safe markets and protecting customers. But I caution
4 against moving maybe too quickly without really
5 evaluating what the outcome is.

6 And appreciating that we should always be
7 working towards a better system as we relate to the our
8 regulated entities and other individuals or
9 institutions. I look forward depending on where this
10 rule goes, certainly to see how this plays out and it's
11 something that I'm concerned about.

12 Quickly, my time is running out here. But I
13 do want to quickly flip to the non-enumerateds and I
14 know my colleagues have talked a little bit about this
15 10-day, two-day process. I guess my biggest -- you
16 know, there's the primary concern of the role that we
17 are going to play as the primary regulator vis-à-vis
18 the exchange. And making this assumption where the
19 exchange plays the primary role or sort of arbiter of
20 the non-enumerated hedge requests.

21 How -- I'm going to focus on this one phrase
22 -- full Commission action under this 10-day rule. So

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1 for those of you in the audience, if you're a
2 commercial end-user, you have a hedge request, you go
3 to the exchange and request hedge exemption and at that
4 point, we, the agency, has 10 days to essentially
5 review it upon Commission action.

6 Now, I'm going to take a quick step back. I
7 would love to know what market participants are
8 going to choose to go to us versus the exchange? I
9 know there is a binary path of you can either go to the
10 CFTC or the exchange for your exemptions and I
11 appreciate optionality in this case, but I find it hard
12 to believe that a market participant is going to choose
13 to go to the CFTC before they go to the exchange. But that's
14 a separate concern.

15 Given the challenge of Commission action and
16 many of you may not know this, there is a lot of hard
17 work that has to go through OCE, OGC, to put into documents
18 before the Commission to consider them. And I'm a little
19 puzzled as to how we are going to be able to step in as a
20 primary regulator within 10 days and make a full
21 Commission action on matters of significant importance
22 in my mind, related to hedge exemptions and

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1 participants using hedge exemptions and whether or not
2 they will breakthrough a limit.

3 MS. CURTIS: So, we think the goal of this
4 proposal and this particularly new streamlined process
5 was to really balance the need for bona fide hedgers to
6 quickly receive an answer or approval or response with
7 respect to their bona fide hedging needs, balancing
8 that with the need for the Commission to have an
9 opportunity to review or verify and object to, if
10 necessary, grants of non-enumerated bona fide hedges.
11 But your point is well taken and we certainly look
12 forward to comments on this particular topic.

13 COMMISSIONER BEHNAM: Thank you, Jeanette.
14 And I appreciate all the answers and the team for all
15 your work. Thanks, Mr. Chairman.

16 CHAIRMAN TARBERT: Thank you very much
17 Commissioner Behnam. Commissioner Stump.

18 COMMISSIONER STUMP: Well, the benefit to all
19 of you is that because all my colleagues asked such
20 remarkable questions, you won't have to listen to me
21 talk for the entire time.

22 So, I just want to drill down a little bit on

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1 this idea of how we are going -- the process by which
2 non-enumerated hedge exemptions will be granted,
3 because we may have confused folks. Not because what
4 we are saying is confused or what the proposal is going
5 to state is confusing but because we have had historic
6 processes for the nine legacy Ag contracts. There have
7 been many other proposals that have presented a
8 different way of doing this.

9 So I just kind of want to walk through all of
10 that and you can correct me when I get it wrong.

11 So with regard to the nine Ag legacy
12 contracts, we have a process under Rule 1.47 that has been
13 established. If the exchanges cannot find a reason to
14 grant an exemption based upon those things enumerated
15 in the regulation, then they send the person who
16 applied for the hedge exemption to the Commission.
17 That's how it works for the nine Ag contracts
18 today. They say have you to go to the Commission and
19 ask for permission for that sort of a hedge exemption
20 to be granted because it's not enumerated. And the
21 exchange therefore cannot grant it.

22 Is that accurate?

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1 MS. CURTIS: That's correct.

2 COMMISSIONER STUMP: So under 1.47, there is
3 quite an extensive process already in place. So I'm
4 going to make an assumption that prior Commissions when
5 faced with expanding the list of contracts that are
6 going to be subject to limits, well beyond nine, to 25
7 or 28 in some cases, determines that that process
8 perhaps, given that there were less enumerated -- there
9 were many things that were requested to be enumerated
10 that the Commission had not made a determination on.
11 So there are going to be a number of things in the
12 energy and metals space that were not enumerated so there
13 were going to be a lot of folks coming to us to apply
14 for a non-enumerated hedge exemption under the 1.47
15 process. And that was going to be extremely
16 complicated.

17 So in at least one of the prior proposals,
18 there was the notion that the exchanges could make a
19 determination relative to non-enumerated hedge
20 exemptions that was contemplated and, in fact, proposed and
21 the Commission, -- the non-enumerated hedge exemption
22 would have taken effect. There would not have been a

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1 10-day waiting period but the Commission could have
2 retroactively reviewed those on a case-by-case basis.

3 Is that accurate?

4 MS. CURTIS: That's correct.

5 COMMISSIONER STUMP: So today, we're walking
6 back from that a bit to say that,
7 you're going to need to wait 10-days while the
8 Commission takes a look at these things that are not
9 enumerated. But at the same time, we are putting a
10 number of other things into the enumerated bucket such
11 that we hope the universe of things that require
12 Commission review in 10-days is narrower.

13 So just to level-set that's where we've been
14 and that's where we are going. That's why it might
15 have been confusing to hear all of us talk about
16 different views on this.

17 My concern remains that I think many people
18 have identified some operational challenges with this
19 particular approach and I, like the General Counsel, am
20 anxious to hear the comments relative to our delegation
21 authority and what we are -- what the public thinks we
22 are able to do legally.

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1 But drilling down even further, there was
2 this conversation about when traders encounter sudden
3 or unforeseen increases in their bona fide hedging
4 needs -- and I just want to talk a little bit more
5 about that so the public has an understanding of how
6 that plays into this process.

7 So if that happens and someone exceeds their
8 limit, they have five days after they exceed the limit
9 to notify the exchange and to notify us. And then, the
10 exchange can determine if they believe it is a bona fide
11 hedging transaction and let us know. And at that
12 point, we have two days to review it.

13 Is that accurate?

14 MS. CURTIS: Yes. I would just clarify one
15 detail. If someone determines that they have increased
16 needs in their bona fide hedging needs and it's
17 suddenly or unforeseen, the market participant would
18 apply to the exchange under the streamlined process and
19 then when the exchange makes a determination, the
20 exchange would notify both the market participant and
21 the Commission simultaneously. And then --

22 COMMISSIONER STUMP: Exactly, two days.

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1 MS. CURTIS: And we have two days.

2 COMMISSIONER STUMP: Two days.

3 And if we make a determination or say that
4 the exchange makes a determination and that it's not bona
5 fide, the legal vulnerability, that that market
6 participant faces is?

7 MS. CURTIS: Basically the market participant
8 would be required to lower their position and bring it
9 back into compliance within a commercially-reasonable
10 amount of time. They would not be open to an
11 enforcement action by the Commission in those
12 situations.

13 COMMISSIONER STUMP: So where
14 the exchange finds it to be legitimate bona fide
15 hedging and then we find it not to be, the market
16 participant doesn't have a legal vulnerability so long
17 as they are able to reduce the position within a
18 commercially reasonable amount of time?

19 MS. CURTIS: That's correct. And this is
20 also assuming that the market participant submitted
21 this application in good faith and that they have a
22 legitimate reason for requesting it and can demonstrate

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1 there were legitimate unforeseen increases in their
2 bona fide hedging needs.

3 COMMISSIONER STUMP: And who determines what a
4 commercially-reasonable amount of time is?

5 MS. CURTIS: So the proposal sets forth that
6 the Commission would make the determination. However
7 the Commission would make that determination in
8 consultation with both the market participant and the
9 relevant exchange.

10 COMMISSIONER STUMP: Thank you. I just have
11 one other question and it's related to the enumerated
12 hedge exemptions. And it's really more informational
13 for the public because I don't think it has been
14 discussed yet, that we are moving the list of
15 enumerated bona fide hedge exemptions in this proposal,
16 which currently exists inside of Rule 1.3(z). We are
17 moving them to an appendix.

18 And I would just like for you all to discuss
19 if moving these exemptions makes them any less binding
20 or applicable or enforceable. So long as they are part
21 of the rule and the appendix, it's my understanding
22 they can be relied upon, just as they would if they

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1 were spelled out inside the text of the rule as they
2 are today.

3 Is that accurate?

4 MS. CURTIS: That's correct.

5 COMMISSIONER STUMP: Thanks. That's all I
6 have.

7 CHAIRMAN TARBERT: Thank you very much
8 Commissioner Stump. Commissioner Berkovitz?

9 COMMISSIONER BERKOVITZ: Thank you Mr.
10 Chairman.

11 I'd like to clarify my understanding of the
12 current position with respect to the 2012 court
13 decision. The decision held that it was ambiguous
14 whether there was a mandate.

15 I'm reading the District Court's -- quoting
16 the Commission's statement in the Federal Register, and
17 I guess the final rulemaking.

18 "Congress did not give Commission a choice.
19 Congress directed the Commission to impose position
20 limits and do so expeditiously." And the 2012 decision
21 basically says that the Commission said that in that

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1 litigation we argued that that was an unambiguous
2 mandate and the court said, no, you're wrong. It's
3 ambiguous whether in fact there was a mandate to impose
4 position limits and to do so expeditiously.

5 Is that essentially correct?

6 MR. SCHWARTZ: Yes.

7 COMMISSIONER BERKOVITZ: So -- and today if I
8 understand correctly -- your position is based on this
9 decision, we have the obligation to interpret the
10 statute? Correct? According to our expertise and
11 knowledge?

12 MR. SCHWARTZ: Correct.

13 COMMISSIONER BERKOVITZ: And that policy -- I
14 think you stated in your earlier presentation that
15 policy objectives can play into that interpretation?

16 MR. SCHWARTZ: Under Chevron, yes.

17 COMMISSIONER BERKOVITZ: So the
18 interpretation advanced today in the proposal is not
19 something that you believe is fixed in stone or this is
20 the only way the statute can be read? That it can be
21 read different ways. There may be other reasonable
22 interpretations and it's up to the Commission to adopt

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1 one of those, the interpretation that it feels is best.

2 MR. SCHWARTZ: Correct.

3 COMMISSIONER BERKOVITZ: Okay. So I will be
4 in the course of this offering an alternative
5 interpretation. If there is an alternative
6 interpretation that meets the Chairman's criteria of
7 getting this rule done expeditiously and insulating it
8 from judicial review and enables us to accomplish
9 objectives, including some of the ones you outlined,
10 like considering the costs in terms of how these
11 position limits are developed, that could be an
12 alternative approach.

13 MR. SCHWARTZ: Legally there is no obstacle.

14 COMMISSIONER BERKOVITZ: One of those things
15 you said that was motivating or a rationale behind the
16 interpretation that's in the document today, is to
17 enable the Commission to consider the impacts and the
18 costs and the benefits of the actual limits that are
19 imposed.

20 MR. SCHWARTZ: Correct.

21 COMMISSIONER BERKOVITZ: So I'll be offering,
22 and I have some questions, but I'll be offering an

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1 interpretation rather than putting all that in a
2 predicate necessity finding and contradicting 80 years
3 of experience, I believe we can get to the same place
4 by having all those considerations, instead of the
5 predicate necessity finding, come into as appropriate
6 finding, basically.

7 And I'll get there. I just want to
8 understand certain things about the interpretation
9 before we go forward.

10 Specifically, the 1981 interpretation that
11 the capacity of any -- in 1981, the Commission
12 concluded it could impose position limits
13 prophylactically without a predicate finding of
14 necessity, because "it appears the capacity of any
15 contract market to absorb the establishment and
16 liquidation of large speculative positions in an
17 orderly manner is related to the relative size of such
18 positions, i.e., the capacity of a market is not
19 unlimited." That's a 1981 rationale for position
20 limits, basically.

21 MR. SCHWARTZ: I don't agree with that as you
22 have phrased it. There is no necessity finding at all

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1 in 1981 because it's not primarily based on the same
2 statutory provision we are talking about today.

3 The rulemaking describes this as an alternate
4 procedure. So what it's using is the Commission's
5 general rulemaking authority under Section 8a(5), which
6 it interpreted --

7 COMMISSIONER BERKOVITZ: Which one? The
8 1981?

9 MR. SCHWARTZ: The 1981 rule, correct. Which
10 the standard the Commission articulated is that rule
11 8a(5) -- Section 8(a)5 rule must be reasonably related to a
12 purpose of the act.

13 So, this being a rule about exchange set
14 limits, it's sensible, at least to me, the bar would be
15 lower for exchange set limits than it would be for
16 limits imposed by the federal government. There are
17 different --

18 COMMISSIONER BERKOVITZ: So we could require
19 the exchanges to set limits without any necessity
20 finding?

21 MR. SCHWARTZ: We could in 1981. I don't
22 know that law -- and I don't know that the law is not

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1 the same. In 1981, I have no quarrel with the
2 Commission's use of authority then.

3 COMMISSIONER BERKOVITZ: You believe in the
4 current rule the federal speculative position limits
5 are set forth in proposed Section 150.2, correct?
6 Those are the federal speculative limits in the
7 proposal. Rule 150.2? Did I get it correct?

8 MR. SCHWARTZ: I'll take your word on the
9 section number.

10 MR. BRODSKY: That's correct.

11 COMMISSIONER BERKOVITZ: That's correct,
12 150.2 is the federal speculative limits. And for each
13 of those -- is that the core referenced futures
14 commodities, in 150.2? Those are identified in 150.2?

15 MR. BRODSKY: Correct.

16 COMMISSIONER BERKOVITZ: And the predicate
17 necessity finding goes to all of those in 150.2, is
18 that correct?

19 MR. SCHWARTZ: Correct.

20 COMMISSIONER BERKOVITZ: And 150.5(b), we
21 require the exchanges to set position limits for
22 everything else that we don't have -- that aren't

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1 covered in 150.2, is that correct?

2 MR. SCHWARTZ: That's how it reads, yes.

3 COMMISSIONER BERKOVITZ: So this rule
4 requires the exchanges to set position limits for
5 commodities we don't set limits for, correct?

6 MR. SCHWARTZ: Is that right?

7 MR. BRODSKY: That's correct.

8 COMMISSIONER BERKOVITZ: And we give them
9 guidance on how to do it, correct?

10 MR. BRODSKY: Just to clarify, for physical
11 commodities?

12 COMMISSIONER BERKOVITZ: For physical
13 commodities, yes. That's correct.

14 There is not a predicate necessity finding
15 for that, is there?

16 MR. BRODSKY: There is not.

17 COMMISSIONER BERKOVITZ: We don't need a
18 predicate -- what is the legal authority for that? Is
19 it 4a or 8(a)5?

20 MR. BRODSKY: It's the statutory core
21 principle.

22 COMMISSIONER BERKOVITZ: Well, the statutory

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1 core principle says necessary and appropriate, doesn't
2 it?

3 MR. BRODSKY: I believe so.

4 COMMISSIONER BERKOVITZ: But there's no
5 predicate finding for necessary and appropriate under
6 the core principle is there?

7 MR. BRODSKY: We haven't made one in
8 connection.

9 COMMISSIONER BERKOVITZ: And there is no
10 legal determination that one is necessary, is there?

11 MR. SCHWARTZ: Not --

12 COMMISSIONER BERKOVITZ: Okay. So I think
13 the position today of the staff and the analysis before
14 us in this proposal is, we can require the exchanges to
15 impose limits on all physical commodities without
16 predicate necessity finding.

17 We just can't do it ourselves but we can tell
18 them to do it, is that correct?

19 MR. SCHWARTZ: I would have to go back and
20 look further at that but I can't disagree with you.

21 COMMISSIONER BERKOVITZ: Okay, so I think
22 that is significant Mr. Chairman, that if we set the

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1 number, we have to make a predicate necessity finding.
2 But if we tell them to set the number and tell them how
3 to set it, we don't need a predicate necessity finding.
4 That's what the document before us says today.

5 I think that is extremely significant and I
6 don't know why we would have the authority to tell the
7 exchanges to do it without a predicate necessity
8 finding but if a predicate necessity finding ever
9 becomes an obstacle, instead of us just doing it
10 directly, we'll give parameters to the exchange to do
11 it and I find that encouraging, frankly, that we don't
12 need a predicate necessity finding for position limits
13 on commodities if we tell the exchanges how to do it.

14 So that actually answers a lot of my
15 questions. I'm pleased that is the interpretation
16 today.

17 I still don't agree we need a predicate
18 necessity finding for the Commission set limits in
19 150.2 and I'm not even sure under that interpretation
20 whether the better path forward is to go under 150.5
21 and tell the exchanges to do it and tell them how to do
22 it, rather than go through all of this rigmarole of

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1 necessity findings ourselves.

2 The simplest path forward is to just tell the
3 exchanges to do it under the Commission's legal
4 interpretation advanced in this proposal. We can get
5 to the same objective without tying ourselves in knots.

6 And one of the problems that I have with the
7 necessity finding, and I think it's evident in the
8 document and I think when folks read the document, is
9 that it's extremely difficult to make. There are a
10 number of factors in the document as to why the
11 position limits are needed for these particular
12 commodities. And a lot of it relates to the general
13 economic importance of the commodities, the open
14 interest in the commodities, what would be the
15 detrimental consequences if there were excessive
16 speculation in those commodities.

17 But that's a rather high level discussion and
18 I think people will read it not quite understand,
19 for example, coffee-related economic activity comprises
20 1.6 percent of total U.S. GDP. U.S. sugar producers
21 generates nearly \$20 billion per year for the U.S.
22 economy. Supporting 142,000 jobs.

0126

1 Those are all indicating the importance of
2 those commodities, but I'm not sure of the relationship
3 of that to position limits. Those general economic
4 statistics, if anybody wants to volunteer and help me
5 understand why these general economic statistics
6 presented in a necessity finding are important for
7 position limits. I guess they are important
8 commodities.

9 MR. SCHWARTZ: If you would like me to
10 respond?

11 COMMISSIONER BERKOVITZ: Sure.

12 MR. SCHWARTZ: The point of that type of
13 information is to demonstrate the seriousness of the
14 damage it would do if these particular commodities in
15 interstate commerce were to experience price
16 disruptions.

17 COMMISSIONER BERKOVITZ: Let me then, as I
18 said at the outset, explain an interpretation going
19 forward that will get this agency out of this bind that
20 I see it is in and this illogical trap that I think
21 we're presented with today where our hands are tied and
22 we have to make a necessity finding if we impose the

0127

1 limits. But if we tell the exchanges to impose limits
2 and the exchanges how to impose limits, no necessity
3 finding is necessary. A more straightforward way to
4 get to the result that accomplishes all your
5 objectives.

6 For many, many years, as we talked about,
7 Section 4a has been interpreted as a mandate to impose
8 position limits. It's been challenged consistently
9 since it was put in place in 19 -- well, since the
10 position limit's language was put in place in 1938 but
11 the language about excessive speculation causing undue
12 burden on interstate commerce is really the
13 constitutional foundation for the Commodity Exchange
14 Act -- well, for the Grain Futures Act in 1922.

15 And then it's been the constitutional
16 foundation, excessive speculation causes undue burdens
17 on interstate commerce is the foundation for the
18 constitutionality for the Security Exchange Act. It
19 was a foundation for the constitutionality of the
20 Commodity Exchange Act because you needed to tie these
21 transactions to interstate commerce and Congress
22 declared that excessive speculation is a burden on

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1 interstate commerce. And that was necessary for the
2 constitutionality.

3 People have sought to challenge that finding
4 ever since and say, Congress just stated it. There is
5 nothing behind it. Congress just stated it. No
6 economics behind it.

7 Courts consistently for decades have resisted
8 those challenges to those Congressional findings and it
9 was taken from the Section 3 of the -- Section 3 of the
10 Commodity Exchange Act, in turn for the whole
11 constitutionality of the act and put it in Section 4a
12 in 1936 and also in the speculative position language.

13 Over the decades, people have challenged it.
14 There is the Hunt Brothers in late 70s before they
15 cornered the or tried to corner the silver market,
16 created all sorts of mischief in the soybean market and
17 they were -- the agency -- the CFTC went after them for
18 exceeding the spec position limits in the soybean
19 market.

20 In 1979, a Seventh Circuit decision denying
21 the Hunts' challenge to their violation of the soybean
22 position limits and they made the same argument that in

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1 setting up limits, the Commission made no finding that
2 position limits were necessary. And the Seventh
3 Circuit, which is a Circuit near and dear to my heart.
4 I have greatest utmost respect for the Seventh Circuit.
5 They recently issued a great decision, but the Seventh
6 Circuit back in '79 says the Commodity Exchange
7 authority operating under express Congressional mandate
8 to formulate limits in trading in order to forestall
9 evils of large speculation decided whether to raise
10 the then existing limits on soybeans. Operating under an
11 express Congressional mandate, 4a. That's prior to
12 Dodd-Frank.

13 But that language was consistently
14 interpreted as a mandate to do position limits. But as
15 we saw in 1981, the mandate to do position limits
16 didn't mean everything all at once. The Commission did
17 it from time-to-time over the years.

18 Let's move to Dodd-Frank now. That language
19 that is in the Dodd-Frank Act was generated in the Congress
20 in the summer of 2008. I was working for Senate
21 Permanent Subcommittee on Investigations in the Russell
22 Senate Office Building. Commissioner Stump was across

0130

1 the hall from me working at the Senate Agriculture
2 Committee at the time.

3 That language was generated in the heat of
4 the oil price spike. It was meant to tell the
5 Commission to put on position limits and it made it
6 into Dodd-Frank and was adopted by the House.

7 I think looking at the time and the reasons
8 for it, the inescapable conclusion is that language was
9 a directive to the Commission to put on position
10 limits. That doesn't mean, and it's a strawman, I
11 believe, to say the mandate means you have to do
12 limits, hard limits on every commodity to the max. It
13 doesn't mean everything on everything.

14 And there have been statements made today
15 that says the interpretation that Dodd-Frank Act as a
16 mandate, would mean we have to do position limits for
17 12,000 -- we'd have to put limits on 12,000
18 commodities. I don't view the mandate as that precise
19 as to what it requires. It says, as necessary and as
20 appropriate.

21 The necessary and appropriate comes after the
22 mandate, not before the mandate. And under that

0131

1 necessary and appropriate, we have the discretion to
2 use the tools in our toolkit as necessary and
3 appropriate. Considering costs and benefits. So as
4 Congress said do it and you figure out how to deal with
5 it the best way.

6 Okay. All the tools in our toolkit that we
7 have been using since 1981, are still there. There was
8 some strong language about non-spot month limits.
9 There's also exemptive authority for -- let me ask the
10 counsel, 4a(a)(7) for anything that is required under
11 4a, what does 4a(a)(7) do?

12 MR. SCHWARTZ: It gives Commission exemptive
13 authority.

14 COMMISSIONER BERKOVITZ: So even if there is
15 a mandate, there is also exemptive authority from the
16 mandate, correct?

17 MR. SCHWARTZ: Correct.

18 COMMISSIONER BERKOVITZ: So in a rulemaking
19 there may be a mandate to do X but if we decide it's
20 appropriate to do Y, we can do Y even with a mandate.
21 So whether or not there is a mandate, we don't have to
22 do it if we determine it could go under 4a(a)(7).

0132

1 So, we have all these tools. We can do -- we
2 can set spot month limit ourselves. Okay. We can tell
3 the exchange to set spot month limits. We can set non-
4 spot month limits as this proposal does for the Ags or
5 tell the exchange that you do spot month limits or
6 accountability at your discretion or we can authorize
7 them to do accountability. Those are the tools in our
8 toolbox as necessary and appropriate with the statutory
9 language.

10 The other philosophical maxim that is
11 applicable here is Occam's razor, which is that the simplest
12 most direct approach is likely the best. This gives us
13 all the bind that we're in about predicate necessity
14 findings and frankly, read the language in the
15 proposal, going back and you mentioned it in your
16 presentation Mr. Schwartz about interpreting standard,
17 you know, what is appropriate? Does it refer back to this
18 standard?

19 There are pages and pages of analysis in this
20 document as to what does this "standard" mean and as appropriate
21 mean and it really is mind-bending to read that.
22 It's complicated and it doesn't need to be that

0133

1 complicated. It's actually quite straightforward.
2 Congress said, do position limits, do it quickly. We
3 have all these tools to do it. We can consider costs.
4 We can consider whether you want to do accountability
5 or you're going to do hard limits. We can consider
6 what the spot limits should be, whether we do it or the
7 exchanges do it.

8 So, I firmly believe that there is a way,
9 there is a clear path forward that accomplishes all the
10 objectives that you're trying to achieve. What am I
11 objecting to? Why am I getting all worked up on this
12 thing?

13 Because ever since -- going back to what I
14 said earlier, ever since day one, the people who do not
15 want this Commission to regulate position limits or to
16 regulate the markets have been trying to attack our
17 regulations through the necessity finding. They said
18 there is no basis for that finding for the regulation
19 of these markets. And there is no basis for position
20 limits because the Commission hadn't proved they are
21 necessary.

22 So, it -- fundamentally, the necessity

0134

1 finding from day one, from 1923 onwards and it's in the
2 comment letters. We have gotten it in every rule we
3 published recently, that you have to make a necessity
4 finding and you have to prove that excessive
5 speculation is a problem and you have to prove that
6 position limits will prevent excessive speculation.
7 You have to prove the very limits you're proposing
8 prevent excessive speculation, which we don't even try
9 to do.

10 And as a matter of fact, I want to give more
11 credit. It's correct that -- is it accurate that in
12 the document we say we don't have to prove those
13 things?

14 MR. SCHWARTZ: Correct.

15 COMMISSIONER BERKOVITZ: Okay. That's a big
16 step forward, too.

17 But nonetheless, I don't know if the other
18 folks -- once we say we have to do necessity finding,
19 how we do a necessity finding is subject to legal
20 challenge. What I was saying about the fact that these
21 are important commodities and therefore we need
22 position limits, that's subject to a legal challenge.

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1 I think the rule is more vulnerable to legal
2 challenge with a predicate necessity finding. If you
3 consider costs and benefits and the predicate necessity
4 finding, it's much more subject to legal challenge than
5 if you consider cost and benefits in how you implement
6 it as necessary and appropriate. So, I think this
7 alternative is a reasonable interpretation. We have
8 the flexibility to adopt it. It doesn't present the
9 straightjacket. It doesn't mean that we have to put
10 hard limits on 12,000 commodities. And we can
11 accomplish all the objectives we need to and not get
12 tied up in litigation and it preserves the Commission's
13 authority and is consistent with what Congress wanted
14 in the Dodd-Frank Act.

15 So I'll leave my other issues for the next
16 round.

17 CHAIRMAN TARBERT: Thank you very much. As
18 you can see, it's very beneficial to have a former
19 General Counsel sitting on the Commission.

20 We appreciate everyone's questions and we are
21 going to think about them, obviously, over the next few
22 months as we get in the comment period and we'll

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1 continue to discuss together, Commissioner Berkovitz,
2 as well as with our legal team, you know, what's the
3 best way?

4 Because at the end of the day, we want to get
5 this done. Congress clearly mandated something. We
6 can argue about what it mandated but it clearly said,
7 look, at the very least, it said this is important.
8 There is excessive speculation. It leads to all sorts
9 of bad things like corners and squeezes and we compel
10 you within, I don't know, nine months? It's been 10
11 years, but we compel you to take a look at this and put
12 position limits on these sorts of things. Again, using
13 your discretion as an agency and all your ample
14 experience.

15 So I think we want to get to a point where we
16 do that. First order of business is the markets. But
17 -- and I realize for those of you watching, this has
18 gotten very technical in how you interpret this clause
19 but I think the main bottom line here is we want to get
20 it done, we want to get it done right from a
21 substantive standpoint and make sure we put the limits
22 on the behavior that needs the limits. We have the

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1 bona fide hedge hedging for those who actually need
2 these markets. But at the same time, we get this thing
3 done and it's upheld by the courts. So we will
4 continue to have that discussion. And I appreciate
5 your --

6 COMMISSIONER BERKOVITZ: Are we going to have
7 another round?

8 CHAIRMAN TARBERT: Yeah, we're going to do
9 another round. This is round two. That is I don't
10 think I have any further questions. So with that, I
11 will go to Commissioner Quintenz.

12 COMMISSIONER QUINTENZ: Thank you, Mr.
13 Chairman. I don't think I have any further questions
14 myself. And with all due respect to my colleagues up
15 here, if I wanted to write something that was a
16 mandate, man, this is not what I would have written.
17 We have what we have. The Court validated it's open to
18 interpretation. We've heard those interpretations. We
19 have a valid interpretation and I think we get to the
20 right place in policy and my compliments to the staff.
21 Thank you.

22 CHAIRMAN TARBERT: Thank you. Commissioner

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1 Behnam.

2 COMMISSIONER BEHNAM: Thanks Mr. Chairman.

3 Can we talk a little bit about the risk
4 management exemption? I know we've made a decision to
5 remove it, but I'd like to talk about in it's absence
6 we're going with this pass-through exemption.

7 Is that correct?

8 Or I guess that is my question. Can the
9 pass-through exemption be used as a supplement or
10 replacement for the risk management exemption?

11 And I think it is important to understand and
12 I think Lillian you might have talked about the risk
13 management exemption, and then subsequently -- or maybe
14 you talked about the pass-through exemption. But it
15 was one of the more complicated parts of the rule
16 proposal. I think a few of the paragraphs truly are a
17 little bit going around in circles. But if you can
18 just talk through the general idea of what the pass-
19 through exemption is, how it would function in the
20 marketplace and I think you talked about it a little
21 bit.

22 The idea that if you're a dealer providing

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1 liquidity to a commercial, you can then enter into an
2 additional transaction off that original hedge in order
3 to layoff the risks that you've provided liquidity for.

4 If you can just confirm that's right, maybe
5 elaborate on it a little bit more. And I guess my
6 question is, going back to the risk management
7 exemption and our removal of it, do we feel that there
8 is any risk that the pass-through becomes a replacement
9 for it in an unintended way?

10 MS. CARDONA: Thanks Commissioner Behnam. So
11 in regards to your understanding of how we described
12 and proposed, as I described in my remarks this swap-
13 through provision. You're accurate. So I'll let Aaron
14 speak further about that.

15 MR. BRODSKY: Thank you. So we're
16 essentially viewing the addition of the pass-through
17 swap language to the statutory bona fide hedging
18 definition as demonstrating Congressional intent to
19 narrow the Commission's ability to grant risk
20 management exemptions. So the pass-through exemption
21 as Lillian described is limited to situations where a
22 market participant is offsetting risk which is opposite

0140

1 an entity for which that swap is a bona fide hedge.

2 So it's a subset of what the Commission and
3 Commission staff has previously recognized as risk
4 management exemptions under regulation 1.47.

5 MS. CARDONA: And if I could just a little
6 bit.

7 COMMISSIONER BEHNAM: Yes.

8 MS. CARDONA: I think we could ask for some
9 practical real-life situations. I think the concept
10 that the bona fide hedgers pass-through, through the
11 swap dealing counterparty, I guess. Under our current
12 rules, the swap dealer requirements do require that any
13 swap dealer obtain a representation from the bona fide
14 hedger of its status as a bona fide hedger. So that's
15 where the pass-through provision passes through,
16 technically and practicality.

17 COMMISSIONER BEHNAM: And is this going to be
18 in the enumerated bucket? Or how will the Commission,
19 if at all, find out about this pass-through
20 transaction?

21 MS. CARDONA: It's within the proposed
22 definition of bona fide hedging positions or

0141

1 transactions.

2 COMMISSIONER BEHNAM: Okay. Commissioner
3 Berkovitz quickly touched on and Mr. Schwartz you
4 mentioned the 4a(a)(7), the broader exemptive
5 authority. I don't know necessarily if this is an OGC
6 question or just more of a policy question, but do we
7 have any -- and if I recall correctly, the proposal
8 doesn't give much guidance or idea how we would use
9 this authority if at all and as Commissioner Berkovitz
10 mentioned and Mr. Schwartz sort of validated, it's
11 fairly broad and we can use it at our discretion, but
12 given the context of the larger rule and what we are
13 trying to accomplish, does anyone have the sense of how
14 we would if at all use it in the future? Or are we
15 just reserving it as exemptive authority on a case-by-
16 case basis?

17 MR. DAVIS: I mean from our perspective, it's
18 available. It hasn't been invoked here but it is
19 certainly one of tools that is available to the
20 Commission to use in the future.

21 COMMISSIONER BEHNAM: Okay. Just two more
22 quick questions Mr. Chairman.

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1 I want to talk about deliverable supplies and
2 the 25 percent number that we came up with and Aaron,
3 you may have touched on this. There's a quote in the
4 proposal about how the exchanges, I think, in our
5 relationship with them and are engaging with them as we
6 constructed this proposal had different ideas and views
7 about where a limit should be set relative to
8 deliverable supply and I think you mentioned this, we
9 ended up at 25 based on, you know sort of an aggregate
10 perspective of what we heard and what we thought was
11 best. But there's this quote, which -- I hesitate --
12 "these distinctions reflect philosophical and other
13 differences among the exchanges."

14 How did we come up with this? And if we're
15 talking about philosophical differences and I don't
16 mean to make light of this, but it's just a little bit
17 puzzling to me. If you could just elaborate a little
18 bit on what you said earlier in your opening about how
19 we got to 25 and in your view how the differences among
20 the DCMs contributed to the decision.

21 MR. BRODSKY: Thank you Commissioner.

22 So the proposed spot month levels are all set

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1 either at or below 25 percent of deliverable supply and
2 those deliverable supply values are based on estimates
3 submitted by the exchanges and based on recommended
4 limit levels based on the estimates. In some cases,
5 the exchanges recommended levels at the maximum of 25
6 percent, in other cases the exchanges recommended limit
7 levels that were less than 25 percent of deliverable
8 supply.

9 Often that came down to differences between
10 the contracts and the commodity types. But we also
11 have heard anecdotally from certain exchanges that they
12 generally prefer to increase limit levels more
13 incrementally in order to take a more measured approach
14 to evaluating the impact of the increase over a period
15 of time.

16 So your reference to the philosophical
17 differences reflects the different approaches the
18 exchanges took in setting the limit levels as a
19 percentage of deliverable supply.

20 COMMISSIONER BEHNAM: Thanks. And lastly, I
21 want to just conclude on enforcement and I know we
22 talked about this in my previous round at least within

0144

1 the context of surveillance and Vince you talked about
2 this a little bit. To the extent at all, and the
3 answer might be none, but I think it would benefit me
4 and certainly the public. Going back to what I was
5 discussing earlier about our decision to not impose or
6 set non-spot month limits. Does this effect in any way
7 our relationship and our ability to sort of enforce our
8 rules in the law?

9 MR. MCGONAGLE: Right. So thinking about
10 available enforcement tools and the application of a
11 position limit regime. So to the extent that we have
12 exchange limits that have been established, the
13 Commodity Exchange Act provides the Commission, and
14 this is definitely unique, in that we have the ability
15 to bring a federal action in the event there is an
16 exchange -- violation of exchange-based position limit.
17 Not accountability level.

18 And then separately, the Commission has the
19 ability, we have several anti-manipulation provisions.
20 We have disruptive trading practices provisions and so
21 the fact frankly, the fact that someone has obtained a
22 bona fide hedge availability does not mean that their

0145

1 trading in the market is not otherwise subject to
2 review.

3 So for example, the exchanges also have
4 provisions that relate to orderly trading in the
5 market. So their market participants have to trade in
6 a manner that is orderly and to the extent that anyone
7 otherwise violates the federal rules, the Commission
8 has full authority and is not prevented in any way,
9 because someone says well, I traded because I had a
10 hedge exemption. We will look at the manner of trading
11 and evaluate whether there are any potential violations
12 in the act.

13 COMMISSIONER BEHNAM: Thanks, Vince. Mr.
14 Chairman, we are going to do a vote and then closing?

15 CHAIRMAN TARBERT: Yes.

16 COMMISSIONER BEHNAM: All right. So I have a
17 short statement, but I'll reserve it for the closing
18 time.

19 CHAIRMAN TARBERT: Feel free -- if you want
20 to give it now or do you want to give it --

21 COMMISSIONER BEHNAM: Why don't I just wrap
22 it up then.

0146

1 CHAIRMAN TARBERT: Okay.

2 COMMISSIONER BEHNAM: Again, thanks to the
3 entire team. This was very helpful, and I appreciate
4 the time that you all have put in as we sort of gotten
5 to this day and I look forward to the public comment
6 period. And hopefully as my colleagues have said, we
7 can get this into a better place.

8 The ceremony of the 92nd Academy Awards will
9 air in a little over a week. I haven't seen too many
10 movies this year given my two young girls and hectic
11 work schedule. But I did see Ford versus Ferrari.
12 Ford versus Ferrari earned four award nominations
13 including Best Motion Picture of the Year, and the film
14 tells the true story of American car designer, Carroll
15 Shelby and Ken Miles, the British-born driver who built a race car
16 for Ford Motor Company and competed with Enzo Ferrari's
17 dominating and iconic red racing cars at the '66 24
18 Hours of Le Mans.

19 This high-drama action film focuses foremost
20 on the relationship between Shelby and Miles, the co-
21 designers and driver of Ford's GT40 and their triumph
22 over the competition, the course, the rule book, and

0147

1 bureaucracy. Even if you aren't a car enthusiast the
2 action, acting, and accuracy of the story are well
3 worth your time. There's a lot more to the movie than
4 just racing.

5 There was a great scene where Miles was
6 talking to his son about achieving the perfect lap. No
7 mistakes, every gear change and every corner perfect.
8 In response to his son's observation that you can't
9 just push the car hard the whole time, Miles agrees.
10 Pensively staring down the track towards the setting
11 sun.

12 He says, "If you're going to push a piece of
13 machinery to the limit, and expect it to hold together,
14 you have to have some sense of where that limit is."

15 It's been nine years since the Commission
16 first set out to establish the position limits regime
17 required by amendments to Section 4a of the CEA under
18 Dodd-Frank. While I'd like to be in a position today
19 to support this rule, unfortunately, I cannot. Because
20 I don't think it's leading us towards that perfect lap.

21 While the proposal purports to respect
22 Congressional intent and the purpose and language of

0148

1 CEA Section 4a, in reality it pushes the bounds of
2 reasonable interpretation by deferring to the exchanges
3 and setting the Commission on a course where it will
4 remain perpetually in the draft. Unable to acquire the
5 necessary experience to retake the lead in
6 administering a position limits regime.

7 In 2010, and in the decades leading up to it,
8 Congress understood that for the derivatives markets
9 and for physical commodities to perform optimally, there
10 needed to be limits on the amount of control exerted by
11 a single person or persons acting in agreement. In
12 tasking the Commission with establishing limits and the
13 framework around their operations, Congress was aware
14 of our relationship with the exchanges but nevertheless
15 opted for our experience and our expertise to meet the
16 policy objectives of the act.

17 Right now, we are pushing to go faster and
18 just to get to the finish line, making real-time
19 adjustments without regard for even trying for that
20 perfect lap. It's unfortunate but despite the
21 Chairman's leadership, and I do appreciate Mr. Chairman
22 your leadership on this effort, and the talented

0149

1 staff's hard work, I do not believe that this proposal
2 will hold itself together.

3 I will therefore not be supporting the
4 proposal. I believe that the proposal has many flaws
5 and therefore I will publish a more complete statement
6 outlining my concerns on the Commission website and the
7 Federal Register.

8 My principle disagreement is with the
9 Commission's determination to in effect disregard
10 the tenants supporting the statutorily created parallel
11 federal and exchange set position limits regime, and
12 take a backseat when it comes to administration and
13 oversight. In doing so, the Commission claims victory
14 for recognizing that the exchanges are better
15 positioned in terms of resources, information,
16 knowledge, and agility and therefore, they should take
17 the wheel.

18 While the Commission believes it can withdraw
19 and continue to retain access to information that is
20 critical to oversight, I fear that giving it away absent
21 sufficient understanding of what we are giving up
22 and planning for ad-hoc Commission and staff

0150

1 determinations on key issues that are certain to come
2 up, will let loose a different set of responsibilities
3 that we have yet to consider.

4 Based on consideration of the Commission's
5 mission and Congressional intent, as in the Dodd-Frank
6 Act in the amendments to section CEA 4a, and elsewhere
7 in the act, I believe that the Commission is required
8 to set limits based on its reasonable judgment within
9 the parameters of the Act. The Commission has not
10 provided a rational basis for determining not to
11 propose limits outside of the spot month for reference
12 contracts based on commodities other than the Legacy 9
13 agricultural commodities.

14 And the Commission's seemingly unlimited
15 flexibility in proposing to significantly broaden the
16 bona fide hedge definition, codifying the expanded list of
17 self-effectuated enumerated bona fide hedges, providing
18 for exchange recognition of non-enumerated bona fide
19 hedge exemptions with respect to federal limits and
20 simultaneously eliminate notice and reporting
21 mechanisms is both inexplicably complicated to parse
22 and in my view, inconsistent with Congressional intent.

0151

1 The 24 hours of Le Mans awards a victory to
2 the car that covers the greatest distance in 24 hours.
3 While the proposal before us shoots for victory by
4 similarly attempting to achieve a great amount over a
5 short period, I'm concerned that all of it will not
6 hold together. The proposal attempts to justify
7 deferring to the exchanges on just about everything and
8 in so doing, it pushes to the back any earnest
9 interpretation of the Commission's mandate or
10 Congressional intent.

11 This in my view, is not cooperation. This is
12 sidestepping backing down, giving way, and getting
13 comfortable in the draft. I'm not comfortable in this
14 or any draft.

15 It's my understanding that the Commission has
16 the tools and resources to develop a better sense of
17 where these federal position limits ought to be in
18 order to achieve the purposes for which they were
19 designed, while maintaining our natural
20 Congressionally-mandated lead. The proposal fails to
21 recognize that Congress already set the course in
22 directing us, that our derivatives markets will operate

0152

1 optimally with limits. We just need to provide a sense
2 of where they are. Perhaps the proposal was just never
3 aiming for that perfect lap.

4 Thanks again Mr. Chairman and thank you to
5 the staff for your efforts and I look forward to
6 working on this proposal in the future.

7 CHAIRMAN TARBERT: Thank you Commissioner
8 Behnam. Commissioner Stump.

9 COMMISSIONER STUMP: Thank you. Like
10 Commissioner Behnam, that's the only movie I have seen
11 all year and I highly recommend that you go watch it.
12 It's quite good.

13 I am hopeful that we can continue to build
14 upon the proposal, maybe retro fit it a bit to make it
15 a better machine such that it can sustain the perfect
16 lap. But, that's not what I'm going to talk about.
17 Unlike Ford versus Ferrari, I don't think necessity
18 versus mandate is going to win any Academy Award. So
19 unfortunately, because of all the things that have been
20 said, I feel as though I have to give you my view, and
21 I do not take any pleasure in disagreeing with
22 Commissioner Berkovitz.

1 We have done this before. We have disagreed
2 before. I prefer to agree with him but sometimes we
3 have different interpretations of what the statute
4 says.

5 I think Commissioner Berkovitz said that
6 Congress didn't intend to tie the Commission's hands.
7 And I would agree with him. But they also didn't
8 abandon the tie that was already present in the statute
9 with regard to tying limits to a necessity.

10 In fact, when the Court remanded this back to
11 the Commission, they didn't say, come back to us and
12 tell us again you have a mandate or come back to us
13 again and tell us that you need to do
14 a necessity finding. They said, use your expertise.
15 So we all have different expertise and we all have
16 different interpretations.

17 My expertise is not one -- I'm not a lawyer.
18 But if you told me that there was any common sense to
19 the notion that we would apply position limits without
20 finding them necessary, that doesn't make any sense to
21 me. But regardless, the lawyers here tell me we need a
22 more robust discussion on this.

0154

1 So, I have a visual that I would like to ask
2 to be put up on the screen.

3 And I'd like to walk through some of the
4 statutory text in Section 4a(a) of the Commodity Exchange Act
5 that I think is relevant to the question of whether or
6 not necessity is a prerequisite to the CFTC's mandate
7 of imposing position limits.

8 (Flow chart shown.)

9 COMMISSIONER STUMP: You may have trouble
10 seeing it so we'll post it later; but this is the way I look at
11 this, and I thought maybe a picture would be helpful.

12 So Subsection 1, the top box is the legacy
13 text. That's been in the statute for -- or elements of
14 it have been in the statute for quite some time. And
15 it has long-mandated that the Commission impose position
16 limits that it finds necessary to diminish, eliminate
17 or prevent the burden on interstate commerce resulting
18 from excessive speculation.

19 So there is a mandate. Once we determine
20 that the contracts are - once there is a necessity finding
21 that potentially would result in diminishing,
22 eliminating or preventing the burden on interstate

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1 commerce. So that has been there for a long time.
2 Then Dodd-Frank added Subsection 2. And when Dodd-
3 Frank added Subsection 2, it's my view that the
4 provisions in Subsection 1 and in Subsection 2 must be
5 read as linked. They cannot be considered in isolation
6 because the Dodd-Frank Act specifically ties them
7 together.

8 First, Subsection 2 in Subparagraph A links
9 the Commission's obligation to set position limits to
10 the standards set forth in Subsection 1. It does this
11 by saying, "in accordance with the standards set forth
12 in" Subsection 1. Then, in this Subparagraph B, it goes
13 on to link the timing of any limits required under
14 Subsection A, which I have already stated, I believe,
15 is connected to the standards in Subsection 1.

16 So Congress could have just taken out the
17 word, "necessary." But they didn't. And then they went
18 on to say that Subsection 2 is going to be linked to
19 Subsection 1 in accordance with the standards in
20 Subsection 1. Then they went on to say that
21 Subparagraph B of Subsection 2 is going to be linked to
22 Subparagraph A because it says, "required under Subparagraph A".

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2 So again, I know this is confusing but to me
3 they are all related, and they're all connected and
4 they're all linked.

5 So I have a question, OGC's judgment -- is it
6 OGC's judgment that the prerequisite of finding
7 necessity is one of the standards set forth in
8 Subsection 1 and in the language in Subsection 2A?

9 MR. SCHWARTZ: We think that is the better
10 interpretation.

11 COMMISSIONER STUMP: So some have isolated
12 and relied on this "shall establish limits" wording in
13 Subparagraph A to argue that the Dodd-Frank Act imposed
14 a mandate on the Commission to establish position
15 limits. Some have also pointed to the timing
16 provisions in Subparagraph B to argue that the Dodd-Frank
17 Act imposed a mandate on the Commission by using the
18 words twice, the position limits "shall be
19 established."

20 I agree. I totally agree with all of that.
21 Under Subparagraph B, position limits "shall be
22 established" as "required under Subparagraph A," which

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1 states that the Commission shall establish limits in
2 accordance with the necessity standard in Subsection
3 1. And we can't ignore that last point. It's there.
4 It has been there. They did not take it out.

5 My rationale is simple. The language in
6 Subparagraph B mandates in both instances that the
7 Commission establish the limits required under
8 Subparagraph A," and the limits required under
9 Subparagraph A are those that are established in
10 accordance with the standards of Subsection 1.

11 Is that correct? In the General Counsel's
12 opinion?

13 MR. SCHWARTZ: We agree that's the better
14 reading of the statute.

15 COMMISSIONER STUMP: Okay. Some have also
16 asked why would Congress add all of this new language
17 at all if not to impose a new mandate?

18 And for me it's simple. Congress is going
19 through the exercise of adding an entirely new
20 regulatory authority to the agency's objectives and
21 missions. They were giving us authority over trillions
22 of dollars worth of over-the-counter swap transactions.

0158

1 So in doing so, they took the opportunity to consider
2 how position limits would apply to swaps and how
3 to refine the language that existed in Section 4a(a)
4 to account for swaps, and also to better reflect what
5 Congress wanted us to do with regard to establishing
6 position limits and the timing by which they would like
7 for us to have considered establishing limits for
8 physical commodities.

9 To me, I just think that whether you're a
10 lawyer or not, the court asked us to use our expertise.
11 In my opinion, a common sense application is, you need
12 a necessity finding. In my opinion, my
13 interpretation, is you need a necessity finding.

14 I will be happy to debate this further with
15 others and I'm sure we will have to, but I really felt
16 as though it was important to explain my views on this
17 because we've been asked to apply our expertise in
18 coming to terms with how we are moving forward and so
19 we have an obligation to do so.

20 I thank the General Counsel's Office for many
21 hours of spending -- answering questions from my office
22 and working with us. And I thank them for the -- what

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1 I consider to be an improvement in the proposal in this
2 regard.

3 CHAIRMAN TARBERT: Thank you very much.
4 Commissioner Berkovitz.

5 COMMISSIONER BERKOVITZ: Thank you Mr.
6 Chairman.

7 I want to start off on a note of agreement
8 with Commissioner Stump. I want to follow Commissioner
9 Stump's presentation of her views on the necessity
10 finding, which I may come back and address but I want
11 to raise some issues that I think we may be closer on
12 than that issue. And that concerns the non-enumerated
13 hedge exemption process or also the enumerated hedge
14 exemption process.

15 So, I've spent a lot of time over the past
16 number of months since I have come back to the
17 Commission and this position limits was imminent on
18 the horizon and I'm glad we finally
19 reached the landmark day today. Again, I want to thank
20 all the staff for helping work on this so hard in
21 getting here. I know what a lift it was.

22 But I spent a lot of time meeting with folks.

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1 make all the determinations as to what is appropriate
2 in any particular commodity market.

3 I'm concerned about the significant jump in
4 these limits that are being proposed and I'd like us to
5 retain ability to phase it in if necessary or not
6 necessarily increase the individual months to the full
7 level of what the formula would suggest, if that would
8 more appropriately ensure orderly trading and
9 preservation of price discovery of individual
10 contracts.

11 And then on the hedge exemption process, I
12 have been favorably inclined to push as much forward as
13 possible and not have us in this 10-day review. I
14 really don't want to be reviewing hedge exemptions with
15 lobbyists and nothing wrong with the lobbyists, but
16 it's not the appropriate place to be reviewing hedge
17 exemptions. It's not a political process. It's a
18 substantive process. And I don't want -- market
19 participants shouldn't have to come to our offices in
20 Washington, D.C. to get on their hedge exemptions.

21 So those are my major concerns. I would say,
22 I want it to be clear where we are today, though, given

0172

1 the discussion back-and-forth on the necessity finding.

2 What the Commission is saying today is, we
3 need a necessity finding for federally-imposed numbers
4 and we've made a necessity finding for those 25
5 commodities, for every single other commodity under
6 today's interpretation and interpretation of that
7 document or the document, we do not need a necessity
8 finding. Okay?

9 So other than what is in the necessity
10 finding, we don't need a necessity finding. That's
11 where we left today. We can impose limits and tell the
12 exchanges what to do in terms of position limits
13 without a necessity finding. That is a legal
14 interpretation before us today.

15 And I think that that gives us pretty solid
16 grounds to impose position limits on all commodities as
17 we determine to be appropriate and obviously when we
18 give the directions to the exchanges under this
19 interpretation, we should consider many of the factors,
20 many of the factors that are considered in the
21 document, such as costs and what's the best way to do
22 it?

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1 If we don't have the tools to do it directly,
2 we can do it to the exchanges and tell them to use
3 their tools to do it. And we don't have to make a
4 necessity finding. I think that is what the position I
5 heard today was and so I'm glad that that
6 interpretation and it doesn't mean we need a necessity
7 finding on everything, that is going to have a position
8 limit going forward.

9 CHAIRMAN TARBERT: Thank you very much. Are
10 the Commissioners prepared to vote?

11 If so, Mr. Kirkpatrick, will you please call
12 the roll for the proposed rule on speculative position
13 limits.

14 MR. KIRKPATRICK: Thank you Mr. Chairman.

15 The motion now before the Commission is on
16 the approval of the proposed rule on speculative
17 position limits. Commissioner Berkovitz?

18 COMMISSIONER BERKOVITZ: No.

19 MR. KIRKPATRICK: Commissioner Berkovitz
20 votes no. Commissioner Stump?

21 COMMISSIONER STUMP: Aye.

22 MR. KIRKPATRICK: Commissioner Stump votes

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1 aye. Commissioner Behnam?

2 COMMISSIONER BEHNAM: No.

3 MR. KIRKPATRICK: Commissioner Behnam votes

4 no. Commissioner Quintenz?

5 COMMISSIONER QUINTENZ: Aye.

6 MR. KIRKPATRICK: Commissioner Quintenz votes

7 aye. Chairman Tarbert?

8 CHAIRMAN TARBERT: Aye.

9 MR. KIRKPATRICK: Chairman Tarbert votes aye.

10 Mr. Chairman, on this matter the ayes have three and

11 the noes have two.

12 CHAIRMAN TARBERT: Thank you Mr. Secretary.

13 The ayes have it and the motion to adopt the proposed

14 rule is approved. We'll now move to closing statements

15 on this proposed rule if any, proceeding in reverse

16 order of seniority.

17 COMMISSIONER BERKOVITZ: No, thank you Mr.

18 Chairman, I think I don't have anything further at this

19 point.

20 CHAIRMAN TARBERT: Thank you very much.

21 Commissioner Stump?

22 COMMISSIONER STUMP: I just want to express

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1 gratitude. The folks from DMO, the folks from OGC and
2 the Chief Economist Office and some of you I see you're
3 not sitting at the table and you all have spent
4 considerable amounts of time with us over the past few
5 months and I very much appreciate it. I know many of
6 you didn't sleep last night. I know folks on my team
7 who didn't sleep last night.

8 So I hope that everyone gets a few days of
9 rest before you have to start reading comment letters.

10 Thank you.

11 CHAIRMAN TARBERT: Thank you, Commissioner
12 Behnam.

13 COMMISSIONER BEHNAM: No closing, but thanks
14 to the entire team for your work and your dedication.

15 CHAIRMAN TARBERT: Thank you. Commissioner
16 Quintenz?

17 COMMISSIONER QUINTENZ: Thank you, Mr.
18 Chairman. I was just thinking about the seal that we
19 have for the Commission. We have a wonderful new logo.
20 It has less symbolism on it than the seal so it's
21 harder to use rhetorically. So I'm going to use the
22 seal, which has a scale on it for representing balanced

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1 interests. And as I think about this proposal, I think
2 that that is a symbol that I really associate with this
3 rulemaking and with this thought process.

4 It's a proposal that adds new flexibility
5 while creating new regulations. It's a proposal that
6 provides exchanges with some direction while also
7 having a Commission review. And it's a proposal that
8 broadens exemptions and removed exemptions.

9 And I'm really proud to support it. I hope
10 all of you are very proud of the work you have done. I
11 actually happen to have known the story of the 1966 La
12 Mans race before the movie came out because I'm an avid
13 race car fan. And I think not a lot of people knew
14 that there is a running start to that race.

15 You don't start in your car as you start on
16 the outside of the car at a line and run towards the
17 car and I understand staff felt like that was the
18 process that we were going through over the last couple
19 of months. But I think it's really a testament to how
20 engaged you have been with our offices and how
21 responsive you have been, how open to considering our
22 points of view and just to thank you very much. I'm

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1 very pleased to support your hard work.

2 CHAIRMAN TARBERT: Thank you very much
3 Commissioner Quintenz.

4 I'll just close by simply again thanking all
5 of you, DMO, Chief Economist, General Counsel's Office,
6 a tremendous amount of work has gone into this. Not
7 only this time, but obviously over the last decade.
8 And I appreciate the work the staff has done in the
9 past and the predecessors that have sat in our seats.
10 I do think this is something we're, quite frankly,
11 regardless of what the vote is, you probably have --
12 it's probably 1:1:1:1:1. There are probably five
13 different views of how this should be done. Not only
14 on this Commission but in prior Commissions.

15 It's very complex as I said and if there were
16 an easy solution, we would have had it long ago. And
17 we see that where Commissioners disagree. We have too
18 much role of the exchanges and others say we have given
19 them or they have too little. So we see that --and I
20 think Commissioner Quintenz is right. Is that we've
21 really sought to balance it in this proposal.

22 I think many of the things that my fellow

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1 Commissioners have raised today are extremely important
2 for people to comment on. The phase-in, particularly
3 for the Ags over time we asked a specific question
4 about that. We would really value the views of market
5 participants.

6 Enumerated hedges. Adding to enumerated
7 hedges I think I'm interested and open to that but I
8 don't want a situation where we have people that really
9 are speculating using these enumerated hedges. So I
10 think we want to find, again, the right balance there.

11 But finally, as I mentioned before, is the
12 issue of clarity. The agency voted on our four core
13 values a few months ago and one of those was clarity.
14 Clarity to market participants and the clarity to the
15 American people and it's been a long time coming.

16 I haven't seen the race car movie that you're
17 talking about but given my discussions with the staff
18 lately, I'm also reminded that there are ominous
19 parallels to the movie 1917 with everyone being in
20 trenches and every now and again the whistle blows and
21 people feel like they are running into machine guns.
22 But this time hopefully will be different because all

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1 of your input and the work you have done over the last
2 few months and also the contributions of my fellow
3 Commissioners, including some of those that didn't feel
4 like they could support the proposal today. They still
5 gave a lot of value added and we incorporated that
6 where we could.

7 So I thank you each and every one of you, my
8 fellow Commissioners. Your staffs who are sitting
9 behind us who have worked very diligently on this. All
10 of you and I also thank the community, the American
11 people as a whole for commenting on this for
12 understanding its seriousness and for helping us take
13 it forward.

14 So with that, we'll take a brief recess for
15 lunch. We'll resume this meeting at 1:30 p.m. for
16 discussion of a proposed rule on swap execution
17 facilities.

18 Thank you very much.

19 (Whereupon, at 12:25 p.m., a luncheon break
20 was taken.)

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

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(1:33 p.m.)

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CHAIRMAN TARBERT: This meeting will come to order. Welcome back to this meeting of the Commodity Futures Trading Commission, We had a very good morning session.

I just want to remind everyone that we will have a 90-day comment period for speculative position

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1 limits and that comment period starts today. And the
2 rule should be published, or at least the voting
3 version of the rule, later today when we put out a
4 press release, if it's not already out now.

5 We're now going to address a proposed rule
6 relating to swap execution facilities under Parts 37
7 and 43 of our rules. The proposed rule would codify
8 longstanding no-action relief for certain swap trading
9 and reporting requirements. I'd now like to open the
10 floor for any statements. We'll proceed in order of
11 seniority. So I'll start. But what I'm going to do is
12 I'm actually going to, I think I'm going to hold my
13 statement during my question period so I will not have
14 an opening statement. So with that, I will go to
15 Commissioner Quintenz.

16 COMMISSIONER QUINTENZ: Thank you, Mr.
17 Chairman. And thank you to the staff. Roger, Vince,
18 Dorothy for your engagement on this topic and the
19 briefings that you've given to us and the calls we've
20 had.

21 I do have, I do have a statement, Mr.
22 Chairman, but I don't think I'm going to read it and go

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1 through it. I think the points that I'll make will
2 come out in my questions. So I think I'll save us all
3 some time and yield back for now.

4 CHAIRMAN TARBERT: Sounds good. Commissioner
5 Behnam.

6 COMMISSIONER BEHNAM: Thanks Mr. Chairman.
7 And most importantly, thanks to Roger coming in from
8 Chicago, Dorothy, of course, and Vince. And I have a
9 statement that I'll publish on the website. I look
10 forward to supporting this rule and I think it's
11 important that we think about this in the context of
12 the effort that was made in the Fall of '18 with the
13 larger proposal.

14 And as I supported that proposal but made a
15 point that, you know, the whole overhaul was not
16 necessary, but there were certainly things within the
17 context of that large proposal that were worth moving
18 forward on. And I think today's proposal and effort
19 hits that goal. And again, thanks to the staff for
20 their hard work. I know this has been a long time
21 coming and thanks Mr. Chairman.

22 CHAIRMAN TARBERT: Thank you very much.

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1 Commissioner Stump.

2 COMMISSIONER STUMP: Thank you. Thanks to
3 the team. Thanks Roger, Dorothy, and Vince. Dorothy
4 and Vince, you've spent a lot of time with us today.

5 So I just wanted to say, I mentioned this when
6 we proposed the broad SEF reforms previously that I
7 don't think anybody thought it was going to be easy to
8 design an entirely new regulatory structure around a
9 marketplace that was already somewhat developed. But I
10 think the challenges proved even more vast than we
11 could have imagined. And so, the no-action relief that
12 was required was a logical outgrowth of the rule sets
13 and the things that we were learning as we were
14 designing the regulatory structure. But today -- after
15 several years, six years, we have the benefit of time
16 and experience and it is time to think about codifying
17 some of that relief. That makes sense.

18 You know, the SEFs, the market participants,
19 and the Commission have benefited from this time and we
20 have an obligation to provide more legal certainty
21 through codifying these provisions into rules. So I'm
22 supportive of what we're doing. And I look forward to

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1 the presentation, and I have a couple of questions, but
2 most importantly, thank you all. It's easy to simplify
3 that we're codifying no-action relief when it's much
4 more complex than that.

5 So thank you all for all the efforts.

6 CHAIRMAN TARBERT: Thank you Commissioner
7 Stump. Commissioner Berkovitz.

8 COMMISSIONER BERKOVITZ: Thank you Mr.
9 Chairman. I also would like to thank staff, Dorothy
10 and Vince, but particularly Roger. Roger's been
11 extremely helpful to my office, my staff, and improving
12 the document. And Mr. Chairman, this is a excellent
13 example of a process and we worked with DMO on the
14 other rule, too, but in this one, we're actually,
15 obviously it's not quite the same scope, but it's the
16 same spirit.

17 People working with the same spirit on this
18 rule as on the other one. And this one has -- it's
19 yielded results that I think have improved the rule and
20 make the rule stronger and more robust. And I'm
21 happy to support and want to acknowledge your efforts
22 in helping us get there. Thank you.

1 I have some specific questions regarding it
2 and some of these changes or improvements in the
3 document that I think are notably notable and I will
4 talk about those in the Q and A.

5 But I also do want to echo similar thoughts
6 on the no-action process that Commissioner Stump
7 articulated. The no-action processes widely criticized
8 as why don't you codify everything? You shouldn't have
9 to do this, but in some circumstances, in many
10 circumstances, you just can't foresee every
11 circumstance, everything that's going to arise. No-
12 action letters provide a way to address those
13 circumstances without going through a formality of a
14 rulemaking. And also it's generally time-limited.

15 No-action letters are generally timeline time
16 limited. And during that limited time and sometimes
17 they get extended, we can see the various conditions
18 and determine whether the relief should expire or
19 should be continued. And I think in this with some of
20 the package transactions that we're talking about here,
21 some of the relief has expired and now they are required
22 methods of execution and other ones, at this point in

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1 time we're going to fold into the rule.

2 So no-action relief, while it's not
3 necessarily optimal way to go, sometimes it's just very
4 useful and you do the best under the circumstances and
5 then with experience under our belt, we can codify it.
6 So I'm generally supportive of codifying no-action
7 relief in those types of circumstances where you have a
8 record, where we believe it will be beneficial for
9 market certainty in the practices that we're codifying
10 we've seen will not impair market integrity and it will
11 further accomplish the purpose of the rule that we're
12 amending.

13 So thank you. I'll get to specific questions
14 in my turn. Thanks again.

15 CHAIRMAN TARBERT: Terrific. Thank you so
16 much, Commissioner Berkovitz.

17 Well, I'd now like to invite our staff to
18 make a presentation on the proposal from the Division
19 of Market Oversight. I'd, of course, like to welcome
20 Roger Smith who has really taken the lead on this over
21 the last several months and worked closely with all our
22 offices. And I, of course, want to welcome back

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1 Dorothy Dewitt and Vince McGonagle who were here this
2 morning for position limits.

3 Mr. Smith, the rule is yours. The floor is
4 yours and the rule is yours too. And now we're
5 hopefully going to adopt it.

6 (Laughter.)

7 MS. DeWITT: Good afternoon, Mr. Chairman and
8 Commissioners.

9 Before we get started, I would like to take
10 the opportunity on behalf of those sitting here today
11 at a table with smaller limits, to thank our colleagues
12 in OGC, DCR, DSIO and our counterparts at the SEC, as
13 well as the staff at Chairman Tarbert, Commissioner
14 Quintenz, Commissioner Behnam, Commissioner Stump and
15 Commissioner Berkovitz for their time, efforts, and
16 contributions to making this rule proposal into
17 what it is before you today.

18 I'll now turn over to Roger Smith, Special
19 Counsel in DMO's Office of Chief Counsel to make the
20 staff's presentation for this proposal.

21 MR. SMITH: Thank you Dorothy.
22 Good afternoon Mr. Chairman and Commissioners. Thank

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1 you for the opportunity to present this proposal to the
2 Commission. Today, staff is recommending that the
3 Commission approve a proposal to amend certain swap
4 execution facility, trade execution, and processing
5 requirements related to package transactions, block
6 trades, and error trades.

7 This proposal would provide long overdue
8 legal and regulatory certainty to SEFs and market
9 participants in these areas. Specifically, this
10 proposal would amend Part 37 to allow required
11 transaction swap components of certain categories of
12 packaged transactions to be executed on SEF but through
13 flexible means of execution pursuant to 37.9(c)(2),
14 rather than through the required methods of execution
15 under 37.9(a).

16 In addition, this proposal would also amend
17 Part 36 to include an exemption from the trade
18 execution requirement for swap components executed in a
19 package transaction with new issuance bonds. Further,
20 this proposal would amend Part 37 to establish a
21 principles-based approach for SEF error trade policies.
22 The proposed amendment would enable SEF's to permit

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1 market participants to execute swap transactions to
2 correct operational or clerical errors using execution
3 methods other than those required under 37.9(a).

4 While the proposal permits SEFs to have
5 flexibility in determining the most suitable error
6 trade rules and procedures for their markets and
7 participants. The proposal also requires that any such
8 error trade rules or procedures be fair, transparent,
9 consistent, and allow for the timely resolution of an
10 error trade. The proposal would also require market
11 participants provide prompt notice to the SEF of an
12 error trade and as applicable the corresponding
13 correcting trade and offsetting trade.

14 Finally, with respect to block trades, the
15 proposed rules would amend the definition of block
16 trade in 43.2, which requires the execution of block
17 trades pursuant to the rules of a SEF to occur away
18 from the SEF, i.e., to be executed outside of the SEF's
19 trading systems or platforms. The amendment would
20 enable SEFs to offer non-order book methods of
21 execution from market participants to execute swap
22 block trades on the SEF.

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1 By allowing market participants to execute
2 block trades for swaps intended to be cleared on the
3 SEF's non-order book execution methods. It will help
4 SEFs and FCMS comply with their respective pre-
5 execution credit check responsibilities.

6 Thank you for your time and I look forward to
7 your questions.

8 CHAIRMAN TARBERT: Thank you very much Mr.
9 Smith, Roger.

10 To begin the Commission's discussion and
11 consideration of these rulemakings, I'll entertain a
12 motion to adopt the proposed rule relating to SEFs.

13 COMMISSIONER QUINTENZ: So moved.

14 COMMISSIONER BERKOVITZ: Second.

15 CHAIRMAN TARBERT: Thank you very much. I'd
16 now like to open the floor for Commissioners to ask
17 questions and give comments in order of seniority.

18 As I mentioned, I don't have any questions.
19 I just wanted to take a second though to explain. You
20 know, I'm the newest guy here on the Commission and
21 this whole area of SEFs, I feel like when people hear
22 about it, they glaze over swap execution facilities.

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1 So I thought I would just give a very brief
2 overview of what all this is about for those that may
3 be watching that for which this is a new subject area
4 as well as just run through the three things that we're
5 doing today in this no-action and explain why I support
6 them.

7 So before the financial crisis, swaps were
8 executed bilateral over-the-counter rather than on a
9 centralized exchange and in crafting the Dodd-Frank
10 Act. My colleagues were on the Hill at the time I was
11 at the Senate Banking Committee. We all faced sort of
12 a key decision, should we require swaps to trade like
13 futures, that is through a centralized exchange or
14 order book visible to the entire market or should we
15 retain the old bilateral off-exchange trading
16 practices.

17 Now this of course was a difficult decision,
18 after all the crisis highlighted the need for more
19 effective price discovery in our swaps markets. And
20 for more than a century centralized exchanges have
21 supported price discovery in futures products by
22 providing a liquid and transparent market. On the

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1 other hand, swaps are not futures. Many swaps products
2 are executed only episodically and through the
3 negotiation of very bespoke terms.

4 So ultimately, Congress sought what I think
5 was an attempt at a Golden Mean that would balance
6 these competing concerns. The Dodd-Frank Act gave
7 birth to the concept of the swap execution facility.
8 And these are platforms in which more standardized
9 swaps are required to trade. They resemble centralized
10 exchanges in some ways, but they have a lot more
11 flexibility in the execution methods to accommodate the
12 unique trading characteristics of swaps.

13 So when we, this Commission, implemented the
14 Dodd-Frank Act, or at least initially started, we
15 required swaps that must be executed on SEF to trade
16 via either the central limit order book or a request-
17 for-quote for at least three SEF participants. These
18 are known as the required execution methods.

19 I think overall, the SEF regime has worked
20 generally well, but as we all know, rarely is statutory
21 implementation perfect on the first attempt. Some
22 requirements work well for the swaps market as a whole,

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1 but not for particular types of transactions. And I
2 wholeheartedly agree with Commissioner Berkovitz that,
3 you know, no-action letters are a way to address
4 bespoke type situations that we couldn't necessarily
5 contemplate in advance or also things that are going to
6 be time limited.

7 So you have addressed DMO on a lot of these
8 issues over the last six years. And I think codifying
9 them makes a lot of sense.

10 And so, what are the three areas we're
11 dealing with today?

12 Well, first of all, package transactions. So
13 what is a package transaction? Well, it's basically
14 when you're executing different instruments that aren't
15 necessarily the same, either at the same time or close
16 in the same time. So I was trying to think what is an
17 analogy that might make sense here. And I think it's
18 conceptually similar to booking a flight and a hotel
19 for an overnight trip.

20 So each booking utility is contingent on the
21 other, so you want to book them at the same time to
22 make sure you get both. And you can often improve cost

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1 and efficiency by bundling the bookings through a
2 travel broker like Expedia or Kayak, for example. And
3 as a practical matter, the derivatives markets are no
4 different, but when the liquid and illiquid instruments
5 sort of trade together in a package, I think what we've
6 found is over the last several years, the more liquid
7 instruments tend to take on trading features of the
8 less liquid components. And as a result, it makes it
9 somewhat unfeasible to go through the required methods.
10 And it also increases a sort of the cost and reduces
11 the liquidity.

12 So under the today's rule issues, as you
13 stated, Roger, components of these could trade through
14 any execution method, not just the required method, but
15 the trade would have to still go on SEF. So I
16 certainly support that.

17 Error trades. Well, error trades is
18 essentially that a trade that involves an operational,
19 a clerical mistake. And so, here I think this is great
20 evidence of the principles-based approach. The Dodd-
21 Frank Act actually created core principles for SEFs and
22 allowed flexibility in their compliance with the core

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1 principles. And as I've said before, principles-based
2 regulation isn't a euphemism for a light touch approach
3 or deregulation. And so, I think what we've done is
4 provide some flexibility, but at the same time the SEF
5 needs to require its participants to reformative error
6 trades so the SEF can maintain orderly markets. And
7 so, I support that.

8 And finally, block trades. Similar to
9 package trades, but now you've got the same instrument
10 and you're doing it in a larger than average quantity.
11 I think of these as the Costco version of swaps.
12 You're trading in bulk.

13 Our swap trading rules in language borrowed
14 from our futures rules require block trades to go to
15 occur away from the SEF platform. Now the interesting
16 thing here is when Congress set forth its goals for
17 SEFs, one of those goals was to foster as many -- as
18 much trading as possible, promote as much trading as
19 possible.

20 On a futures exchange. You would never have
21 someone wanting to put a block trade on the central
22 limit order book because immediately the market would

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1 probably move against them. But here it seems rather
2 odd that we're forbidding them to do it on the SEF when
3 in fact Congress's goal is to put more stuff on the
4 SEF. So I think what you've done here on that is fine
5 as well.

6 So those are my comments. I really support
7 it. I think you've done a great job. And with that
8 I'll turn to Commissioner Quintenz.

9 COMMISSIONER QUINTENZ: Thank you, Mr.
10 Chairman. I just wanted to ask a couple of quick
11 questions on some specifics of the codifications and
12 then on some of the things that have not been proposed
13 to be codified here.

14 But Roger, you mentioned the prompt notice of
15 an error trade requirement. Just for the avoidance of
16 doubt, if a SEF's policies and procedures require market
17 participants to identify themselves in the course of
18 resolving an error trade in a timely manner, then would
19 those policies and procedures satisfy the regulations
20 notice requirement?

21 MR. SMITH: Thank you Commissioner Quintenz.
22 So the proposal makes clear that the notification of

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1 the error trade can -- does not have to be separate
2 from the error correction process. So in the scenario
3 that I think you're positing if the market participant
4 in the course of correcting the error trade notifies
5 the SEF of the error trade as well as the correcting
6 and offsetting trades, if applicable at all -- at the
7 same time, while simultaneously that would meet the
8 requirements under this proposal.

9 COMMISSIONER QUINTENZ: Okay. Secondly, can
10 you just describe a little bit how a SEF's error trade
11 policies and procedures relate to their other CFTC
12 requirements and SRO obligations?

13 MR. SMITH: We would expect that SEFs when
14 they implement their error trade rules, that they
15 ensure that their error trade rules are consistent with
16 their existing obligations under core Principle 2.
17 Specifically, we would look for them to be consistent
18 with 37.203(a), which prohibits fraudulent or
19 manipulative trading as well as we'd look for some
20 consistency -- we'd look for consistency with 37.203(e) and 37.400,
which require
21 monitoring for disorderly or manipulative trading on
22 their markets.

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1 COMMISSIONER QUINTENZ: Okay, okay. Thank
2 you.

3 The 2018 proposal codified a few additional
4 staff letters that are not in the proposal today.
5 Namely, the outstanding DMO staff guidance in letters
6 15-26 and 17-25 regarding the calculation of projected
7 operating costs by SEFs as well as staff No-Action
8 Letter 17-67, which provides relief from the trade
9 execution requirement for inter-affiliate swaps and
10 staff No-Action Letter 17-54, which provides relief from
11 audit trail requirements related to post-execution
12 allocation information.

13 Does the absence of those in this proposal
14 mean that the Division has changed its view on those or
15 not necessarily?

16 MR. SMITH: No. The absence of those letters
17 from this proposal does not change the Division's view
18 of those letters. I will note that all no-action
19 letters are always subject to modification and
20 potential withdrawal by the Division at our discretion
21 and the fact that the letters are still outstanding and
22 remain in effect, I think signals the Division support

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1 for those letters.

2 COMMISSIONER QUINTENZ: Thank you. I
3 appreciate that iteration of the view. And let me just
4 say that I would encourage the Commission to consider
5 codifying those no-action letters as well in the near
6 future.

7 And lastly, I think, there's a lot of
8 conversation around, you know, what is current market
9 practice in the SEF space and whether or not it may or
10 may not conflict now or in the future with what is in
11 our regulations. Is it current market practice now for
12 certain SEFs to facilitate the execution of acquired
13 transactions through auction platforms or work-up
14 trading protocols that the DMO staff at some point is
15 found to satisfy RFQ 3 or the CLOB requirements?

16 MR. SMITH: Thank you, Commissioner. So and
17 I think I've mentioned this at the 2018 SEF proposal,
18 but throughout the SEF registration review process,
19 staff worked very closely with the SEFs to ensure that
20 their legacy execution methods complied with the order
21 book and execution method requirements under 37.3 and
22 37.9. And I would further note that in order for

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1 a SEF to become registered with the Commission, it
2 needs to comply with all relevant Commission rules and
3 regulations.

4 COMMISSIONER QUINTENZ: Okay. Thank you for
5 that. I guess I would also note that I'm not aware of
6 any formal opinion or public opinion to that effect but
7 do appreciate you know, the candor of your response.
8 And because of a lack of a formal opinion it would be
9 my assumption that a subsequent Commission or Chairman
10 could change that interpretation which would lead me to
11 support again the potential codification of what you
12 have already done through that initial review.

13 So with that, let me leave it there. Thank
14 you all for your hard work on this and engaging with us
15 and I'm very pleased to support your work. Thank you.

16 MR. SMITH: Thank you.

17 CHAIRMAN TARBERT: Thank you very much,
18 Commissioner Quintenz. Commissioner Behnam.

19 COMMISSIONER BEHNAM: Thank you Mr. Chairman.
20 A quick process question, Roger, if you don't mind,
21 just as a matter of the existing no-action letters that
22 we are codifying. What's the Division's intention

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1 while we go through the rulemaking process? Will we
2 keep those in place until hopefully we get to a final
3 rule?

4 MR. SMITH: Yes. The Division's intent is
5 that those no-action letters will remain in place until
6 there is a permanent solution for these areas.

7 COMMISSIONER BEHNAM: Thanks. And then
8 regarding the error trades, there were a few conditions
9 within the no-action letters that are not included in
10 this proposal. Can you talk a little bit about those
11 conditions that are not in this proposal? And
12 specifically the ones I'm thinking of dictate who
13 determines when an error trade occurs.

14 So within the context of the proposal,
15 without those conditions what's your expectation of how
16 that will play out in the marketplace?

17 MR. SMITH: Thank you, Commissioner Behnam.
18 I think the intent of the proposal is to provide
19 SEFs the flexibility to determine the error trade
20 policies and procedures that are most suitable for
21 their market participants in their markets.
22 Understanding that the current existing No-Action 17-27

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1 and the supplemental no-action in 20-01 had various
2 conditions. And as you mentioned, specifically had
3 provisions dictating who would determine how an error
4 is resolved.

5 Nothing in this proposal, and we have a
6 footnote that makes this clear. Nothing in this
7 proposal would preclude a SEF from implementing or
8 maintaining those error trade rules and conditions that
9 are currently reflected in 17-27 and 20-01. Someone
10 mentioned, it's very much if you like your plan, you can keep your
11 plan
12 type of solution.

12 COMMISSIONER BEHNAM: Okay. Do you think --
13 would there be any circumstance where we as the
14 Commission would step in and opine that whatever
15 conditions the SEF created around dictating an error
16 trade would be insufficient?

17 MR. SMITH: As I mentioned in my opening
18 statement that while we're providing flexibility, the
19 proposal does, you know, require that error trade rules
20 and procedures that are adopted by a SEF must be fair,
21 transparent, consistent, and allow for the timely
22 resolution. So if a SEF adopted policies that were

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1 inconsistent with those requirements, I think that we
2 would step into, you know, find them to be
3 insufficient.

4 I would also note that if the procedures that
5 they implement are inconsistent with other Commission
6 rules and regulations, that that would also be another
7 scenario where it would necessitate action on our
8 behalf.

9 MS. DeWITT: May I add Commissioner that the
10 Division of Market Oversight has a Clients and
11 Examination Division that examines exchanges and
12 including SEFs for rule enforcement. They look at
13 their rules. They had the opportunity, or DMO has the
14 opportunity, to review rules in a separate division of
15 DMO before they are put in place, but they look at the
16 rules that are in place and make sure that they're
17 being implemented appropriately; consistent with the
18 obligations that Roger just outlined.

19 Starting last year we initiated at DMO a SEF
20 examination program that's continuing on now and
21 through this year to examine SEFs across various areas.
22 And that's one that we'll obviously factor in based on

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1 your comments.

2 COMMISSIONER BEHNAM: Thank you.

3 And finally, pivoting to block trades.

4 Roger, correct me if I'm wrong, but you mentioned
5 within the proposal blocks can occur on SEF but not the
6 CLOB or away from the SEF.

7 MR. SMITH: That is correct.

8 COMMISSIONER BEHNAM: Does the SEF have to
9 provide both options to its -- to the counterparties
10 or can it pick one or the other? Or is it -- how is
11 that going to play out in your view?

12 MR. SMITH: There's no explicit requirement
13 that a SEF offer a block trade functionality on the SEF
14 or offer a block trade functionality that occurs away.
15 However, I would note that to the extent that they are
16 facilitating swaps that are intended to be cleared, they
17 do have obligations regarding pre-trade credit checks
18 that they need to be cognizant of. And I would say
19 that that would limit the ability to completely go to
20 an occurs away tight policy on those SEFs.

21 COMMISSIONER BEHNAM: Thanks. It's very
22 helpful. And again, thank you guys for all your hard

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1 work. It's exceptional and I appreciate your
2 engagement with my office and as always look forward to
3 the comments and moving this rule forward. Thank you,
4 Mr. Chairman.

5 CHAIRMAN TARBERT: Thank you very much.
6 Commissioner Stump.

7 COMMISSIONER STUMP: I just have one question
8 with regard to this specific proposal we're considering
9 today and it relates to the pre-trade credit checks
10 that everyone's talked about now and the FCMs have an
11 obligation under Rule 1.73 to conduct pre-trade credit
12 checks.

13 But in the context of what we're doing today,
14 I was wondering if you could just speak a little to
15 what the obligations of the FCM are with regard to
16 transactions that are intended to be cleared, but that
17 they may not actually know are occurring at the SEF or
18 away from the SEF. If they're occurring on SEF and as
19 this rule would allow for, is it the expectation that
20 the FCMs would utilize the pre-trade credit check
21 functionality that the SEF is providing? And then if
22 they choose to transact off SEF, what are the

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1 obligations of the FCM in that regard?

2 MR. SMITH: So the expectation is, and one of
3 the main bases for this proposal is to provide a pre-
4 trade credit check function and that can be provided
5 through using the non-order book methods of execution
6 on the SEF. And that was one of the genesis behind the
7 original issuance of the no-action letter is that FCMs
8 made clear that there wasn't a functionality for them
9 to conduct their pre-trade credit checks away from the
10 SEF because they were -- they would be unaware that
11 their clients may be executing the transaction and then
12 bringing it to the SEF.

13 We do note in the proposal there's a footnote
14 which makes clear that if the FCM is unaware when it
15 clears the transaction that this transaction had been
16 executed away from the platform without its knowledge.
17 The FCM would not be found to have violated its pre-
18 trade credit check responsibilities under 1.73.

19 COMMISSIONER STUMP: Sorry. They would not
20 be found to, that's what you said. Right?

21 MR. SMITH: Yes.

22 COMMISSIONER STUMP: I just want to clarify.

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1 MR. SMITH: Yes.

2 COMMISSIONER STUMP: Thank you. And if on
3 SEF, as this rule is permitting, the FCM would be
4 expected to utilize the functionality that the SEF
5 offers with regard to pre-trade credit checks, is that
6 right?

7 MR. SMITH: Yes. And I would also just note
8 that we do ask in the proposal whether or not the
9 ability for swaps -- swap block trades to occur away
10 from the SEF still has a utility and we're very
11 interested in finding out market participants feelings
12 and thoughts on that.

13 COMMISSIONER STUMP: Okay. I don't have any
14 other questions. I would just like to echo some of the
15 things that Commissioner Quintenz said. I think there
16 are a number of no-action relief letters that are out
17 there that I would like to see us move forward with
18 codification and I look forward to working with you
19 guys on those. Thank you.

20 MR. SMITH: Thank you.

21 CHAIRMAN TARBERT: Thank you very much.
22 Commissioner Berkovitz.

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1 COMMISSIONER BERKOVITZ: Thank you, Mr.
2 Chairman.

3 The proposal notes that several of the no-
4 action letters for several of the types of package
5 transactions that are subject to no-action letters
6 saying you don't have to use required method execution.
7 In fact, during the pendency of while there were those
8 no-action letters out there. In fact, the market the
9 SEFs developed a way or the these transaction moved
10 onto the SEF and could be re-executed by required
11 methods of execution and therefore we've seen an
12 evolution over time, some of these packages
13 transactions actually have moved into one of the
14 required methods of execution. So by permitting -- by
15 codifying, so to speak, that current outstanding, no-
16 action relief. Do you think this will deter market
17 participants from developing assistance where increased
18 execution of package transactions on SEF under the
19 required methods of execution?

20 MR. SMITH: Thank you, Commissioner
21 Berkovitz. Staff does not believe that this proposal
22 would deter SEFs from developing and implementing new

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1 execution methods to facilitate the trading of the
2 package transactions covered by this proposal.

3 In particular, given the competitive
4 landscape that SEFs are under, they are incentivized to develop the
5 most effective and efficient methods of execution to
6 provide to their markets. However, as you point out,
7 the market is continuing to develop and there are new
8 developments every day and so we make clear in the
9 proposal that the Commission will continue to monitor
10 these developments to make sure that the package
11 transactions in which the swap component can be
12 executed through flexible means remains to be
13 appropriate going forward.

14 In addition, we also ask a question along
15 that line as well.

16 COMMISSIONER BERKOVITZ: I appreciate it. I
17 think that's, I'm sorry, go ahead Dorothy.

18 MS. DeWITT: Well, I was just going to add
19 that I think the making these no-action letter or the
20 relief of these no-action letters more -- have a longer
21 duration or more permanent does actually allow market
22 participants to go ahead and finalize their systems,

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1 put them in place, make sure they're running well and
2 move on to other areas of innovation with those, you
3 know, finite budgets that they have to develop. And
4 so, it does give some of that element of certainty and
5 allows them to innovate in areas rather than holding
6 some funds back and some resources back to the
7 contingency that these areas might change.

8 COMMISSIONER BERKOVITZ: I appreciate that.
9 And I agree that it's important to keep monitoring
10 these markets and use whatever authority we have to
11 ensure that we're not holding back development, let me
12 put it this way -- or that our regulatory structure
13 doesn't impede the facilitation of more efficient and
14 effective methods of execution. So I'm glad to see
15 that this will continue to enable the market to
16 develop.

17 With respect to error trades. The proposal
18 references and I'd like to just make clear, I
19 understand. This doesn't change the current rules
20 regarding or the current status. Let me put it that
21 way. The current status of void ab initio. And if you
22 could just maybe explain to the audience what exactly

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1 what that is and just confirm that we're not
2 -- the rule and how we're dealing with error trades
3 here does not affect that prior guidance or staff
4 position.

5 MR. SMITH: So void ab initio is essentially
6 when a trade is rejected from clearing, it is
7 considered to be no longer a valid transaction. So it
8 is void ab initio, which means it's as if it never
9 happened. This proposal, the intent of the proposal is
10 not to change, alter or supersede any of the status
11 around void ab initio as it is today.

12 COMMISSIONER BERKOVITZ: So given a trade may
13 or may not be void ab initio do it an error or
14 whatever. How you correct an error trade doesn't
15 change anything with respect to void ab initio?

16 Correct?

17 MR. SMITH: Correct.

18 COMMISSIONER BERKOVITZ: Okay. Thank you
19 very much for that clarification. And thank you again
20 for working with my office on these and other items
21 that I think help make this a robust rule that I'm
22 happy to support.

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1 MR. SMITH: Thank you.

2 CHAIRMAN TARBERT: Thank you very much,
3 Commissioner Berkovitz.

4 Are the Commissioners prepared to vote? If
5 so, Mr. Kirkpatrick, will you please call the roll for
6 the proposed rule on SEFs?

7 MR. KIRKPATRICK: Thank you Mr. Chairman.
8 The motion now before the Commission is on the approval
9 of the proposed rule related to SEFs. Commissioner
10 Berkovitz?

11 COMMISSIONER BERKOVITZ: Aye.

12 MR. KIRKPATRICK: Commissioner Berkovitz
13 votes aye. Commissioner Stump?

14 COMMISSIONER STUMP: Aye.

15 MR. KIRKPATRICK: Commissioner Stump votes
16 aye. Commissioner Behnam?

17 COMMISSIONER BEHNAM: Aye.

18 MR. KIRKPATRICK: Commissioner Behnam votes
19 aye. Commissioner Quintenz?

20 COMMISSIONER QUINTENZ: Aye.

21 MR. KIRKPATRICK: Commissioner Quintenz votes
22 aye. Chairman Tarbert?

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1 CHAIRMAN TARBERT: Aye.

2 MR. KIRKPATRICK: Chairman Tarbert votes aye.

3 Mr. Chairman on this matter the ayes have five, the
4 noes have zero.

5 CHAIRMAN TARBERT: The ayes have it and the
6 motion to adopt the proposed rule is hereby approved.

7 I'd now like to open the floor for any
8 Commissioner who would like to make a closing statement
9 or any other comments in reverse order of seniority.
10 Commissioner Berkovitz.

11 COMMISSIONER BERKOVITZ: Thank you Mr.
12 Chairman. I'd just like to note a couple things. I've
13 said this before and but I think it continues because
14 both of these things merit saying again, first of all -
15 - today again demonstrates the value of public meetings
16 and open dialogue and discourse. And I am just very
17 supportive of your commitment to do that and to have
18 these meetings and these deliberations in public.

19 I really think it's benefit to us. This is
20 the only time if five of us, like are in one room and
21 we were talk about these issues. We can say hello to
22 each other, but, you know, we really discuss the

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1 issues. And so, it's a great opportunity to do that
2 here directly, what others on the Commission think and
3 also for the public to see that dialogue too. I think
4 it's tremendously valuable and informative on the back
5 and forth.

6 So I continue to support these public
7 meetings and look forward to more of them as I
8 understand we're going to be having in the near future.

9 And then along those lines, again, I'd like
10 to thank today was a really heavy a lift for the
11 Division of Market Oversight and Office of General
12 Counsel, Office of Chief Economist on the two rules.
13 And we also did the Volcker rule today, which staff is
14 not at the table to present. But there was a lot of
15 work that went into that. I just want to thank all the
16 divisions for all the work put into it.

17 And we have an ambitious agenda. But and you
18 know, hopefully we'll be working hard and it'll be
19 paced out so we can do it, but it will be ambitious and
20 I'm committed to working with you and the staff to get
21 these things out.

22 And I'd also like to also thank my staff for

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1 all the hard work they've put in over the past several
2 weeks, if not months, to get us here today on these
3 rules and all the other things and many of the things
4 that public doesn't see all the enforcement actions and
5 all the meetings and the paperwork that goes through to
6 facilitate all of the Commission's business.

7 And then again, the interactions with my
8 colleagues in the Commission offices, so I thank Lucy,
9 Sebastian, and Eric for all their work on these
10 rulemakings. So with that thank you Mr. Chairman. I
11 look forward to being here in a few more weeks.

12 CHAIRMAN TARBERT: Thank you very much,
13 Commissioner Berkovitz. Commissioner Stump.

14 COMMISSIONER STUMP: Just briefly as we move
15 forward, I think there are a lot of other things that we
16 could continue to consider and talk to the public
17 about. And I know we will always be recalibrating our
18 rules, but particularly in the swap execution space
19 because it's new.

20 So I want to thank Roger, in particular, for
21 advancing these particular items today, but I know that
22 you're going to continue to work on the many other

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1 things that we are always talking to you about and I
2 appreciate all the time you've spent with us over the -
3 - it has been a year and a half now that you've spent a
4 lot of time with us working on these.

5 Outside of that, I would like to thank -- I'm
6 very appreciative of all of DMO's efforts, but I failed
7 to thank my team this morning and I think Terry is not
8 here right now, but I don't think Terry Arbit slept at
9 all last night as he was preparing for the position
10 limit meeting. And so, I want to -- I owe him a great
11 debt of gratitude. I thank Dan Bucsa for working on
12 the rules that we're considering now and Libby
13 Mastrogiacomo who got to do everything else while
14 everyone else was preoccupied. So thank you all very
15 much.

16 CHAIRMAN TARBERT: Thank you very much,
17 Commissioner Stump. Commissioner Behnam.

18 COMMISSIONER BEHNAM: Mr. Chairman, thanks
19 for your leadership on this. It was a very productive
20 day. And you know, echoing Commissioner Berkovitz's
21 statement, it's always good to be together and
22 deliberate these issues. And special thanks to DMO,

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1 it's a huge day and ton of work went into it, but I
2 appreciate your engagement and your commitment and
3 certainly look forward to more work to be done in the
4 future. Thank you.

5 CHAIRMAN TARBERT: Thank you very much.
6 Commissioner Quintenz.

7 COMMISSIONER QUINTENZ: Yeah, I'd like to
8 echo the comments of my colleagues and congratulate
9 you, Mr. Chairman and thank you for your leadership. I
10 think there are additional opportunities for leadership
11 in this space and I thank the staff for their hard work
12 on this rule as well as interaction with us. And
13 continuing to think, as Commissioner Stump said, about
14 how to recalibrate how we approach this environment to
15 make sure that our rules are clear and provide
16 certainty as well as protect the marketplace.

17 So my compliments to you, Roger, for your
18 work today and your work over the last month -- number
19 of months and years in this area and Dorothy and Vince
20 for your hard work, you know, across the board with
21 both of the rules today.

22 You know, you think about the last couple

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1 months, Mr. Chairman, we've done the cross-border rule.
2 We've done the capital rule, and now we're doing a
3 position limits rule and we have more rules coming up.
4 And I certainly couldn't have done that without the
5 phenomenal staff that I have behind me of Kevin, Margo,
6 and Peter.

7 And I know we're all so grateful for the
8 talent and the time of our teams, but I'm just
9 particularly grateful for mine. So thank you all. And
10 thank you again, Mr. Chairman.

11 CHAIRMAN TARBERT: Thank you very much.
12 Well, I won't -- I have so many people to thank about
13 700 to be exact and probably more than that. So I
14 just, again, thank you to everyone that has
15 participated in today's rulemakings. You've done a
16 fabulous job. And I thank my fellow Commissioners and
17 their staffs.

18 This really has been a collegial process. We
19 don't always agree, but we do have excellent dialogue
20 and I think all of us care about this agency, care
21 about the statute that we've been tasked with
22 implementing, and we want what's best for the nation.

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1 And so, that really does come out, even if we don't
2 always agree on the policy, we care about the agency.
3 And so, I'm grateful for that.

4 On the SEF area in particular, as I said, you
5 know, this is an area where I think ultimately it's
6 about evolution, not revolution. You know, we want
7 this market to continue to evolve to a place where even
8 if it doesn't look like our futures markets, there's
9 more, you know, transparency, price, discovery, et
10 cetera. But we don't want to move too far, too fast,
11 and try to force something ahead of the natural
12 progression. And so, I think we're all trying to
13 figure out, you know, how best to do that.

14 And so I'm certainly open to codifying
15 further no-action letters. I'm open to further tweaks
16 in this area as well, but I'll be looking for whatever
17 we propose to have a broad-based consensus of market
18 participants and stakeholders and fellow Commissioners.
19 So this seems like an area where we can perhaps come
20 together and both stakeholders in the market, staff
21 obviously, and your recommendations as well as the
22 Commission to continue to move this along. So with

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1 that are there, is there any other Commission business?

2 Anyone?

3 (No response.)

4 CHAIRMAN TARBERT: Okay. Well, then I will
5 move to adjourn the meeting.

6 COMMISSIONER BERKOVITZ: So moved.

7 COMMISSIONER QUINTENZ: Second.

8 CHAIRMAN TARBERT: Thank you very much. All
9 in favor say aye.

10 (Ayes.)

11 CHAIRMAN TARBERT: All opposed?

12 (No response.)

13 CHAIRMAN TARBERT: Okay. The ayes have it.
14 Again, grateful to everyone for their hard work. This
15 meeting is hereby adjourned.

16 (Whereupon, at 2:18 p.m., the Open Commission
17 meeting was adjourned.)

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