

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

PUBLIC MEETING OF ADVISORY COMMITTEE

Washington, D.C.

Friday, October 1, 2010

1 PARTICIPANTS:

2 Commission Members:

3 GARY GENSLER, Chairman

4 BART CHILTON, Commissioner

5 MICHAEL V. DUNN, Commissioner

6 SCOTT D. O'MALIA, Commissioner

7 JILL E. SOMMERS, Commissioner

8 Staff:

9 DAN BERKOVITZ
General Counsel

10 PHYLLIS DIETZ
11 Division of Clearing and Intermediary
12 Oversight

13 JOHN LAWTON
14 Division of Clearing and Intermediary
15 Oversight

16 SUSAN NATHAN
17 Division of Market Oversight

18 ANANDA RADHAKRISHNAN
19 Division of Clearing and Intermediary
20 Oversight

21 NANCY SCHNABEL
22 Division of Clearing and Intermediary
Oversight

RICK SHILTZ
Division of Market Oversight

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P R O C E E D I N G S

(9:35 a.m.)

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3 CHAIRMAN GENSLER: Good morning. This
4 meeting will come to order. This is the public
5 meeting of the Commodity Futures Trading
6 Commission to consider issuance of one interim
7 final rule and two proposed rules. It's an
8 interim final rule relating to the timeframe for
9 the reporting or preenactment unexpired swaps to a
10 swap data repository or to the Commission itself;
11 a proposed rule that would prescribe certain
12 financial resource standards for derivative
13 clearing organizations including those clearing
14 organizations that may in the future be designated
15 systemically important by the Financial Stability
16 Oversight Council under Title VIII of the
17 Dodd-Frank Act, and as that council's first
18 meeting is later today, of course these
19 designations are not yet made. And thirdly a
20 proposed rule specifying requirements for
21 derivatives clearing organizations, designated
22 contract markets and swap execution facilities on

1 their governance arrangements and ways to mitigate
2 conflicts of interest.

3 This is the first public meeting that we
4 have had to consider rulemakings under Dodd-Frank,
5 the Wall Street Reform and Consumer Protection
6 Act. The next meeting will be scheduled for
7 October 19. We anticipate putting out the Federal
8 Register notice for that. We also anticipate
9 continuing to have meetings through the fall
10 approximately once a week, we're still working on
11 our collective schedules, but we will notice each
12 of them and the specific topics to be discussed in
13 those meetings through the Federal Register as we
14 go along.

15 We will hear from staff today, and I'd
16 like to thank my fellow Commissioners for all
17 their hard work on the passage of the Dodd-Frank
18 Act, that was a team effort, but now that we have
19 these existing authorities I certainly
20 particularly want to thank their input into these
21 three proposals. We have a challenging agenda but
22 I know staff is up to it and I know for sure the

1 Commissioners are up to it as well.

2 I'd also like to welcome members of the
3 public. Two members of the public who are
4 particularly special who I want to mention include
5 John and Bev O'Malia, Commissioner O'Malia's
6 parents. I don't know if they're going to have
7 particular comments on these rules, but we look
8 forward to all of the public's comments.

9 COMMISSIONER O'MALIA: I'm going to have
10 them edit my statements next time.

11 CHAIRMAN GENSLER: Having met them, they
12 might have different views though. I don't know.
13 Welcome to all market participants and members of
14 the media at today's meeting as well as welcoming
15 those listening to the meeting on phone or
16 watching live on the webcast. I'd like to thank
17 staff for all their hard work. This was passed
18 July 21, and they had their first initial thoughts
19 and memos to the chair within days sometimes,
20 sometimes week, but to the full Commission within
21 4 or 5 weeks including term sheets and the debates
22 and dialogue with the SEC, the Federal Reserve and

1 other prudential regulators has been an enormous
2 accomplishment and I am so proud of what you all
3 have done. You've been able to incorporate as
4 best you can all the thoughtful recommendations
5 from fellow regulators and certainly the many
6 thoughtful comments from our Commissioners here
7 and considering international regulators as well.

8 This is the first step in a long path.
9 Two of the rules are proposals and we look forward
10 to receiving public comment and that public
11 comment is critical. The final rules often are
12 similar to the proposals but they naturally change
13 as we get the full input from the public, and
14 certainly I know for me that's going to be very
15 important as we move forward. Within regard to
16 the interim final rule on swap data repositories,
17 staff will come back later in the fall with
18 specific proposals at the appropriate time on
19 those swap data repositories themselves. This is
20 a specific feature of Dodd-Frank about
21 preenactment swaps.

22 We've organized ourselves around 30

1 rulemaking teams and they're all actively at work
2 so that we will be reviewing additional
3 recommendations from these teams as well as other
4 teams in a similar format going forward. Before I
5 turn to staff I'd like to turn to my fellow
6 Commissioners. Commissioner Dunn?

7 COMMISSIONER DUNN: Thank you, Mister
8 Chairman. I appreciate the hard work of the
9 staff. As I look out there I see you've twisted
10 Susan's arm just a little too far to get her to
11 give you everything we need.

12 As we begin the first steps in
13 implementing the Dodd-Frank Act, this is this
14 country's most significant financial reform bill
15 during my entire government service. While
16 Congress worked for nearly 2 years crafting the
17 legislation, they have charged us with
18 implementing it in 360 days. For an agency the
19 size of the CFTC with very limited fiscal and
20 human resources at its disposal, this will be a
21 Herculean task. Under the leadership of Chairman
22 Gensler, almost a third of CFTC staff have been

1 working in 30 areas to develop the rules necessary
2 to implement this legislation. We will be holding
3 a series of public meetings this fall to consider
4 rules in an effort to meet the timelines mandated
5 by Congress. Congress has worked hard, our staff
6 is working hard and now it is time for the public
7 to go to work.

8 In most cases we will be adopting
9 proposed regulations. There will be a period of
10 time for the public to comment on those proposals
11 and then we will adopt final regulations taking
12 the public's comments into account. If we are to
13 get it right, it is imperative that we have a firm
14 understanding of how the regulations created will
15 impact the markets we regulate and those who use
16 them. It is the role of the public to help us
17 understand that impact. Your input begins now.

18 Please take the time to review and comment on
19 these proposed regs to ensure we succeed together.

20 Due to the congressionally mandated
21 deadlines, comment period may be much shorter than
22 we might desire and extensions of comment periods

1 may not be feasible. It is therefore crucial that
2 those designed to have input on this process do so
3 as soon as possible. Your comments are important
4 in shaping the final outcome of the regulations.
5 As a Commissioner I intend to be liberal in
6 letting proposed regulations be published. This
7 includes proposals that I may not entirely agree
8 with. I intend to keep an open mind and take into
9 consideration the public's comments when making a
10 decision on a final rule. As staff work to
11 prepare these proposed rules, I would ask them to
12 keep two concepts in mind. First, I believe that
13 the principle- based regulatory regime that the
14 Commission currently adheres to works well. It is
15 no coincidence that with the advent of
16 principle-based regulations the markets we oversee
17 experienced a new wave of innovation and explosive
18 growth due in no small part to the nimbleness of
19 the CFTC. To the extent possible, I will ask
20 staff to continue to follow our principle-based
21 regime and forego prescriptive rules that mandate
22 a one-size-fits-all approach.

1 Second, I also believe that there are
2 several approaches this agency can take to
3 implement Dodd-Frank and still follow the
4 intentions of the drafters. I would ask staff to
5 present alternatives to proposed regulations that
6 would allow the public to comment on more than
7 just one solution and allow the Commissioners to
8 have choices on final rules adequately considered
9 by the public. I would be remiss if I did not
10 mention one other externality that will have a
11 major impact on the rulemaking process. Adequate
12 funding of the CFTC is essential to fulfill the
13 mandates of Congress. During the debate over this
14 legislation the CFTC was asked to provide an
15 estimate of the cost of implementing various
16 provisions of the bill. This estimate was based
17 on being funded at current request levels for FY
18 2011 with additional resources to reflect the
19 burdens imposed by the new law. Without full
20 funding it will be impossible to meet all of the
21 law's mandates and continue to fulfill our duties
22 under the current law. This puts the Commission

1 in the position of choosing what parts of
2 Dodd-Frank we actually have the resources to
3 implement and whether we can do so while
4 continuing to fulfill the core mission of the
5 agency. I would ask that staff provide an
6 estimate of the cost of each proposed regulation
7 and an analysis detailing whether the CFTC can
8 delegate duties to SROs to fulfill the mandates of
9 Congress. Further, I would ask staff working in
10 concert with the Chairman to provide the
11 Commissioners with a list of prioritizing
12 regulations based on available funding. It is
13 also important that the implementation of
14 Dodd-Frank means that certain services the CFTC
15 provides will no longer be provided. Those
16 services must be made public. Finally, I would
17 ask that staff begin to determine what rules and
18 regulations the CFTC can rescind as a result of
19 the adoption of new rules and I would encourage
20 CFTC Commissioners in the future to review the
21 Dodd-Frank rules within 3 years of enactment to
22 determine if they were actually doing what they

1 were designed to do.

2 I want to thank you, Mister Chairman,
3 for your leadership and the hard work of the
4 dedicated employees of the CFTC in preparing these
5 and future proposals.

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

8 COMMISSIONER SOMMERS: Thank you, Mister
9 Chairman. Good morning.

10 Now that Congress had done its part over
11 the last year and given us Dodd-Frank, regulators
12 are tasked with putting meat on the bones by
13 crafting the many regulations required to give
14 effect to the statute. Generally the headline
15 from Dodd-Frank is that the OTC swaps market will
16 now be subject to stringent regulatory oversight.
17 To implement this regulator oversight we have set
18 up 30 rule- writing teams that are drafting dozens
19 of regulations that we expect to formally propose
20 before the end of this year. This is a very
21 ambitious agenda, but Congress has given us little
22 choice with the statutory deadlines imposed.

1 While the rule-writing teams are
2 composed of very capable and hardworking staff and
3 have already been working for months, they will
4 have a daunting amount of work ahead of them. The
5 Commission began the process of publishing rules
6 last month. So far we've published final rules
7 relating to the retail forex trading, a project
8 that dates back to the passage of the 2008 Farm
9 Bill and was also included in Dodd-Frank, a
10 petition process for grandfathering exempt
11 commercial markets and an advanced notice of
12 rulemakings for agricultural swaps. Going forward

13 the process of proposing new rules will begin
14 rather quickly. Today we hold a meeting to vote
15 on three agenda items from Dodd-Frank. I fully
16 expect there to be many more such meetings as the
17 Chairman just discussed where the Commission will
18 publicly deliberate and vote on these proposed
19 rules. I want to continue to urge all interested
20 parties to engage in this transparent process.
21 Commenting before a regulation is proposed can be
22 very helpful as well as commenting after a

1 proposal has been published. It's imperative for
2 us to have this input from stakeholders and I
3 agree with Commissioner Dunn about encouraging you
4 to do is as soon as a rule is proposed.

5 Some of the issues we are discussing
6 today are much more complex than they first
7 appear. Adding to the complexity, many of the
8 provision require multiagency coordination. I
9 know the Chairman and the rulemaking teams have
10 been very mindful of the importance of successful
11 cooperation among regulatory agencies that are
12 tasked with enforcing this new statute. Without
13 continued progress in this area and consistent
14 rule proposals, the agencies risk injecting
15 additional uncertainty into the already complex
16 process by which the OTC markets and participants
17 will come under the regulatory regimes of one or
18 more agency. In my view, additional uncertainty
19 could be devastating and I will do all I can to
20 ensure that we do not have such an outcome.

21 It goes without saying that market
22 regulators have their hands full. Achieving these

1 reforms will take time, and comprehensively
2 changing the regulatory landscape in such a short
3 period will not be easy. I recognize that it is
4 imperative that we get it right and that our goal
5 as regulators is smart regulation. We can do
6 damage to these vital markets without that goal.
7 I fully intend to do all I can to make sure we
8 don't get it wrong and that our markets continue
9 to thrive. I want to staffs of these three
10 rule-writing teams for all of the work that they
11 have done to get these proposals ready in such a
12 short amount of time. I know you've spent a lot
13 of long hours and I want to let you know how much
14 we all appreciate that. Thank you.

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

17 COMMISSIONER CHILTON: Thanks, Mister
18 Chairman. I was thinking about this last night
19 and I was thinking about that old Chicago song, I
20 don't know if people remember it, but I'm going to
21 put it in your head for the day if you do, "Only
22 the Beginning," remember it's only the beginning,

1 it's only just the start. So this is the first
2 public meeting that's just the beginning and just
3 the start and it's important and I thank all the
4 staff who have been working double-time on this.

5 There has been a lot of talk and a lot
6 of news articles lately about the flash crash and
7 there will be more on that in the next little bit,
8 but here is what's clear, that these markets are
9 all inter-related, the securities markets, the
10 futures markets, even the global markets and to
11 the extent that we can harmonize in the U.S. and
12 globally, as the Chairman has been talking about
13 earlier this week in Brussels, it's really
14 critical. Some of the things that we're doing in
15 the markets with our brethren regulators,
16 particularly the SEC, but with our other sister
17 regulators in the U.S. government, they're
18 Band-Aids. They are important, they're
19 significant, like Commissioner Sommers said I
20 think these are imperative changes that we're
21 doing. But the work that we're doing today, that
22 we're starting today, are the real structural

1 changes. The Dodd-Frank stuff is the long-term
2 stuff and I share Commissioner Dunn's concerns
3 about the funding. We can deal with some of these
4 issues with the flash crash but these longer-term
5 things, if we don't have the money I think it will
6 be really tough for us to aggregate position
7 limits much less enforce them. I think doing the
8 clearing that's required particularly with regard
9 to what's currently dark markets, the OTC trades,
10 that will really just be I think almost an
11 insurmountable task for us. Likewise, the new
12 authority we've been given in enforcement,
13 disruptive trading practices, going out and
14 investigating these things, that's another thing,
15 whereas as Commissioner Dunn said we're going to
16 have to make some tough choices if we don't have
17 the money. Finally, dealing with things like the
18 advent of high-frequency trading. I'm not saying
19 it's a good or a bad thing, but it's certainly
20 something we need to get our arms around.

21 I hope that we get the funding we need
22 and we can make it for a few months, we can put

1 the rules in place but we can't actually monitor
2 them and oversee them like Congress intends. So
3 this is just the beginning and it's just the start
4 and I look forward to doing the work we have to do
5 with all of you. Thanks.

6 CHAIRMAN GENSLER: Thank you,
7 Commissioner Chilton. Commissioner O'Malia? Did
8 you want your folks to do the statement?

9 COMMISSIONER O'MALIA: No, thanks. I do
10 appreciate having them here and while I have no
11 illusion that grandchildren might have been a
12 stronger draw than a Commission meeting it is good
13 to have them in my corner.

14 I would also like to echo my fellow
15 Commissioners in thanking staff for the very hard
16 work that has gone into this rulemaking, long
17 hours have resulted and this is the culmination of
18 that and we're going to put these rules out. I'd
19 also like the compliment the other 27 teams for
20 their work in identifying issues and preparing the
21 proposed rules. I can say from firsthand
22 experience that the amount of paper and the number

1 of meetings that I've endured is overwhelming.
2 It's a massive amount of work, staff is under
3 great pressure to come up options and ideas and we
4 appreciate all the work that they do to give us
5 those options so we can make informed decisions
6 and then obviously put them out for public comment
7 which is essential and I strongly urge the public
8 to comment. It will be under tight timeframes,
9 but their input is essential.

10 With regard to the rulemakings today I
11 intend to support all three. However, I have a
12 number of concerns associated with the
13 prescriptiveness of the proposed
14 conflict-of-interest rules. I believe that we
15 have other remedies within Dodd-Frank that could
16 be more effective in achieving the goal of
17 expanding access to clearing. With regard to the
18 conflict of interest, I'm mindful that the main
19 goal of this Act is to reduce systemic risk and by
20 imposing mandatory clearing that's the way the
21 Congress has chosen to achieve that. The business
22 of clearing is a serious and a financially complex

1 matter and it should be treated as such. I am
2 concerned that the proposed rules seek to impose
3 limited and inflexible ownership caps and not
4 afford the Commission the flexibility to consider
5 all statutory objectives including promotion of
6 competition in reducing systemic risk.

7 In addition, I'm quite confident that
8 the open access and product eligibility provisions
9 in Sections 2(h) and 2(b) under the Act will be
10 more effective in guaranteeing access to clearing
11 than the ownership rules which I believe to be an
12 imprecise and ineffective tool to enhance
13 competition, mitigate systemic risk and resolve
14 conflicts of interest all specified in the
15 statute. With that said, I do appreciate the
16 inclusion of the waiver provisions resulting from
17 working with the Chairman's staff that will
18 provide the Commission with greater flexibility,
19 and considering the Commission is yet to receive a
20 single DCO application, I believe this flexibility
21 is warranted.

22 With regard to financial resources, core

1 principle B, this rulemaking is the first among
2 many designed to mitigate systemic risk through
3 clearing in the swaps market. However, as the
4 Commission proposes rules to implement the Act,
5 DCOs will be required to meet more stringent
6 capital requirements which will be passed on to
7 their customers. Market participants should have
8 no illusion that the cost of clearing will
9 increase. At the end of the day it remains to be
10 seen whether lower returns on capital and higher
11 transaction costs will have its own unintended
12 negative impact on liquidity, competition and
13 innovation in the markets. As to the interim
14 final rule on margin and preenactment swaps, I
15 agree with the Commission's decision to report
16 swaps entered into before enactment and I know
17 many commercial entities are interested to know
18 whether or not the Commission will impose margin
19 on these preenactment swaps. I understand this is
20 an issue that will be addressed in a future
21 rulemaking, but I would like to take the
22 opportunity to make it crystal clear that I oppose

1 interfering with privately negotiated contracts
2 entered into prior to the Act and I believe that
3 ant rule of regulation designed to do so would be
4 of questionable legality and an extraordinarily
5 unwise policy decision.

6 Mister Chairman, I'm pleased that we're
7 going to have this first rulemaking and I look
8 forward to the many rulemaking meetings to come
9 and to have our say in these things. With that,
10 let's move on.

11 CHAIRMAN GENSLER: Thank you,
12 Commissioner O'Malia. I want to associate with so
13 many of the remarks of my fellow Commissioners in
14 their openings but particularly that we really do
15 look for and need the public's comments. I'm
16 going to as you will see support all three of
17 these rules, but I suspect 6 months from now or in
18 the case of governance just 3 months from now when
19 we try to finish it up that I will have changed my
20 mind based on the public comments on all of these
21 because the public's views are really important.
22 I think we've all stressed that and that's what's

1 so important. These are just proposals. These
2 are to get the public dialogue really moving to
3 the next stage and I don't think they should be
4 confused with where we'll end up as a final rule.

5 We have 288 days to go until we finalize
6 all this. We've had 170-plus meetings with public
7 participants that we list on our website. We've
8 counted it up and we've had 145 meetings at least
9 with fellow regulators and 100 of those were with
10 the SEC. We didn't count up the international
11 regulators but there are probably a dozen or more.
12 With that the first proposed rule we're
13 considering today is an interim final rule
14 relating to the timeframe for reporting
15 preenactment swaps. These transactions existed
16 before the President signed the bill and so what
17 Congress asked is that those preenactment swaps
18 that are still in existence be reported to a swap
19 data repository and that's why it comes to this.
20 Susan Nathan from the CFTC's Division of Market
21 Oversight will be presenting an overview of the
22 proposed interim final rule, Rick Shiltz who is

1 the head of the Division of Market Oversight will
2 be I guess supporting Susan and giving guidance to
3 Susan as her boss, but Susan and Rick will be
4 presenting. I'm going to introduce the whole
5 panel and then we'll be off.

6 The second set of proposed rules being
7 considered today prescribes certain financial
8 resources standards for derivatives clearing
9 organizations. These are the organizations that
10 have existed from the 1890s that help lower risk
11 to the American public that stand between parties
12 in these complex transactions. Phyllis Dietz and
13 John Lawton from the CFTC's Division of Clearing
14 and Intermediary Oversight will be presenting here
15 today. Ananda Radhakrishnan who is their boss and
16 the head of the Division of Clearing and Oversight
17 I guess will support Phyllis and John and give
18 them direction. Finally, the third set of
19 proposed rules being considered today specifically
20 require derivative clearing organizations and
21 various exchange platforms, what we call
22 designated contract markets and swap execution

1 facilities, to have certain governance
2 arrangements and mitigate their conflicts of
3 interest. I think this is the one that's had the
4 most debate not only here among the five of us in
5 101 sessions, never on the wrong side of the
6 Sunshine Act, but also public debate. This was a
7 very healthy debate in Congress as well and I do
8 look forward to a lot of comments there. Nancy
9 Schnabel from the Division of Clearing and
10 Intermediary Oversight with Ananda's support and
11 guidance as well will be presenting that.

12 The procedure will be you'll present,
13 Susan and Rick will do this first one, and after
14 your presentation I'll entertain a motion and then
15 we'll have questions, debate, a vote and then
16 we'll move to the second and third. With that,
17 Susan and Rick?

18 MS. NATHAN: Thank you, Mister Chairman
19 and Commissioners. I'm pleased to provide a brief
20 summary of this interim final rule. Essentially
21 this rule imposes a present obligation on
22 counterparties to preserve transaction data

1 associated with swaps executed prior to the
2 enactment of the Dodd-Frank Act and a future
3 obligation to report that data to an appropriate
4 registered swap data repository or SDR. Before
5 discussing the substance of the rule, I'd like to
6 remind the Commission that this rule is styled as
7 an interim final rule. Interim final rulemakings
8 are designed to permit a federal agency to adopt
9 as final for good cause shown a rule that hasn't
10 been noticed for comment in the Federal Register
11 in the traditional way. Instead, the agency may
12 publish the rule as final while concurrently
13 soliciting public comment. Frequently, public
14 comment received in connection with an interim
15 final rule will be responded to if and when a
16 permanent rule is subsequently proposed by the
17 agency.

18 Here good cause is demonstrated first by
19 the explicit direction in Section 729 of
20 Dodd-Frank which requires the Commission to adopt
21 such a rule. In addition, staff believes that an
22 interim final rule is warranted in these

1 circumstances by the necessity to promptly provide
2 notice to swap dealers, major swap participants
3 and other counterparties that they may become
4 subject to reporting requirements which
5 necessitate that they preserve data relevant to
6 those transactions.

7 Among other things, Title VII of the
8 Dodd-Frank Act amended the CEA to require that
9 swaps be reported to a registered SDR or to the
10 Commission if there is no registered SDR that
11 would accept the swap. Practically this might
12 occur where no SDR has yet been registered by the
13 Commission or where no SDR has been approved for a
14 particular asset class. Section 723 of Dodd-Frank
15 adds Section 2(h)(V) to the CEA to require that
16 swaps executed prior to enactment must be reported
17 to a registered SDR or to the Commission no later
18 than 180 days from the effective date of that
19 subsection, so that would be approximately 540
20 days from enactment. The statutory provision that
21 is directly relevant here which is 729 establishes
22 a new Section 4(r) of the CEA reporting

1 requirements in connection with preenactment
2 unexpired swaps, those entered into before July
3 21, 2010 and unexpired as of that date and that
4 rule will remain in effect until the effective
5 date of the permanent reporting rules to be
6 adopted pursuant to 2(h)(V). Specifically,
7 Section 4(r) provides that within the time period
8 prescribed by the Commission, each swap must be
9 reported to a registered SDR or where there is no
10 SDR that would accept the data to the Commission.
11 This section further specifies that each
12 preenactment unexpired swap must be reported to a
13 registered SDR or the Commission and directs the
14 Commission to promulgate within 90 days of an
15 enactment of Dodd-Frank an interim final rule
16 governing reporting of such swaps. It's
17 anticipated that the provisions of this rule will
18 be supplanted by the permanent reporting rules to
19 be enacted pursuant to new CEA Section 2(h)(V),
20 but in the meantime these will govern how these
21 swaps are to be traded.

22 Consistent with the mandate of Section

1 729, new Part 44 of the Commission's regulations
2 will first establish a reporting timeframe for
3 preenactment unexpired swaps that is no later from
4 60 days from the date the appropriate SDR is
5 registered with the Commission or by the
6 compliance date that will be established in the
7 swap reporting rules required by new Section
8 2(h)(V) of the CEA whichever comes first. And,
9 two, will require that swap reporting parties
10 specified in Section 4(r)(A)(iii) of the CEA, and
11 those are swap dealers, major swap participants
12 and other counterparties, report information
13 concerning such swaps to the Commission on request
14 during this interim period. The Part 44 rules
15 will specify the information to be reported under
16 the interim final rule including a copy of the
17 transaction confirmation in electronic form where
18 available and, two, if available the time the
19 transaction was executed. The rules additionally
20 provide that the Commission may request from
21 reporting parties any information related to a
22 swap transaction. Part 44 also includes an

1 interpretative note explaining the Commission's
2 view that in order to comply with the reporting
3 requirements of Part 44, each counterparty to a
4 preenactment unexpired swap transaction that may
5 be required to report that transaction must retain
6 in its existing format all information and
7 documents related to the terms of the swap
8 transaction. The requirement takes the form of an
9 interpretative note because a retention
10 requirement is not explicit in Section 4(r). The
11 requirement to retain information is nevertheless
12 in staff's view implicit in a future reporting
13 requirement. Thank you and I'll be happy to
14 entertain any questions.

15 CHAIRMAN GENSLER: Thank you very much,
16 Susan. I think the Chair will now entertain a
17 motion to accept the staff recommendation to issue
18 the proposed interim final rule relating to the
19 reporting of preenactment swap transactions to
20 data repositories or to the CFTC.

21 COMMISSIONER DUNN: So moved.

22 CHAIRMAN GENSLER: Second?

1 COMMISSIONER SOMMERS: Second.

2 CHAIRMAN GENSLER: All in favor?

3 (Chorus of ayes.)

4 CHAIRMAN GENSLER: I'm supposed to let
5 questions happen. I know where we are, but are
6 there questions for Susan or debate? Commissioner
7 Chilton?

8 COMMISSIONER CHILTON: Susan, thank you
9 and thanks for all your work on this. I know
10 you've spent a lot of time on it. I was looking
11 through the comments online and for those of you
12 who don't know, we're taking them even before we
13 have these proposed rules. They've set it up on
14 our website and there are a lot of them up there
15 already. On this one, the Electric Power Supply
16 Association sent us a comment talking about the
17 transaction rule, but they are concerned that
18 since we don't have the definitions done yet for
19 major swap participants or for SDs, they wonder
20 whether or not institutions should be responsible
21 for -- they think they're going to have a
22 reporting problem and that there perhaps -- let me

1 just get it right what they said. I'm looking for
2 specifically what they said. In particular, we're
3 recommending that financial institutions with
4 prudential regulators be responsible for reporting
5 or if there is perhaps it should be the seller,
6 what's your view on that?

7 MS. NATHAN: I'm not sure I entirely
8 understand the comment. If their concern is that
9 they may be subject to a reporting requirement
10 before it's been determined that they should be
11 subject to a reporting requirement, I think the
12 best advice is that if they preserve the data
13 until such time as these definitions are in place,
14 it will become clear to potential reporting
15 parties before there is any present obligation to
16 report whether or not they are affected by these
17 rules.

18 CHAIRMAN GENSLER: Because we're allowed
19 to deliberate, I think the question that's come up
20 by many market participants is who might be a
21 major swap participant. I was asked this question
22 at a congressional hearing yesterday and I can't

1 say where you all are, but I think Congress has
2 really laid out three criteria in that
3 circumstance where this should be a very narrow
4 set of companies. They're people who are not
5 otherwise swap dealers and yet under each of these
6 three prongs have some systemic relevance, their
7 positions in the swaps market are such that
8 Congress would deem and through us the rule makers
9 deem that they should have a full regulatory
10 regime. I'm hopeful when the SEC and the CFTC
11 finish up the rulemaking that it will be quite
12 clear that this is a pretty small set of parties.

13 COMMISSIONER CHILTON: I have one more
14 if it's okay. We've heard a lot about the
15 practical problems with real-time swaps reporting
16 for nonfinancial organizations that are designed
17 to capture trades as they occur both in the
18 grandfathering phase and in going forward and that
19 this would be a compliance burden for them and
20 perhaps even an enforcement problem, front-running
21 for example. How does this proposal address that?

22 MS. NATHAN: If I'm understanding your

1 question, I'm not sure that this proposal does
2 address that.

3 COMMISSIONER CHILTON: Like we said, we
4 look forward to getting comments.

5 CHAIRMAN GENSLER: Commissioner Dunn?

6 COMMISSIONER DUNN: Thank you, Mister
7 Chairman. Susan, to get it straight in my mind
8 and in the public's that this is an interim final
9 rule under the Administrative Procedure Act. It
10 goes into effect immediately. But there is a
11 comment period and we have 30 days on this one for
12 people to look at it and comment. So under the
13 Administrative Procedure Act we can take those
14 comments and we can change this interim final
15 rule. What we're really waiting for is the
16 permanent rule on reporting.

17 MS. NATHAN: That's correct.

18 COMMISSIONER DUNN: Again it's incumbent
19 on the public to take a look at this. If they
20 think we've missed something or we should have
21 included something, they can comment within 30
22 days, but after that period this is what will be

1 in effect until the permanent rule?

2 MS. NATHAN: Until the permanent rules
3 are in effect.

4 CHAIRMAN GENSLER: Commissioner Sommers?

5 COMMISSIONER SOMMERS: I'm going to
6 follow-up on Bart's line of questioning and ask if
7 you can clarify because I think maybe where the
8 questions are surrounding these issues is not
9 whether you are considered a swap dealer or a
10 major swap participant, but the questions are
11 surrounding what is a swap. All of these people
12 who have entered into transactions pre-Dodd-Frank
13 and are not positive that these transactions are
14 going to be defined as swaps have concerns about
15 what information they should or should not retain.
16 If you could maybe clarify your advice to people
17 who are not sure about the transactions that they
18 have entered into and whether or not they should
19 retain that information.

20 MS. NATHAN: My advice is that they
21 should retain information necessary -- I can give
22 you a short laundry list with the caveat that

1 you're absolutely right, we have no way of knowing
2 now precisely who will be affected by the
3 reporting rules so the best advice would be for
4 anyone who thinks there is the potential for
5 reporting to maintain basic advice, any
6 information necessary to identify and value the
7 transaction, the date and time of execution,
8 information relevant to the price of the
9 transaction, if the transaction was accepted for
10 clearing, the identify of the clearing
11 organization, any modification to the terms of the
12 contract and the final confirmation. That would
13 be a small dataset.

14 COMMISSIONER SOMMERS: Thank you. I
15 also have one other question in relation to the
16 statutory language that requires preenactment
17 unexpired swaps to be reported. I'm wondering if
18 you have given any thought to considering
19 exempting swaps from reporting requirements if
20 they were unexpired before the date of Dodd-Frank
21 but expire in the interim and if it is useful for
22 us to have swaps reported to us that have expired

1 in the interim.

2 MS. NATHAN: I take your point. The
3 statutory language though is fairly clear that
4 they want unexpired swaps. If they were unexpired
5 on the date of the legislation then they count and
6 without any clear legislative guidance on that, I
7 am assuming and my counterparts at the SEC
8 likewise believe that Congress may have intended
9 that this would give a good snapshot of what the
10 status of what the swaps markets were at that
11 point.

12 COMMISSIONER SOMMERS: Thank you.

13 CHAIRMAN GENSLER: To give a little bit
14 more context to this question of definitions which
15 I think is an excellent question that Commissioner
16 Sommers raises, the SEC and the CFTC under the Act
17 as I understand it have to do joint rulemaking on
18 two sets of definitions broadly, entity
19 definitions, the swap dealer is pretty well
20 defined in statute, major swap participant is
21 defined in statute, but entity definitions will
22 give more clarity to that. Then product

1 definitions. Again a swap is defined in statute
2 and has a list of 15 or 20 things right there in
3 statute and it excludes forwards for instance and
4 the SEC and CFTC will work together. Our current
5 working goal is to get a proposal out this fall.
6 I think in fact that we may have even ambitiously
7 tried to schedule that for a November hearing both
8 at the SEC and at the CFTC. I say ambitious
9 because 10 Commissioners ultimately will be
10 involved and not just five and so there are just
11 more moving parts. It will only be a proposal at
12 that time but it will give some foreshadowing of a
13 final rule that both Commissions are trying to do
14 definitions. If we're successful before
15 Thanksgiving or if we're not, hopefully shortly
16 after Thanksgiving.

17 COMMISSIONER DUNN: Mister Chairman, you
18 make it sound like working with five is tough.

19 CHAIRMAN GENSLER: I think that it's
20 terrific, but it's five here, five there, the
21 Federal Reserve, the international regulators, the
22 FSOC and taking all of the public's interests and

1 congressional intent.

2 COMMISSIONER DUNN: For the interim
3 then, we're allowing people to look at the Act,
4 read the definitions that are in the Act and then
5 they have to make some assumptions on their own.
6 Is that correct?

7 MS. NATHAN: Yes, that's correct.

8 CHAIRMAN GENSLER: Before I call the
9 vote I was going to mention a couple of things. I
10 wanted to clarify the comment period on this
11 interim final rule is 30 days just to make sure
12 the public knows that again as Commissioner Dunn I
13 think helpfully pointed out. I'm going to vote
14 for this. I support the interim final rule. I
15 think it fulfills the Dodd-Frank requirement that
16 those swaps executed before the bill's enactment
17 but still in force at that point be reported to a
18 swap data repository or the Commission if no swap
19 data repository in the future takes this. I'm
20 hopeful that a swap data repository does for all
21 the resource reasons that Commissioners talked to.
22 Under the interim final rule, swap participants

1 would preserve preenactment swap transactions and
2 report the data to a registered swap data
3 repository once it's established and since swap
4 data repositories have not yet been established I
5 think it is an appropriate thing to give people
6 time and in a sense give them notice. The
7 Dodd-Frank Act said we had to do this within 90
8 days, but since swap data repositories are not
9 registered yet and don't exist in that way I think
10 it is appropriate that we in essence to fulfill
11 this requirement are giving a delay to this and
12 just asking people to maintain -- I don't know if
13 any my fellow Commissioners wanted to say
14 anything.

15 COMMISSIONER DUNN: One more on
16 clarification. Then if folks do have doubts of
17 where they stand then they can contact staff?

18 MR. LAWTON: They can contact someone
19 here and we'll try to provide guidance to the
20 extent we can.

21 CHAIRMAN GENSLER: There is a motion on
22 the floor. All those in favor?

1 (Chorus of ayes.)

2 CHAIRMAN GENSLER: Are there any
3 opposed? The vote being unanimous, the interim
4 final rule should be sent to the Federal Register.

5 I think I'll now turn to Phyllis Dietz
6 and John Lawton. They'll present the staff report
7 on the proposed rule considering clearinghouses,
8 core principles and systemically important
9 clearinghouses. Phyllis and John?

10 MR. RADHAKRISHNAN: Thank you, Mister
11 Chairman, and good morning to members of the
12 Commission.

13 Today we're going to recommend to the
14 Commission that it approve three rulemakings on
15 the Dodd-Frank Act. The first one relates to
16 proposed rules to give effect to DCO Core
17 Principle B which is in the statute as augmented
18 by Dodd-Frank with respect to the prescription of
19 financial resource requirements for derivatives
20 clearing organizations including DCOs that would
21 be designated as systemically important by the
22 Financial Stability Oversight Council pursuant to

1 Title VIII of the Dodd-Frank Act. The team leader
2 for the first rulemaking is Phyllis Dietz of DCIO.
3 The team leader for the systemically important DCO
4 rulemaking is John Lawton also of DCIO.

5 Then the second set of rulemakings
6 applies to potential conflicts of interest in
7 connection with the interaction between swap
8 dealers and major swap participants and certain
9 DCO designated contract markets and swap execution
10 facilities and proposed rules to adopt numerical
11 limits on control of voting rights that enumerated
12 entities may hold in certain DCOs, DCMs and SEFs.
13 And also proposals specifying requirements for
14 these entities on governance arrangements and
15 mitigation of conflicts of interest. The team
16 leader for that particular set of rulemakings is
17 Nancy Schnabel of DCIO. Before I pass it on to my
18 colleagues I would like to thank the other team
19 members of each of these teams. There was a lot
20 of effort that went cross-divisionally. I'd also
21 like to thank the Commission for their feedback on
22 these proposed rules and the staffs of the

1 relevant Commissioners for their helpful comments.
2 With that I will turn it over to Phyllis Dietz.
3 Thank you.

4 MS. DIETZ: Good morning, Chairman
5 Gensler and Commissioners. I am pleased to
6 recommend that the Commission approve for
7 publication the proposed rulemaking for
8 derivatives clearing organization financial
9 resources.

10 Prior to enactment of the Dodd-Frank
11 Act, the Commodity Exchange Act set forth 14 core
12 principles with which a derivatives clearing
13 organization must comply in order to be registered
14 as a DCO and to maintain its registration.
15 Dodd-Frank revised several of the core principles
16 and it added four new core principles, bringing
17 the total to 18. One of the core principles that
18 was revised is Core Principle B concerning
19 financial resources. It was amended by the
20 Dodd-Frank Act to require more specifically that a
21 DCO possess financial resources that at a minimum
22 satisfy two requirements. First, the financial

1 resources must exceed the total amount that would
2 enable the DCO to meet its financial obligations
3 to its clearing members notwithstanding a default
4 by the clearing member creating the largest
5 financial exposure for the DCO in extreme but
6 plausible market conditions. This is what we
7 refer to as default resources. Second, it
8 required that the DCO have sufficient financial
9 resources to enable it to cover its operating
10 costs for a period of 1 year calculated on a
11 rolling basis. These we sometimes refer to as the
12 operating resources.

13 The proposed rule before you today would
14 codify the standards set forth in Core Principle B
15 with additional specificity concerning five areas,
16 the types of financial resources that can be used
17 to meet these requirements, computation of
18 required resources, valuation, liquidity and
19 reporting requirements regarding the DCO's
20 financial resources. I would add to the earlier
21 discussion about comment periods that there will
22 be a 60-day public comment period for this

1 proposal.

2 Going back to each of these five areas
3 very briefly in overview, the types of financial
4 resources that we are stating may be used to
5 fulfill the requirements for default resources
6 would include margin of the defaulting member,
7 DCO's capital, guarantee fund, default insurance
8 if any, assessments of nondefaulting clearing
9 members with certain requirements and any other
10 resource that might be acceptable to the
11 Commission. The purpose of this catchall
12 provision is to provide some flexibility for both
13 the Commission and the DCO in meeting financial
14 resource requirements. With respect to operating
15 resources, permitted would be DCO capital and
16 again a catchall for other acceptable resources,
17 resources acceptable to the Commission.

18 Second, computation of required
19 resources. This would require that a DCO conduct
20 monthly stress testing to determine the financial
21 resources needed to withstand default of the
22 clearing member with the largest exposure and a

1 monthly calculation of the financial resources
2 needed to cover 1 year of operating costs. The
3 DCO would be permitted to use its discretion in
4 determining the stress- testing methodology, but
5 it would be required to take into account historic
6 data and hypothetical scenarios.

7 In valuing resources, the regulation
8 would require at least monthly that the DCO
9 compute the current market value of each financial
10 resource. It would have discretion regarding
11 haircuts to be applied except in one instance and
12 that would be with respect to assessments of
13 nondefaulting clearing members. Assessments would
14 be subject to a 30-percent haircut and the DCO
15 would only be permitted to count the value of
16 assessments after the haircut to meet up to 20
17 percent of the financial resources requirement to
18 cover a clearing member default.

19 Fourth, the liquidity of resources.
20 Financial resources would be required to be
21 sufficiently liquid to enable a DCO to fulfill its
22 obligations during a 1-day settlement cycle and

1 sufficient capital in the form of cash to meet the
2 average daily settlement variation pay per
3 clearing member over the last fiscal quarter. In
4 addition, the DCO would be required to have
5 unencumbered liquid financial resources equal to
6 at least 6 months' operating costs. There would
7 also be regulations for a DCO's guarantee fund
8 which include prohibiting the use of letters of
9 credit as a permissible asset.

10 Finally, there is a proposed reporting
11 regulation. The DCOs would be required to file
12 quarterly reports with the Commission that among
13 other things would describe the financial
14 resources that they believe are required, provide
15 the value of financial resources that are
16 currently available, explain how the DCO meets
17 liquidity requirements and discuss the methodology
18 used in calculating the financial resources
19 requirements. Thank you.

20 CHAIRMAN GENSLER: John? Let's do the
21 whole clearing piece then Nancy gets to await her
22 turn.

1 MR. LAWTON: Good morning. The rules
2 that Phyllis just described are being proposed
3 pursuant to Title VII of Dodd-Frank. The rules
4 I'm about to describe are being proposed pursuant
5 to Title VIII of the Dodd-Frank Act.

6 Title VIII allows the Financial
7 Stability Oversight Council to designate certain
8 entities as systemically important. This includes
9 DCOs as well as some other types of entities
10 subject to jurisdiction of the Fed, SEC and other
11 entities. The staffs of the various members of
12 the FSOC have begun consulting with regard to the
13 designation process but clearly the FSOC has not
14 met yet and no entity has been designated as yet.
15 Pursuant to Title VIII, the Commission is allowed
16 to prescribe enhanced risk-management standards
17 for certain DCOs that the council has designated
18 as systemically important. We have been calling
19 them SIDCOs for shorthand. Any DCO that was
20 designated by the FSOC would be subject to all the
21 standards that Phyllis has just described. In
22 addition, there would be certain areas where they

1 might be subject to enhanced standards. In the
2 financial resource are there are two modifications
3 to the rules that Phyllis has described that we
4 would propose with regard to SIDCOs. The first
5 would go to the amount of financial resources that
6 the DCO was required to have. The second would go
7 to the valuation of those financial resources.

8 As Phyllis described, the DCO rules and
9 Core Principle B currently requires that a DCO
10 have sufficient resources to cover its largest
11 single exposure. For SIDCOs we're proposing that
12 they have sufficient resources to be able to cover
13 their two largest exposures. The effect of that
14 would be that a DCO which was designated as
15 systemically important would be subject to a
16 higher financial resource requirement.

17 The second aspect that we are proposing
18 is with regard to the valuation of the components
19 of the resource package. As Phyllis described,
20 there are certain haircuts that are being applied
21 to any assessment power that a DCO would have if
22 it had the power to assess nondefaulting clearing

1 members in the event of a default. What we are
2 proposing for SIDCOs is that any assessment power
3 be haircut 100 percent with regard to the
4 calculation of the single largest default. With
5 regard to the second-largest default it would be
6 the same rule that Phyllis described. Effectively
7 again the result of this proposal would be a SIDCO
8 would have to have more financial resources on
9 hand than another DCO because assessment powers
10 are resources that are not in hand, they're
11 something that you go to a nondefaulting clearing
12 member if you need to. The other resources such
13 as margin and guarantee funds are assets on hand.
14 We have those two distinctions that we are
15 proposing in the area of financial resources for
16 systemically important DCOs. We'll be happy to
17 take any questions.

18 CHAIRMAN GENSLER: I think before the
19 questions the chair will entertain a motion to
20 accept the staff recommendations on the proposed
21 rules concerning clearinghouses and the
22 systemically important clearinghouses and how they

1 comply with the Core Principles.

2 COMMISSIONER DUNN: So moved.

3 COMMISSIONER SOMMERS: Second.

4 CHAIRMAN GENSLER: For questions I might
5 start. One of the things from my trip to Europe
6 earlier this week is that the Europeans have
7 proposed to their parliament and they're at least
8 probably 9 months away from getting parliamentary
9 action and finalizing it that they have very
10 prescriptive rules on clearinghouses and that they
11 would recognize U.S.-registered clearinghouses but
12 only if they meet an equivalence to European
13 standards and international standards as put
14 forward by the organization which is called
15 CPSS-IOSCO. In that context I'm going to bring
16 this perspective to each clearinghouse rule, I
17 want to know whether the staff's views and what
18 you're recommending will the clearinghouses that
19 are registered with us, if they would be the final
20 rule, would they meet either the European test as
21 we think it will come out on equivalence or the
22 CPSS-IOSCO standards. John and Phyllis?

1 MR. LAWTON: The current CPSS-IOSCO
2 standard for example is that you must be able to
3 meet the default of your single-largest clearing
4 members so that the proposal does meet that.

5 CHAIRMAN GENSLER: I'm sorry to
6 interrupt. You said the current IOSCO standards,
7 but there is a draft as well.

8 MR. LAWTON: Right, and the draft is
9 still open. They're still discussing exactly what
10 the final standard will be. It would one, it
11 could be two or it could be one plus some other
12 number that is not necessarily the largest, so
13 that is still under discussion.

14 CHAIRMAN GENSLER: If you look at the
15 whole rule, those five areas that Phyllis went
16 through, will it meet for the for the DCOs or
17 international standards or will it only meet
18 international standards for these so-to-speak
19 systemically important ones?

20 MS. DIETZ: It will be consistent with
21 and meet the standards. The international
22 standards in some cases there may be even more

1 detailed or higher standards for example in our
2 reporting requirements based on the current
3 CPSS-IOSCO standards and what I have is again a
4 draft. I think that our standards are a little
5 more specific when it comes to reporting and there
6 may be other areas where it's a little higher, but
7 certainly it meets the standards.

8 CHAIRMAN GENSLER: My second question is
9 how does this compare to what I might call
10 industry best practice and the guidance and rules
11 that we have in place? We currently regulate 14
12 clearinghouses, some small, some very large.

13 MR. LAWTON: I think it's generally
14 consistent with best practice again going back to
15 the standard of meeting the default of your
16 single-largest clearing member. In doing DCO
17 reviews in the last few years we have in fact used
18 that standard. We've been able to do stress tests
19 which indicated that the DCOs were in compliance
20 with that standard. Again it moves because it's
21 based on a stress test so that it's based on open
22 interest current positions, it's based on the

1 inputs to the stress test, but we have done
2 reviews in the past and the DCOs are currently in
3 compliance.

4 CHAIRMAN GENSLER: I'm going to turn it
5 over to Commissioner Dunn. Again the prism that
6 I'm going to look at least as one Commissioner
7 through the clearinghouse rules is how does it
8 compare to international standards? We'd want to
9 ensure that around the globe they can use
10 clearinghouses that we register and regulate here
11 and that these clearinghouses will meet
12 equivalency. And also since for the first time
13 we'll have a mandate that swaps must go into
14 clearinghouses, we would ensure that these are
15 robustly managed for risk.

16 MR. RADHAKRISHNAN: Mister Chairman I
17 think it would be fair to say that the staff will
18 propose standards that will at a minimum meet the
19 international standards but in most cases exceed
20 international standards because of the specificity
21 which we will propose.

22 CHAIRMAN GENSLER: So it would be more

1 specific but not necessarily higher capital? It
2 would be just more specific?

3 MR. RADHAKRISHNAN: Correct, because the
4 draft is a moving target so we look at the draft
5 as of a particular day and that's the language
6 that we put in the proposal. When it comes to
7 finalizing the rules, we will look at the draft
8 again because the new iteration of these standards
9 will not be finalized by July of next year because
10 it is still in draft form and it has to go through
11 a consultation period and because we are working
12 on different timeframe we will look at the
13 language in the draft as of the day that staff
14 proposes the final rules.

15 CHAIRMAN GENSLER: Thank you.
16 Commissioner Dunn?

17 COMMISSIONER DUNN: To follow-up on that
18 line, I guess I would also be concerned that we're
19 not setting up an environment for regulatory
20 arbitrage that our capital requirements aren't so
21 high that folks are saying we're just going to go
22 offshore or some place else.

1 MR. RADHAKRISHNAN: I think that's a
2 fair comment, Commissioner, but at the same time
3 staff is very mindful of the fact that with
4 Dodd-Frank there is the potential for our DCOs to
5 have large concentrations of risk and if that
6 happens, and we are always preparing for what
7 could happen and I always assume the best-case
8 scenario which is a lot of business comes to our
9 DCOs, so we want to make sure that our DCOs have
10 very safe and sound capital standards because if
11 you look at the notional value of swaps, it's 10
12 times futures contracts so if you take even a
13 significant percentage of that, the amount of
14 clearing that will be done by our DCOs is going to
15 be dwarfed by what -- it will be tremendously
16 higher than what they do right now, so we want to
17 be prepared for that.

18 COMMISSIONER DUNN: Mister Chairman, I'm
19 intrigued about how the designation of the SIDCO
20 comes about especially as we have to interact with
21 the FSOC, if you're going to have your first
22 meeting today I guess we'll know more by Saturday.

1 There are requirements in here that we have and,
2 Phyllis, one of the things that I find intriguing
3 in here is that we're requesting a living will,
4 that we know how to unwind things and that is to
5 be done on an annual basis. I know a lot of times
6 that things happen very quickly and from quarter
7 to quarter may change very, very rapidly. Is
8 staff going to be updating and are there
9 provisions for us to get updates on these living
10 wills and how they go about it? Then again how
11 does dovetail with what the FSOC might be doing?

12 CHAIRMAN GENSLER: Phyllis, do you want
13 to take the first and I'll try to answer
14 Commissioner Dunn's question about this
15 afternoon's meeting as best I know about this
16 afternoon's meeting?

17 MS. DIETZ: There is always the option
18 that the Commission can request information and
19 receive it even in between the scheduled quarterly
20 reports. One of the things we are also
21 contemplating, and this goes to a future
22 rulemaking, is establishing certain special events

1 reporting requirements so that there are periodic
2 reports that a derivatives clearing organization
3 would have to provide like financial reports.
4 Then there would be certain circumstances that are
5 a significant change in the level of financial
6 resources or certain other aspects that affect
7 risk management that would trigger a reporting
8 requirement so that we don't find ourselves
9 finding out after the fact or only on a quarterly
10 basis that 3 days after the last report something
11 dramatic happened. So we are in the process and
12 we're working with our risk surveillance people to
13 come up with the special events reports and I
14 think that they will address some of those
15 concerns.

16 COMMISSIONER DUNN: All of that is going
17 to take human resources to analyze. Again Ananda
18 I would go back to my opening statement that I
19 would like to see what these are going to cost and
20 how we go about meeting those based upon the
21 resources that are going to be allocated to us by
22 Congress.

1 CHAIRMAN GENSLER: Commissioner Dunn and
2 my fellow Commissioners, the Financial Stability
3 Oversight Council which is under statute chaired
4 by Secretary of the Treasury Tim Geithner will
5 first meet this afternoon. As I understand it,
6 there will be a closed session and an open session
7 so that the public will be able to see and there
8 will be a transparency policy and the like. In
9 terms of the systemically important clearing
10 organizations, that council gets to make that
11 determination I think by a two-thirds vote, if
12 somebody reminds me by a two-thirds vote. There
13 are various criteria in statute in Section 804.

14 COMMISSIONER DUNN: I'm giving you an A
15 plus.

16 CHAIRMAN GENSLER: So the council though
17 today is considering I would hope putting out an
18 advanced notice of proposed rulemaking about
19 another section under Title I about designating
20 systemically important nonbank financial
21 companies. I think that's under Section 113 if I
22 remember. This topic as well will be discussed a

1 bit. I plan to at least raise the intersection of
2 what we've done this morning and to raise with my
3 fellow council members at the first meeting that
4 as to our timing it would be helpful in my opinion
5 that if whatever designations are made would come
6 into place by next summer or so, that it might not
7 align perfectly but that's one thing that I would
8 be hopeful for. The council may in fact put out,
9 and we're not going to do it today, and ask for
10 comment on the systemic designation of what are
11 called financial market utilities. We may have a
12 short handful. We have 14 clearinghouses we
13 regulate now. I know staff has estimated that
14 that would grow to maybe 20 or so. There may be a
15 handful that are systemically relevant by the
16 council and that will be the council's
17 determination. But also the SEC may have some
18 they oversee, there may be payment systems the
19 Federal Reserve oversees so that all of them have
20 to have some consistency and I know the council
21 will take it up. My hope though is that these
22 designations might come into place by next summer

1 as our new rules come into place. Of course it
2 doesn't have to happen that way but that is my
3 hope. Commissioner Sommers?

4 COMMISSIONER SOMMERS: To follow-up on
5 that line of questioning, I would be interested to
6 know about our coordination with both the SEC and
7 the Fed on these rules and if we anticipate that
8 they will also be putting out rules for financial
9 resources for their clearing organizations and any
10 significantly important clearing organizations
11 they may have.

12 MR. LAWTON: We've been consulting quite
13 a bit with them. We've had meetings where we've
14 shared drafts with them and we've in some cases
15 modified our documents based on their comments
16 both the Fed and the SEC in particular and some of
17 the other members of the council as well.

18 COMMISSIONER SOMMERS: Thanks. I have a
19 more specific question for Phyllis I think. With
20 regard to the computation of the financial
21 resources, I understand and think it's very
22 reasonable to have the stress tests done on a

1 monthly basis because it's an evolving process
2 knowing where the risks are in the clearinghouse.
3 The part that I'm not sure I understand is about
4 the operating costs and if that is more of a
5 static number, and if we define what operating
6 costs are do we assume that all clearinghouses
7 will calculate operating costs in the same way,
8 and how do we figure out if what they're
9 allocating for operating costs is appropriate?

10 MS. DIETZ: First of all, the monthly
11 calculation is consistent with IOSCO and the idea
12 here is that the operating costs are based on
13 their business plan, their budget and what they
14 expect their expenses to be. We would not expect
15 that number to change dramatically, perhaps if
16 they enter a new line of business or set up a new
17 subsidiary of something like that. The
18 calculation goes not only to what they think
19 they're going to need but what they have to
20 satisfy that requirement so that that's what we're
21 looking for. Even if the operating costs are
22 static over the course of a year, what is the

1 level of financial resources that you have, what
2 financial resources do you h have and what's their
3 value in order to satisfy that.

4 COMMISSIONER SOMMERS: The kind of
5 calculations for operating costs, do we currently
6 do that so that that's something that's not really
7 going to change for us or this is different than
8 what we currently apply?

9 MR. RADHAKRISHNAN: We've been asking
10 new DCO registrants to do that and we started
11 doing it as a result of the Commission's
12 experience with one exchange/DCO which engaged in
13 what I would call just-in-time financing meaning
14 they realized that they were going to go out of
15 business if they didn't get money and there would
16 be a mad scramble to get money, and the
17 Commission's staff had to shepherd them through
18 this process. At that time we realized that it
19 would be useful for DCOs to be able to demonstrate
20 that they had enough resources to pay the light
21 bill and to keep on operating.

22 The other concern is we wanted to make

1 sure that if they stop operating they've got
2 enough resources to be able to either liquidate
3 all contracts or transfer all contracts because
4 the last thing we want to see is a disruption in a
5 particular market because a DCO doesn't have
6 resources just to be able to function.

7 COMMISSIONER SOMMERS: Thank you.

8 MS. DIETZ: If I could add to that that
9 the statute itself now requires this 1 year of
10 financial resources to cover operating expenses,
11 but even prior to that as Ananda says, we have
12 informally been applying that standard. An
13 example of that is recently the Cantor
14 Clearinghouse, a derivatives clearing organization
15 registration, among the conditions in the order
16 that was issued I think in June was this 1-year
17 financial resources standard. Many of these
18 standards are not really new, it's just we're
19 codifying them in the regulation now, but they've
20 been around and they can be satisfied and are
21 being satisfied now.

22 CHAIRMAN GENSLER: Phyllis, that last

1 part is very helpful to me. You're saying much of
2 what we're doing here is codifying what is either
3 industry practice or what we've put in orders and
4 guidance, but given this new environment where
5 we're mandating swaps into clearing and we have a
6 whole systemic risk council, the FSOC, that we're
7 trying to put these in a rule, get public comment
8 on it but put it in a rule. Commissioner Chilton?

9 COMMISSIONER CHILTON: I wanted to
10 follow-up on Commissioner Sommers's question or at
11 least get a clarification. Does the static part
12 of this stay the same always? Is it revisited
13 when certain actions take place or on a certain
14 time period?

15 MS. DIETZ: I think on a monthly basis
16 there is stress testing of the resources and we
17 require quarterly reports in the ordinary course
18 to update us on the operating expenses and what
19 the status of the financial resources is.

20 COMMISSIONER CHILTON: Quarterly?

21 MS. DIETZ: There are quarterly reports.

22 COMMISSIONER CHILTON: One of the things

1 is that I'd asked folks about comment letters and
2 I just looked when I stepped out here and didn't
3 see like there were any comment letters on this
4 one specifically. I am curious if you can give me
5 a little bit of insight into your thinking about
6 the formula where you say we're going to cover the
7 largest two entities or some other formula. Where
8 did you come up with the two? Why wasn't it
9 three? Why wasn't it one? Why wasn't it six?
10 How did you come up with this?

11 MR. LAWTON: I think we started because
12 two has been discussed in the various
13 international forums as a potential standard, they
14 haven't landed there, but that's where it came
15 from. We also again did some testing ourselves to
16 see how that would work for our DCOs and I think
17 some of them do that themselves already as well.

18 COMMISSIONER CHILTON: Thanks, John.

19 CHAIRMAN GENSLER: Commissioner O'Malia?

20 COMMISSIONER O'MALIA: I have a question
21 for the Commission. We have talked about having a
22 public meeting on segregation and bankruptcy and

1 Bob Wasserman is leading that group. It's all
2 related to the clearing and obviously under the
3 larger clearing requirements and the cumulative
4 needs we're going to have going forward under this
5 Act. I know we're planning a hearing on
6 segregation. Would it be possible to have both
7 Phyllis and John participate in that or due to the
8 fact that it's out for comment that might prohibit
9 having their participation?

10 CHAIRMAN GENSLER: I'm trying to
11 clarify. Are you talking about a hearing or are
12 you talking about a staff roundtable?

13 COMMISSIONER O'MALIA: Staff
14 roundtables.

15 MR. RADHAKRISHNAN: That would be
16 perfectly fine because we're going to have a staff
17 roundtable in my view which is open to the public
18 and it will be recorded and there will be a court
19 reporter. We'll be talking about this matter, but
20 whatever people say will form part of the comment
21 file.

22 COMMISSIONER O'MALIA: Yes. Nancy's

1 already off the hook. She started this off with a
2 comment period. But I think cumulatively we need
3 to look at all the rules affecting clearing, the
4 costs associated with that and the requirements
5 we're considering in order to get a better sense
6 of the totality of this rule.

7 MR. RADHAKRISHNAN: Yes.

8 CHAIRMAN GENSLER: I think in the staff
9 roundtable we'll have more than segregation. I
10 know I'm making news here, but I'm hopeful that
11 we'll have one on credit default swaps because I
12 think that we really need to hear from the public
13 or staff needs to hear from the public with regard
14 to the risk-management standards for credit
15 default swaps and clearinghouses and the
16 risk-standards for credit default swaps at swap
17 dealers. And as we're going to be doing business
18 conduct standards to make sure to lower risk at
19 swap dealers and we're doing clearing rules at
20 clearinghouses, I think that as I understand it
21 staff would like to hear from the public in a
22 roundtable with credit default swaps so that it's

1 the same question.

2 COMMISSIONER O'MALIA: Essentially yes.
3 I know we hadn't agreed on this but I did want to
4 make sure that both John and Phyllis are able to
5 participate in that and there wouldn't be any
6 limitation due to the fact that it was open for
7 comment.

8 CHAIRMAN GENSLER: I see our General
9 Counsel Dan Berkovitz.

10 MR. BERKOVITZ: There will be no
11 limitation.

12 CHAIRMAN GENSLER: Dan Berkovitz our
13 general counsel says there will be no limitation.

14 MR. RADHAKRISHNAN: Mister Chairman and
15 Commissioners, the current plan is to have a
16 roundtable on the segregation and bankruptcy
17 issues, credit default issues and we can these
18 issues as well. What other subjects the
19 Commission would like us to discuss we'll be happy
20 to do so. In fact, the current thinking is to
21 have a 1-day roundtable so that all of these
22 matters can be discussed.

1 CHAIRMAN GENSLER: Working with the
2 Securities and Exchange Commission and
3 coordinating.

4 MR. RADHAKRISHNAN: Absolutely.

5 CHAIRMAN GENSLER: Mary said it would be
6 good if you guys schedule it because we're all so
7 busy.

8 MR. RADHAKRISHNAN: As long as we could
9 have it here we'll be happy to schedule it.

10 CHAIRMAN GENSLER: I think they'd even
11 agree to that as long as you handle the
12 scheduling.

13 COMMISSIONER O'MALIA: We could make a
14 motion.

15 CHAIRMAN GENSLER: No, it's the other
16 Commission. Other questions? I wanted to go back
17 because I got this statute book here. On these
18 designations, Commissioner Dunn, under 804 there
19 is also, and this is very important, a
20 consultation and notice and opportunity for
21 hearing so that the Financial Stability Oversight
22 Council as I recall it in 804 also before making

1 any determinations under this gives notice and
2 opportunity for hearing for those individual
3 companies that may be designated. That's similar
4 in a different context as to what would be done
5 for nonbank financial companies. It's a long
6 process. It may take more than until next summer
7 but I'm hopeful.

8 COMMISSIONER DUNN: At that point,
9 Mister Chairman, will already have made
10 preliminary decisions.

11 CHAIRMAN GENSLER: If we're moving ahead
12 with the proposals, we might not have finalized
13 but we will have proposed the financial resources,
14 the participants, the risk-management standards
15 and I think staff is going to do this on each one
16 of these, here's the base and here's a little bit
17 extra if needed.

18 MR. LAWTON: In some instances we're
19 going to say that the standards would apply to
20 all, but in some other areas we would have these
21 enhanced proposals.

22 CHAIRMAN GENSLER: Are there any other

1 questions? I've entertained a motion. I want to
2 say that I am supporting this notice of final
3 rulemaking. I think it's an important first step.
4 Ananda called it two rules. We're packaging it I
5 guess into one document so that it will be one
6 vote. Is that right?

7 MR. RADHAKRISHNAN: That's right.

8 CHAIRMAN GENSLER: We're going to have
9 four or five of these along the way. We'll
10 probably see Phyllis, John and Ananda in these
11 seats several times in December and December and
12 we're coordinating closely with the Federal
13 Reserve and the SEC and the other regulators as
14 well but particularly those. And the Financial
15 Stability Oversight Council. I'm supporting them
16 mostly because they're staff recommendations and
17 they're consistent with the newest draft
18 CPSS-IOSCO. As I understand them they're largely
19 consistent with the orders and guidance that we've
20 put out. We're not trying to exceed international
21 standards, but these proposed rules have my
22 support because I think they're in line. They may

1 be more specific, but they're in line with those
2 international standards and that's the key basis
3 of where I am on this. Of course the council will
4 designate the systemically important clearing
5 organizations and we won't, but I'm supportive
6 that we anticipate that and I think it's important
7 as the Commission to show where we might come out
8 on that so that when the council is doing those
9 determinations they can take that into
10 consideration and see at least our proposals. And
11 that the parties that might be designated when
12 they have that opportunity for hearing and public
13 comment will have some sense of where we might
14 come out on this. Some have asked why we're doing
15 the systemically important pieces now and the
16 reason I'm supportive is I think it gives market
17 participants and the clearinghouses a sense of
18 where we might come out and I think it's better to
19 inform the public and the council.

20 COMMISSIONER DUNN: Certainly they would
21 take our lead, Mister Chairman. I am struck that
22 we are faced with a number of chicken-and-egg

1 situations here as we try to get through this.
2 Again it's been tough on the staff to
3 clairvoyantly figure out where we're going to be
4 and what it's going to be moving forward and
5 that's why they've worked so hard and it is
6 important that we get public input into this as we
7 go forward with the realization right now that
8 these are all proposed until these things get
9 together.

10 CHAIRMAN GENSLER: That's right, but
11 with 288 days we want to get the proposal out and
12 get the comments. I'll call the vote. All in
13 favor?

14 (Chorus of ayes.)

15 CHAIRMAN GENSLER: Are there any
16 opposed? The vote being unanimous we'll again be
17 submitting it to the Federal Register shortly.
18 Nancy is going to talk about DCOs, designated
19 clearing organizations, designated contract
20 markets and swap execution facilities.

21 MS. SCHNABEL: Thank you, Chairman and
22 Commissioners. Today staff is recommending that

1 the Commission approve a notice of proposed
2 rulemaking to implement among other things Section
3 726 of the Dodd-Frank Act. Before discussing the
4 substance of the proposal, staff wants to echo the
5 Commission's emphasis on the importance of public
6 comment. We've asked many specific questions in
7 the proposals and we hope to receive specific
8 answers and thoughtful answers from the public
9 which will inform our final rule.

10 Section 726 of the Dodd-Frank Act
11 requires the Commission to promulgate rules to
12 address potential conflicts of interest in
13 connection with the interaction between swap
14 dealers and major swap participants on the one
15 hand, and certain DCOs, DCMs and SEFs on the other
16 hand, and it specifically empowers the Commission
17 to adopt numerical limits on control or voting
18 rights that enumerated entities may hold in
19 certain DCOs, DCMs or SEFs. The enumerated
20 entities include certain bank holding companies
21 and nonbank financial companies as well as swap
22 dealers and major swap participants.

1 On August 20, 2010, staff of the
2 Commission and the SEC held a joint roundtable to
3 discuss potential conflicts of interest in DCO,
4 DCM or SEF operation and possible methods of
5 mitigating such conflicts. Based on roundtable
6 discussions as well as external meetings and the
7 materials that the Commission has posted on its
8 website, staff has identified a number of
9 potential conflicts of interest.

10 With respect to a DCO, conflicts of
11 interest may present themselves in among other
12 things determinations regarding whether a swap
13 contract is capable of being cleared, the minimum
14 criteria that an entity must meet in order to
15 become a swap clearing member and whether a
16 particular entity satisfies such criteria. With
17 respect to a DCM or SEF, conflicts of interest may
18 present themselves in among other things
19 determinations regarding the balance between
20 advancement of commercial interests and
21 fulfillment of self-regulatory responsibilities
22 including in regard to DCM or SEF access. In

1 order to mitigate such potential conflicts of
2 interest, staff proposed certain structural
3 governance requirements as well as certain limits
4 on ownership or exercise of voting power. Staff
5 notes that more substantive requirements on
6 determination subject to conflict may be covered
7 in other rulemakings that will be coming in the
8 fall.

9 The proposed structural governance
10 requirements build upon the acceptable practices
11 that the Commission previously adopted for the DCM
12 conflicts of interest core principle. In general
13 the proposals aim to mitigate conflicts of
14 interest at a DCO, DCM or SEF through introducing
15 a perspective that is independent of competitive,
16 commercial or industry considerations to
17 deliberations of governing bodies for those
18 registered entities. More specifically, the
19 notice of proposed rulemaking requires that a DCO,
20 DCM or SEF board of directors be composed of a
21 certain percentage of public directors. It also
22 requires that each DCO, DCM or SEF have a

1 nominating committee and one or more disciplinary
2 panels. It further requires that each DCO have a
3 risk-management committee and each DCM or SEF have
4 a regulatory oversight committee as well as a
5 membership or participation committee.

6 The notice of proposed rulemaking
7 specifics the percentage of public directors that
8 must be included on each committee, and with
9 respect to the DCO risk-management committee, the
10 percentage of customer representatives. The
11 notice of proposed rulemaking also includes
12 modifications to the definition of public director
13 to conform with the definition of independent
14 director that the Securities and Exchange
15 Commission had proposed in 2004 and currently
16 accepted practices among the listing companies.
17 Given that the Commission is currently regulating
18 and may in the future regulate certain of the same
19 entities as the SEC, staff believes that greater
20 harmonization is important.

21 Turning now to limits on ownership and
22 voting power, staff believes that such limits

1 enhance the structural governance requirements in
2 that such limits restrict the direct influence
3 that certain shareholders may exert through
4 election or compensation over the DCO, DCM or SEF
5 board of directors. Staff believes that such
6 influence could among other things affect the
7 independent perspective that we demand of public
8 directors. Because staff is primarily concerned
9 with direct influence, the notice of proposed
10 rulemaking does not impose limits on nonvoting
11 economic equity. With respect to a DCM or SEF,
12 the notice of proposed rulemaking states that no
13 member or its related persons may beneficially own
14 more than 20 percent of any class of DCM or SEF
15 voting equity. An identical limit applies to the
16 exercise of voting rights. With respect to a DCO,
17 the notice proposes two alternatives as well as a
18 waiver procedure. Under the first alternative no
19 individual DCO member and its related persons may
20 beneficially own more than 20 percent of any class
21 of DCO voting equity. Additionally, the
22 enumerated entities and their related persons

1 whether or not they are DCO members may not own
2 more than an aggregate of 40 percent of any such
3 class. Identical limits on exercise of voting
4 rights apply.

5 Under the second alternative, now
6 individual DCO member or enumerated entity whether
7 or not it is a DCO member as well as related
8 persons may own more than 5 percent of any class
9 of DCO voting equity and an identical limit
10 applies to the exercise of voting rights. In the
11 case of a DCO, staff recognizes that circumstances
12 may exist where neither the first nor second
13 alternatives would be appropriate. To enhance
14 flexibility, staff is proposing a procedure for
15 the DCO to apply for and the Commission to grant a
16 waiver of the limits specified in the first and
17 second alternatives for a reasonable period of
18 time. Staff believes that proposing different
19 limits on ownership and voting power for DCOs on
20 the one hand and DCMs and SEFs on the other hand
21 makes sense given that the two different types of
22 entities have differing competitive dynamics and

1 degrees of systemic important.

2 Currently staff does not propose to
3 distinguish for purposes of the notice of proposed
4 rulemaking between DCOs and DCMs that operate only
5 within the commodity futures and options sphere
6 and those that operate within the swaps sphere.
7 In certain ways the two types of products are
8 sufficiently similar that staff does not believe
9 that the Commission should create regulatory
10 arbitrage due to differing governance
11 requirements. Finally, staff would like to
12 observe that the notice of proposed rulemaking
13 provides for a long transition period, 2 years or
14 two regularly scheduled board elections whichever
15 is earlier.

16 Again we would like to emphasize that we
17 welcome public comments and we will devote
18 attention to reviewing public comments in detail
19 and that the final rule will depend on such
20 comments.

21 CHAIRMAN GENSLER: Thank you very much,
22 Nancy. I will now entertain a motion on the

1 recommendation of staff for the proposed rule
2 regarding governance issues for the clearinghouses
3 and exchange platforms.

4 COMMISSIONER DUNN: So moved.

5 CHAIRMAN GENSLER: Do I hear a second?

6 COMMISSIONER SOMMERS: Second.

7 CHAIRMAN GENSLER: With the motion
8 having been moved and seconded we will now have
9 questions. Nancy, I know that you've engaged in a
10 lot of discussions with the SEC and in no way
11 projecting where they will be because that's a
12 separate agency and Commission, but can you give
13 us a sense on whether you know as of today of any
14 material differences in this in your discussions
15 with SEC staff? Is there any recommendation
16 they've made to us that you haven't done you best
17 to incorporate?

18 MS. SCHNABEL: I've done my best to
19 incorporate every recommendation. I think that
20 the SEC staff in certain instances may have a
21 slightly different view with respect to some of
22 the percentages that we've proposed for structural

1 governance requirements and that view may be I
2 think more --

3 CHAIRMAN GENSLER: You don't need to say
4 where they are, but we have a body of regulations
5 that have grown up over 70-plus years and in the
6 futures world they have a body of regulations that
7 have grown up over an equally long time in the
8 securities world and the President asked last
9 summer that we try to seek to harmonize the swaps
10 areas, a new area that's sort of in between
11 securities and futures so that in some instances
12 it will be possible to make sure the swaps
13 regulation is uniform but taking the best and
14 hopefully just the best out of the securities
15 world and taking the best out of the futures
16 world. I think this governance area particularly
17 for a swap execution facilities because there
18 could be SEFs that do both securities-based swaps
19 and swaps so I'm hopeful that at the end of this
20 next summer we end up in the same place on this
21 governance issue. I think we're there at least on
22 the proposal stage, but I for one am going to be

1 very mindful to try to be in the same place when
2 we end this up at the end.

3 My second question is there is no
4 aggregate limit on swap execution facilities being
5 proposed. Is that right?

6 MS. SCHNABEL: That's correct.

7 CHAIRMAN GENSLER: But there is an
8 aggregate voting limit on the clearing which only
9 exists if one individual member has more than 5
10 percent voting control. Is that right?

11 MS. SCHNABEL: That's correct. There
12 are two alternatives. If any one individual
13 member has more than 5 percent then there will be
14 an automatic default to the second alternative
15 which is 20 percent --

16 CHAIRMAN GENSLER: But is it correct if
17 no one is over 5 percent thus then there is on
18 aggregate limit?

19 MS. SCHNABEL: Yes.

20 CHAIRMAN GENSLER: So in essence the
21 aggregate only kicks in if somebody is larger.

22 MS. SCHNABEL: Over. That's right.

1 CHAIRMAN GENSLER: I think it was a
2 terrific suggestion that Commissioner O'Malia
3 made. This is a very deliberative process and the
4 public should know about having to retain some
5 flexibility and that we have waiver ability in
6 there and that's included as well.

7 MS. SCHNABEL: That's correct.

8 CHAIRMAN GENSLER: One other thing. On
9 the nonownership side as to the board governance
10 rules, I take it that they're quite similar, maybe
11 not identical, to what we've recently adopted for
12 contract markets and in this case we're extending
13 them to clearing organizations and SEFs and asking
14 a lot of further questions.

15 MS. SCHNABEL: That's right, previous
16 Commission precedent.

17 CHAIRMAN GENSLER: Thank you.
18 Commissioner Dunn?

19 COMMISSIONER DUNN: Thank you, Mister
20 Chairman. I know in 2007 the Commission had
21 adopted SRO governance and many of them this last
22 month have been put into place and it will take

1 some time to fulfill all of these proposals that
2 we've got in the regulation. I am concerned about
3 the regulations that we have in there for public
4 membership especially in the regulatory oversight
5 committees. I believe for the SEFs it's 100
6 percent. Is that correct? I want to be reassured
7 that we have people who are in the business who
8 know what the impact of these committees are going
9 to have on the overall operation and if we're
10 excluding industry folks or folks that are
11 noninsiders, as they fill these various boards
12 will there be a large enough pool out there to
13 ensure that we get people with the expertise
14 needed to make recommendations from the board's
15 positions?

16 MS. SCHNABEL: That's a very important
17 question and I think that there are people who are
18 out there, for instance, ex-employees or
19 academics.

20 COMMISSIONER DUNN: This isn't a
21 full-employment act.

22 MS. SCHNABEL: I know. I understand

1 that. But there are people who are not currently
2 affiliated with industry and also for the
3 regulatory oversight committee for DCMs we in 2007
4 required that DCMs have 100 percent independent.
5 DCMs have now currently come into compliance, we
6 gave them a long transition period as we are
7 completing for this proposed rulemaking and there
8 should be no reason that SEFs cannot also come
9 into compliance with the 100- percent regulatory
10 oversight committee that's public.

11 COMMISSIONER DUNN: The second question
12 I have is on ownership. With the requirements
13 that we have, are we assured that this will still
14 allow the new startups that will be significantly
15 financed and will it not stifle competition?

16 MS. SCHNABEL: I think that the various
17 alternatives that we've proposed will leave room
18 for new startups. For DCMs and SEFs we're saying
19 a 20-percent single member limit and that would
20 mean that a new startup would need five member
21 investors and it seems as if five is not
22 necessarily an excessively onerous number for a

1 new startup. Plus they can have outside investors
2 as well who are not members and the same limits
3 apply for SEFs. For DCOs we have various
4 alternatives including the waiver procedure so
5 that with respect to the 5-percent limitation if a
6 DCO wants to organize itself as more of a utility
7 it will have a chance to and it will have 20
8 members, and if it would like to organize itself
9 with a more concentrated membership we have a
10 structure that would provide that and we
11 ultimately have the waiver so that if staff
12 believes that having a new DCO in the swaps space
13 is important then staff will recommend that the
14 Commission adopt the waiver.

15 COMMISSIONER DUNN: To the public, I
16 think this is an extremely important part and as a
17 Commissioner I really do look for public comments
18 in this area to help guide my decisions.

19 CHAIRMAN GENSLER: Before I turn to
20 Commissioner Sommers I want to associate myself
21 with this last point. This had a lot of debate in
22 Congress, but I think it really is something that

1 we new public input on in a broad range of views
2 on this. Commissioner Sommers?

3 COMMISSIONER SOMMERS: Thank you, Mister
4 Chairman. I don't have any questions but I do
5 want to comment specifically on this proposal
6 regarding governance and conflicts of interest and
7 specifically where I think the Act and
8 congressional intent leads us. Section
9 7(ii)(V)(D) of the Act directs the Commission to
10 adopt rules mitigating conflicts of interest, and
11 then Section 726 of the Act provides that the
12 Commission shall adopt rules which may include
13 numerical limits on the degree of control or
14 voting rights that certain enumerated entities may
15 possess with respect to DCOs, DCMs and SEFs if the
16 Commission determines after a review that such
17 rules are necessary are appropriate. I recognize
18 that these provisions direct the Commission to
19 adopt strong governance rules and to mitigate
20 conflicts of interest in connection with the
21 interaction between swap dealers and major swap
22 participants on DCOs, DCMs and SEFs in which they

1 may have a material debt or equity investment. In
2 my opinion, however, the voting equity
3 restrictions being proposed are not necessary or
4 appropriate to mitigate the perceived conflicts
5 and in fact may do more harm than good to the
6 emerging marketplace for trading and clearing
7 swaps.

8 In 2009 after more than 2 years of study
9 the Commission finalized acceptable practices to
10 provide a safe harbor for complying with Core
11 Principle 15 for DCMs dealing with conflicts of
12 interest. I support making those acceptable
13 practices mandatory for DCMs, DCOs and SEFs as
14 augmented by some of the additional provisions
15 being proposed such today such as the Risk
16 Management Committee for DCOs. I believe that
17 strong governance rules coupled with the
18 Commission's ultimate authority to determine which
19 swaps must be cleared under Section 723 of
20 Dodd-Frank is sufficient to ensure that swaps that
21 should be listed for trading and cleared will be
22 listed for trading and cleared. I have grave

1 concerns that the proposed limitations on voting
2 equity especially those proposed for enumerated
3 entities in aggregate with respect to DCOs may
4 stifle competition by preventing new DCMs, DCOs
5 and SEFs that trade or clear swaps from being
6 formed. The Commission recognizes in the preamble
7 to the proposal that the enumerated entities will
8 be the most likely source of funding for DCMs and
9 SEFs and thus chose not to propose the aggregate
10 limits for trading facilities. I believe the same
11 logic applies with even greater force for DCOs.
12 I'm equally concerned that a number of recent
13 entrants into the swaps trading and clearing space
14 will potentially be required to disband their
15 operations if they're unable to attract the
16 required amount of nonvoting equity within the
17 2-year two-board election cycle proposed.

18 I also want to note that the European
19 Commission explicitly rejected ownership
20 limitations in its proposal for regulating OTC
21 derivatives which they announced on September 15
22 because such limitations may have a negative

1 consequence for market structures and I agree with
2 that. I hope that we will be mindful of this
3 global consistency as we move forward. The
4 marketplace for trading and clearing swaps is in
5 its infancy and I strongly believe that the
6 limitations the Commission is proposing will have
7 the effect of inhibiting emerging competition
8 rather than promoting it. I therefore am not
9 going to be supporting the proposal. Thanks.

10 CHAIRMAN GENSLER: Commissioner Sommers,
11 I thank you for all your input and many of the
12 points you raise. I will be supporting it but
13 these are the exact questions I'd like to hear
14 from the public. Part of the reason I am
15 supporting this including the aggregate limit in
16 certain circumstances because it's not an
17 aggregate limit in all circumstances is to hear
18 from the public on this important issue on
19 clearinghouses. I think that we share a view that
20 these are challenging issues. Where I come out is
21 I'd like to continue hearing from the public.
22 Commissioner Dunn is so good at this all the time

1 saying he's reserving until the final and I'm very
2 much reserving judgement on whether there's an
3 aggregate position limit. Commissioner Chilton?

4 COMMISSIONER CHILTON: I agree with
5 Commissioner Sommers too on a lot of these things.
6 I'm going to support it also but I think those are
7 really good questions. Congress wanted to make
8 sure that DCOs didn't act solely in their
9 self-interest despite what might be a public
10 interest but that doesn't mean that government
11 should be a control freak. I'm not suggesting
12 this proposal is, but we have to ensure that we're
13 balanced here and that we hit the right level.
14 I've met with a lot of folks and I've mentioned
15 the comments that we've received on other -- or
16 didn't receive them on the second one but received
17 them on the first one and I know we have a bunch
18 on this and we've had the governance roundtable.
19 It seems to me that some of these questions that
20 Commissioner Sommers is asking and some of the
21 questions that were being raised with me in the
22 meetings are really about more texture to the

1 rules. For example, if you go to the Act to what
2 Commissioner Sommers was talking about, 726(c), it
3 says that in looking at conflicts of interest we
4 shall consider equity and ability to vote but
5 there is also an important addition to that list
6 where it says we shall consider governance
7 arrangements at the same time. For example, I've
8 met with folks who say we have a lot of ownership
9 but we don't actually have a governance vote so
10 that setting a hard cap limit may be appropriate
11 for them. So as we go forward and get these
12 comments I hope will put a little bit more texture
13 to these and listen to what makes sense and again
14 that we're not control freaks on this but we're
15 hitting the right balance. I don't really have
16 any questions unless somebody wanted to respond to
17 that.

18 MS. SCHNABEL: I have no incentive for
19 being a control freak so I would welcome the
20 public to comment and that will definitely help
21 inform staff opinion.

22 COMMISSIONER CHILTON: And my comments

1 certainly weren't personally directed to anybody.
2 It's more a general government thing. There are a
3 lot of folks who are control freaks. Thank you.

4 MR. RADHAKRISHNAN: If I could make a
5 general observation, Commissioner. I realize that
6 this is a difficult task because on the one hand
7 clearinghouses are not the same as exchanges
8 because if the clearinghouse fails, trading fails.
9 The argument from one side is if I'm a clearing
10 member, my money is on the hook so therefore I
11 should have a say in risk management and I should
12 have a say in what clears. That's a reasonable
13 argument and it's hard to deny the force of the
14 logic behind the argument.

15 It worked well in an environment where
16 all futures contracts have to be cleared. There
17 is no exception. There is no end-user exception.
18 There is no exception whatsoever. If you list a
19 futures contract, the law says you must clear it.
20 Now you've got an environment where it's
21 backwards. The first decision is is something
22 going to be cleared, and then if something is

1 going to be cleared then does have to be traded
2 and here you have new concerns. The new concerns
3 are if you have a group of people who have
4 benefited from the opacity of the OTC markets
5 deciding what is to be cleared then the incentive
6 for them is let's not clear it, number one.
7 Number two, the second consideration is that a lot
8 of players who want their products to be cleared
9 are not getting access and those are some of the
10 comments that we have heard, that they're not
11 getting access to the clearinghouse because
12 they're not part of a particular group and I think
13 we need to be mindful of that as well. I guess what
14 I'm saying is there needs to be a balance and this
15 is staff's view on a preliminary basis as to how
16 to achieve this balance, but certainly the
17 comments would inform staff and hopefully inform
18 the Commission.

19 COMMISSIONER CHILTON: Thank you for
20 that, Ananda. It's these idiosyncratic things I
21 want to make sure we look at. I'm in favor of
22 board independence. I think having diversity on

1 boards is a big plus. I think it helps market and
2 I think it helps consumers in general so that I
3 like diversity. I don't want anybody to think
4 that that's not the case. But we just need to
5 make sure that we're taking in all these comments
6 particularly the ones that are idiosyncratic to
7 entities that may have a real point about how this
8 could adversely impact them. We want there to be
9 lots of competition. I want there to be lots of
10 competition there and to do that we need to make
11 sure that we have both a rule that's flexible but
12 also does what Congress intended.

13 CHAIRMAN GENSLER: Thank you,
14 Commissioner Chilton. Commissioner O'Malia?

15 COMMISSIONER O'MALIA: Thank you, Mister
16 Chairman. Thank you for your cooperation and
17 staff's cooperation including waiver authority to
18 give us some flexibility or at least have that
19 considered in this rulemaking. I think, Ananda,
20 your point is spot on. People have asked about
21 access to clearing and I think that's a very
22 important issue. I think that is also addressed

1 in the open-access provisions in 723 and then the
2 participant product eligibility provisions in
3 Section 725. I think this rulemaking especially
4 on the ownership rules attempts to solve a problem
5 that these other sections may be able to address
6 more effectively and I don't believe that this
7 rulemaking specifically takes that into account.
8 I have a concurring statement here that I'd like
9 included with the rule and in that I raise these
10 questions and I hope that we'll be able to solicit
11 some good public comment on the balance between
12 ownership and access. We've heard those
13 anecdotally. We've heard the stories about access
14 to clearing. We want to make sure we can get good
15 open access to clearing, get products cleared and
16 the breadth and the depth in the market. That's
17 important and I hope those tools are more
18 effective. I don't think the ownership rules are
19 going to be as effective in reaching that same
20 objective so that I hope we get some good comments
21 on this, and I'd like to associate myself with the
22 comments of Commissioner Sommers as well.

1 CHAIRMAN GENSLER: Commissioner O'Malia,
2 I agree with you. I think of open access in a
3 number of ways such as participants could be
4 members. In the futures world we have 127 futures
5 commission merchants right now and pretty much the
6 futures clearinghouses have figured out a way to
7 have generally open access to those 127 members.
8 The swaps clearinghouses some of whom we already
9 regulate have a much more exclusive club and I
10 think that I'm looking forward to staff's
11 recommendations on participant membership in
12 particular that we can make sure they're more
13 inclusive, balancing risk management, but I for
14 one think they have been too exclusive and
15 sometimes even frankly possibly hiding behind risk
16 management to keep startup swap dealers and
17 smaller swap dealers out of the club. I think
18 you're right that there is participant membership
19 and that there is nondiscriminatory open access to
20 trading venues so that the swap execution
21 facilities can all have access and this will be
22 different from the futures world. The futures

1 world has grown up around the globe to be
2 vertically integrated and we're not suggesting a
3 change to that, but in the swaps world that there
4 be some open access to these trading platforms.
5 Those are key access things on which I concur. I
6 think that we really need how to staff recommends
7 rules for 725, 723 and of course the clearing
8 eligibility determinations.

9 COMMISSIONER DUNN: Mister Chairman, in
10 listening to the Commissioners and thinking about
11 my earlier statement, I do think part and parcel
12 of the Dodd-Frank Act was that Congress thought
13 there was too much concentration primarily in the
14 swaps area and we have to take that under
15 consideration as well as to what is the spirit of
16 what Congress intended to do so that that will
17 also motivate me.

18 CHAIRMAN GENSLER: I would say for the
19 public listening that this is how we would like to
20 talk with each other. The Government in the
21 Sunshine Act says that no greater than two of us
22 can get together at any one time and deliberate

1 unless we're in front of the public so that you
2 will see in these hearings that we will deliberate
3 in front of you because I'm not committed to
4 having stiff staff presentations and votes up and
5 down so that I apologize that participants are a
6 little bored with us going back and forth. It's
7 the way that we get to deliberate.

8 Are there other questions for staff on
9 this one having the vote? I am supporting the
10 rules here. I think like all of my fellow
11 Commissioners including Commissioner Sommers we
12 really do look forward to public comment on this.
13 I'm supporting them not just to get public
14 comment. I do think that there is something
15 positive about having a diverse group of input
16 into governance, that governance is open to
17 diverse views and consistent with what we've done
18 on designated contract markets in that we're
19 trying to bring those board governance rules to
20 clearinghouses. On voting control I think we've
21 had enough back and forth, but I'm supporting it.
22 I think we're putting an aggregate in

1 circumstances on clearinghouses to get the public
2 view as to whether that's appropriate, but it has
3 a waiver and there's a way to have more diversity
4 so that that is where I come out on it. With that
5 I was going to ask all those in favor to say aye.

6 (Chorus of ayes.)

7 CHAIRMAN GENSLER: Opposed?

8 COMMISSIONER SOMMERS: Aye.

9 CHAIRMAN GENSLER: The vote being 4-1,
10 we will be sending that as well to the Federal
11 Register. I want to make sure that I ask also
12 unanimous consent to allow staff to make technical
13 corrections to the documents voted on today prior
14 to send them to the Federal Register. You'll see
15 any markups, but whatever technical corrections as
16 apparently there might be a couple typos in
17 different things here and there. I don't know.

18 COMMISSIONER DUNN: So moved.

19 COMMISSIONER SOMMERS: Second.

20 CHAIRMAN GENSLER: All those in favor?

21 (Chorus of ayes.)

22 CHAIRMAN GENSLER: Are there other

1 things I need to do? I need to make sure I do all
2 the right stuff. Is there is not any other
3 Commission business, I want to thank my fellow
4 Commissioners. I think this was a very healthy
5 and constructive process. We're going to be doing
6 a lot of this together. I think our next meeting
7 will be October 19. Again we'll be trying to do
8 these approximately weekly. We'll let the public
9 know the specifics of those and the topics to be
10 discussed. I think the last motion of the day is
11 do I hear a motion to adjourn the meeting?

12 COMMISSIONER DUNN: So moved.

13 COMMISSIONER SOMMERS: Second.

14 CHAIRMAN GENSLER: All those in favor?

15 (Chorus of ayes.)

16 CHAIRMAN GENSLER: Are there any
17 opposed? It seems it's unanimous to adjourn this
18 meeting. Thank you.

19 (Whereupon, the PROCEEDINGS were
20 adjourned.)

21 * * * * *

22

1 CERTIFICATE OF NOTARY PUBLIC

2 I, Carleton J. Anderson, III do hereby
3 certify that the witness whose testimony appears
4 in the foregoing hearing was duly sworn by me;
5 that the testimony of said witness was taken by me
6 and thereafter reduced to print under my
7 direction; that said deposition is a true record
8 of the testimony given by said witness; that I am
9 neither counsel for, related to, nor employed by
10 any of the parties to the action in which these
11 proceedings were taken; and, furthermore, that I
12 am neither a relative or employee of any attorney
13 or counsel employed by the parties hereto, nor
14 financially or otherwise interested in the outcome
15 of this action.

16 /s/Carleton J. Anderson, III

17

18

19 Notary Public in and for the

20 Commonwealth of Virginia

21 Commission No. 351998

22 Expires: November 30, 2012

