UNITED STATES OF AMERICA
SECURITIES AND EXCHANGE COMMISSION
COMMODITY FUTURES TRADING COMMISSION

JOINT MEETING ON HARMONIZATION OF REGULATION

Washington, D.C.
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ANDERSON COURT REPORTING
706 Duke Street, Suite 100
PARTICIPANTS:

Securities and Exchange Commission:

MARY SCHAPIRO, Chairman
LUIS AGUILAR, Commissioner
KATHLEEN CASEY, Commissioner
TROY PAREDES, Commissioner
ELISSE WALTER, Commissioner

Commodity Futures Trading Commission:

GARY GENSLER, Chairman
BART CHILTON, Commissioner
MICHAEL DUNN, Commissioner
JILL SOMMERS, Commissioner

Panel One:

WILLIAM BRODSKY
Chicago Board Options Exchange

JOHNATHAN SHORT
ICE Futures

CRAIG DONOHUE
CME Group

ANTHONY LEITNER
AJ Leitner & Associates

ANNETTE NAZARETH
Davis Polk & Wardwell

ERIC BAGGESEN
California Public Employees Retirement System
PARTICIPANTS (CONT'D):

Panel Two:

PETER REITZ
Eurex

WAYNE P. LUTHRINGSHAUSEN
Option Clearing Corporation

MARK YOUNG
Futures Industry Association

LAWRENCE LEIBOWITZ
NYSE Euronext

LAWRENCE HARRIS
University of Southern California

MARK COOPER
Consumer Federation of America

Panel Three:

EDWARD ROSEN
Cleary, Gottlieb, Steen & Hamilton

YVONNE DOWNS
Newedge

BRANDON BECKER
TIAA-CREF

STEPHEN LUPARELLO
FINRA

BRIAN NIGITO
GETCO

STEPHEN MERKEL
BGC Partners
MR. GENSLER: Good morning. I want to call to order this joint meeting of the Commodity Futures Trading Commission and the Securities and Exchange Commission.

I'd also like to note the historic nature of the meeting. It's the first joint meeting in the history of our two agencies.

I also want to apologize for being a little late. Scheduling this on the first day back to school for my children was quite a trip, and I live in Baltimore and missed my train this morning. So I appreciate everybody for their forbearance.

I'd like to thank Chair Schapiro — Chairman Schapiro, and my fellow commissioners, members of the SEC, and our distinguished panelists for being here today.

In June, President Obama called on the CFTC and SEC to make recommendations to Congress for changes to statutes and regulations that would
harmonize regulations in the futures and securities world. Specifically, there are three areas where this would benefit the American public.

First, I believe there are significant gaps in our current financial regulatory system. I believe we must act urgently to reduce risk and protect market integrity, promote market transparency by adopting comprehensive regulatory reform for the over-the-counter derivatives world. I believe working together with the SEC and Congress we can get this right and we can get it on the right track. And consistency between our two agencies from the beginning will help and will avoid jurisdictional issues in the future.

Second, there are areas where the CFTC and SEC regulation currently overlap. In some cases this might benefit the American public. For instance, in the enforcement area where we bring a third of our cases with the SEC, and I think that benefits the public. But in some cases it doesn't benefit the public where there might be
inefficiencies or even potential for regulatory arbitrage or uncertainties for regulated parties.

Third, there are areas where the CFTC and SEC regulate similar products, practices, or markets, but do so differently. There are times where these differences are appropriate, but at other times they could stifle competition, increase cost, or limit investor protection.

Upon joining the CFTC, I held a staff town hall meeting and discussed the importance of working with other regulators; directing everyone, as I continue to do, to check turf at the door and focus on solely striving for the best public policy.

We're fortunate to have a great partner in Chairman Mary Schapiro. Our mutual understanding, dedicated staffs, and respective commission support gives me great confidence that we'll be able to get this job done as the President has called us to do.

We look forward to hearing from a wide variety of viewpoints on this very important
issue. Written comments on the topic of this hearing will be accepted by the public through September 14th and included in the record. Please visit cftc.gov or sec.gov for a link and instructions on how to submit written comments for the record.

I'll now turn to Chairman Schapiro for opening remarks.

MS. SCHAPIRO: Thank you very much, Gary. I'm really pleased to be here this morning as well with my fellow commissioners from both the SEC and the CFTC. And for me, personally, it's a special honor to sit at this table once again. I really want to thank Chairman Gensler and the CFTC staff for all the work they've put into hosting this first day of joint meetings, and we look forward to continuing the dialogue tomorrow at the SEC.

I also want to extend our appreciation to all of our distinguished panelists who are with us to share their insights, advice, and recommendations. We are truly grateful that so
many have agreed to participate in these meetings and share their views with us.

Today's hearing will build upon the progress that both agencies have made in discussing harmonization matters, as well as designing a framework to regulate OTC derivatives.

I believe it will move us further down the road of harmonizing our regulations, which should in turn help to increase transparency, reduce regulatory arbitrage, and rebuild confidence in our markets.

As Gary mentioned, the Obama Administration's Financial Regulatory Plan laid out proposals that seek to ensure comprehensive regulation of our financial markets and that seek to fill in gaps that came to light in the wake of the financial crisis.

One important component of the Administration's White Paper and the reason we are here today is a recommendation that we harmonize the existing regulatory regimes for futures and securities products. Specifically, the
Administration asked our agencies to complete a report that identifies all existing differences in statutes and regulations. Where such differences exist, we must either explain why those differences are necessary or recommend changes to those statutes and regulations.

To advance this important harmonization initiative, we at the SEC have been engaging in a continuing dialogue with the CFTC, and staff from both agencies have been developing a coordinated approach to our task. They've undertaken a joint effort to complete a comprehensive evaluation of our regulatory systems to find ways to align the oversight and regulation of similar types of financial instruments. And we have made much progress. We both recognize that enhanced coordination and cooperation concerning issues of common regulatory interest is necessary in order to protect investors, foster market innovation and fair competition, and to promote efficiency in regulatory oversight. I am confident that we will also be able to work towards the goals expressed
in the Administration's White Paper as we seek to build a common foundation for market regulation.

As noted in the White Paper, securities regulation and futures regulation share common ground with respect to the broad public policy objectives of protecting investors, ensuring market integrity, and promoting price transparency.

The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The mission of the CFTC is to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity and financial futures and options, and to foster open, competitive, and financially sound futures and options markets.

While the securities and futures regulatory regimes share broad public policy objectives, differences do exist in the regulation of markets for securities and futures. I believe that some of these differences are necessary to
achieve the underlying policy objectives. However, I also believe that many benefits could be achieved through greater coordination and harmonization between the SEC and CFTC for regulation and oversight of similar types of financial instruments. Some of these benefits include increasing transparency, reducing regulatory arbitrage, promoting product innovation, and rebuilding confidence in our markets.

I do believe that the joint meetings we are holding over the next two days will serve as a strong foundation for that process. We will have the opportunity today and tomorrow to hear from a wide variety of panelists with varying perspectives. We are honored to have with us expert representatives from the investor community, market participants, self-regulatory organizations, academia, and the legal community. With such a broad spectrum of constituencies represented, we look forward to an engaging conversation on this topic.
So thank you all in advance for your participation. The insight that you provide today will be extremely valuable to the CFTC and the SEC as we take further steps towards harmonizing our regulations. Thank you.

MR. GENSLER: Thank you, Chair Schapiro. It's good to be here with you. It's good to be with all of the SEC commissioners. I think we last saw each other during the presidential transition.

And with that, I'm going to turn to Commissioner Casey, I think, for your opening statement.

MS. CASEY: Thank you very much, Chairman Gensler and Chairman Schapiro. I'm also pleased to be here with my colleagues at the SEC and the CFTC at this important inaugural joint hearing.

I would like to first commend the staffs of the two agencies for putting together such a high-caliber roster of panelists representing a wide array of interests and perspectives. And I
look forward to hearing their highly developed views on the challenging and critical issues relating to harmonization of securities and futures regulation.

Calls for rationalizing, harmonizing, or consolidating securities and futures regulation have been made for years, as many of you here can attest to. And yet the challenges -- political, philosophical, statutory, jurisdictional -- have crippled previous efforts. And even today still pose formidable challenges, but they are not insurmountable. Indeed, best efforts by both Commissions in recent years sought to facilitate greater cooperation in order to address cross-jurisdictional issues. But even in the best spirit of cooperation, we are necessarily limited in what we can achieve.

We are here today, as already noted, because the administration has called on both agencies to complete a report to Congress identifying all existing differences in statutes and regulations. The report must either explain
why any differences are necessary or recommend statutory and regulatory changes. And working well with each other doesn't necessarily mean that we will always agree. But to the extent that we do disagree, it should be based on reasoned principles, not merely jurisdictional protection.

Of course, we stand ready to implement any changes that Congress deems necessary. But in the meantime, as both Chairman Schapiro and Gensler have noted, the SEC, and I hope the CFTC as well, is committed to continuing its close work in order to benefit investors and the markets through enhanced investor protection, market integrity, regulatory clarity, and innovation.

So I'd like, again, to thank the staff for their great efforts to assemble this two-day series of hearings. Thank you, all the panelists before us who are lending their wisdom and expertise to this important and worthwhile harmonization effort, and I look forward to your presentations and the discussion that follows.

Thank you.
MR. GENSLER: Thank you, Commissioner Casey. Commissioner Dunn.

MR. DUNN: Thank you, Chairman Gensler and Chairman Schapiro. I commend both of you for holding these meetings. This is truly a historic day for both Commissions.

And part of that historic part is we're going to hear the same story from these entities. Since I arrived at the Commission in 2004, I've called for public meetings between our two agencies so that we could discuss together, analyze, and tackle problems facing the country's financial markets. Most importantly, in my opinion, is a need to identify gaps in our regulatory schemes that put consumers and our economy at risk. Once identified, it's imperative that we work jointly and quickly to address these shortcomings.

While the markets and products we each regulate are more different than similar, it is each agency's mission and duty to ensure that these markets function properly and are free from
fraud and abuse. I believe everyone recognizes
the fact that for a small number of financial
instruments, the once clearly delineated lines
between what is a commodity and what is a security
has been blurred.

On June 17, 2009, President Obama called
our agencies to recommend changes to the law we
oversee to eliminate regulatory differences
between similar types of financial instruments. I
hope our meetings over the next two days allow us
to identify the instruments and differences
described by the president. But more importantly,
I hope that these meetings provide the groundwork
for a new era of cooperation between our agencies.

I would like to thank all of the
witnesses in advance for appearing before such a
large and inquisitive group of policymakers. And
I look forward to hearing your testimony, and
appreciate the service you're providing both of
our agencies. I greatly appreciate the efforts of
the staff at both the CFTC and SEC that have put
into making this meeting a success. As with prior
meetings and hearings, my commitment to you is to
listen with an open mind to your thoughts on
everything we discuss. Thank you.

MR. GENSLER: Thank you, Commissioner
Dunn. Commissioner Walter.

MS. WALTER: Thank you, Chairman Gensler
and Chairman Schapiro.

I am very happy to be a part of this
joint meeting of the SEC and the CFTC to discuss
harmonization of regulation. The two agencies
have worked together for years, and on occasion
dueled. It certainly has become increasingly
obvious, particularly during the recent financial
crisis, that the current bifurcated approach to
securities and futures regulation is outdated and
in need of overhaul. And I believe that the
discussion over the next two days will be a
critical step in this effort.

Splitting the regulation of securities
markets and futures markets between the two
agencies has made it difficult for either agency
to have comprehensive oversight.
Regulatory cooperation is absolutely essential if we are to come as close as possible to consolidated real-time information over markets that have become increasingly interrelated in recent years. That knowledge is necessary if our respective agencies are going to be able to prevent market manipulation, fraud, and other abuses effectively. To put it simply: You cannot regulate what you cannot see.

Also, as financial products have become increasingly indistinguishable in economic function and purpose, it is very difficult to determine their correct regulatory treatment. Agency disputes over products that straddle regulatory boundaries serve neither the interests of investors nor the efficiency and competitiveness of our financial markets. The time has definitely come for our two agencies to not only work together, but to successfully harmonize our regulatory regimes where differences are not justified.

Now, as many of you may know, I once
served as the general counsel of the CFTC, back when SEC Chairman Schapiro was the CFTC's Chairman Schapiro. My experience at the two agencies has given me the good fortune to observe and, on more than a few occasions, participate in these debates and discussions from both sides of the regulatory table. Whatever the differences that may need to be ironed out and the gaps that may need to be filled in in working on this harmonization effort, I believe that each agency has a unique perspective to bring to the table.

For example, I was always struck when I was at the CFTC at the extent to which economists played a central role, which is, I believe, of great benefit to that agency. I cannot help but believe that more cross-agency pollination, particularly of thought, would be beneficial for all of us.

Thank you to both of our staffs. And I very much look forward to the discussion.

MR. GENSLER: Thank you, Commissioner Walter. Commissioner Sommers.
MS. SOMMERS: Thank you. Good morning.

Thank you all for being here.

I also want to say thank you to the staff of both agencies for the enormous efforts that they've put into pulling these two days of hearings together in just a few short weeks. We have a lot to get through today, so I'm going to be brief.

The CFTC and the SEC have been asked to identify conflicts in how the two agencies regulate similar financial products, and to either explain why those differences further important policy goals or make recommendations for resolving differences where they do not.

As many have observed, futures markets, used primarily to manage risk and discover prices, and equities markets, used primarily to raise capital for public companies, serve fundamentally different purposes. A futures contract on corn and a share of IBM stock are not similar financial products. Certain structural differences in how these markets operate necessarily require...
operationally divergent regulatory schemes.

That being said, there is a growing list of derivatives products that straddle jurisdictional lines. I share the frustration of those who complain that our inability to resolve jurisdictional disputes or harmonize our regulatory approach for these products creates capital inefficiencies and delays in bringing beneficial financial tools to the marketplace.

But I am hopeful that these joint meetings are a good start, and today and tomorrow will lead to some real progress. And I look forward to all of the discussions.

Thank you.

MR. GENSLER: Thank you, Commissioner Sommers. Commissioner Aguilar, good to see you again.

MR. AGUILAR: Good to see you. Thank you, Chairman Gensler and Chairman Schapiro.

Good morning. I, too, would like to welcome the panelists and the members of the public present, as well as those that are
observing by webcast. I am delighted to be here for these unprecedented meetings and I welcome these upcoming discussions.

As some of you know, I have been supportive of combining the SEC and the CFTC. Among other reasons, it would permit more comprehensive and coordinated oversight of financial markets that are increasingly interconnected, and would reduce the concerns and uncertainty about jurisdiction.

Although the SEC has many unique responsibilities, such as oversight of capital market offerings and financial reporting, some market and intermediary oversight by the CFTC and SEC involve similar tasks.

Holding these joint meetings can accomplish some of the same purposes as combining the agencies. And I am certain that it will result in important improvements to our markets. For example, harmonized rules could enable more consistent recordkeeping by regulated entities. And investors who seek to engage in both
securities and futures transactions may be able to
better manage their affairs and have their needs
met more efficiently.

It is true that harmonization would not
make sense in every case because of the different
needs of market participants. As a result, as
this process unfolds it would make sense to
consider harmonization consistent with some key
principles. In particular, harmonization should
be pursued, and pursued with vigor, where doing so
would advance the public interest by enhancing
investor protection by providing a fair and
competitive market structure that facilitates
informed decision making, and where harmonization
would further both agencies' efforts in vigorous
law enforcement. Investor protection is the
animating principle of the SEC and it will help
guide our work in this project.

And even where harmonization would not
be appropriate, these meetings will assist our
ongoing efforts to coordinate with one another.

My thanks to the staffs of both agencies
for their work in organizing this important two-day meeting. Thanks, again, to the panelists for agreeing to share their views with us. And thanks to our respective chairmen and my fellow commissioners at the SEC and at the CFTC for agreeing to hold these meetings.

MR. GENSLER: Thank you, Commissioner Aguilar. Commissioner Chilton.

MR. CHILTON: Thanks, Mr. Chairman. You two -- Chairman Schapiro share -- Chairman Gensler -- a really driving leadership at these agencies. And I commend you for doing it, like my colleagues have.

I've got a written statement, but I'm not going to read it, if that's okay. I've got, really, just one point. And it -- for decades some of these issues have been around.

And what happens is they get stuck down at the staff level. And that doesn't mean that the staff aren't working as hard as they should. But if they don't have the ability to resolve the issues, it really is us. It's the people that the
presidents nominate and the Senate confirms that
have the responsibility to actually see a positive
success trajectory on these issues. And so I
think to hold our feet to the fire, we need to
continue these.

I commend Acting Chairman Lukken and
Chairman Cox for doing an MOU last year. One of
the things that several of us tried to get,
including Commissioner Dunn, was meetings that
would be setup regularly by the commissioners. I
think without that it'll go back down to the staff
level, and it may not reach any conclusion.

So, like many of my colleagues have
said, you know, we've got different legislative
mandates, but we've got similar missions to have
efficient and effective markets. And we're two
agencies, but I'm very optimistic that today --
and hopeful that we're going to start acting like
we're one government.

Thank you.

MR. GENSLER: Thank you, Commissioner
Chilton. Well said.
Commissioner Paredes, please.

MR. PAREDES: Thank you. And thank you to the staffs of both agencies for all of their efforts in pulling this together. And, of course, thank you to the panelists who are participating in these joint meetings. I greatly appreciate the chance to hear your views.

Harmonization is not an end in and of itself. Indeed, it's not clear what harmonization means exactly or at what point it's realized. For example, there may be legitimate reasons for certain differences to persist between the regulatory approaches at the CFTC and SEC.

To me, the language of harmonization speaks to a broader objective, namely, the goal of identifying and undertaking regulatory steps to ensure that we have innovative, efficient, and competitive markets that serve investors and our country's economic interests more broadly.

Over the next two days, we'll cover a range of topics: Portfolio margining, the approval of new products, enforcement, clearing,
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to name a few. Even in those particular instances where harmonization is not prudent or achievable, some regulatory change may still be called for. I welcome ideas that could improve the SEC's regulatory regime and approach, even if securities regulation and futures regulation continue to differ. For example, there undoubtedly are regulatory changes that could promote competition in capital formation while properly protecting investors' interests.

Finally, the search for harmonization need not be all or nothing. Whether or not the law on the books is harmonized, there is still room for the two agencies to cooperate and coordinate in a more effective manner. We should take advantage of those opportunities when they present themselves.

MR. GENSLER: Thank you, Commissioner Paredes. And now, in an act of harmonization, I hand it over to Chairman Schapiro, who is going to introduce the first panel.

MS. SCHAPIRO: Thank you, Chairman
Gensler. And thank you to all of our colleagues for your excellent opening statements.

It's my honor to introduce the first panel. And I'll keep the introductions very brief so we can actually get to the substance here.

To the far left, in terms of where they're seated, Bill Brodsky, Chicago Board Options Exchange; Johnathan Short, ICE Futures; Craig Donohue, CME Group; Tony Leitner, AJ Leitner & Associates; Annette Nazareth, Davis Polk & Wardwell; and Eric Baggesen from the California Public Employees Retirement System, known as CalPERS.

Thank you, all. And I guess we'd ask you to make opening statements in that order.

MR. BRODSKY: Thank you, Chairman Schapiro, Chairman Gensler, and all the commissioners for what you have done to get this group together today.

My name is William Brodsky. I'm chairman and CEO of the Chicago Board Options Exchange. I'm also currently serving as chairman
of the World Federation of Exchanges, which
includes 50 of the world's largest regulated
exchanges.

For the past 35 years, I've served in a
leadership role at major U.S. stock, futures, and
options exchanges, including 11 years as CEO of
the Chicago Mercantile Exchange and 12 years in my
current role at the CBOE.

CBOE strongly supports the
Administration's call for the CFTC and the SEC to
work towards harmonizing their statutes and
regulations. I commend both agencies for acting
promptly on this recommendation, and I'm honored
to share CBOE's perspective with you today.

As outlined in the reform proposal, the
differing missions of the SEC and the CFTC, and
the separate statutes under which they operate,
lead to inconsistencies in regulation of futures
and comparable securities products. These
inconsistencies have implications for investor
protection, for tax revenues, and for the
competitive position of the United States in the
The philosophies that guide and inform the approach of the SEC and the CFTC are fundamentally different. CFTC's principles-based approach gives exchanges considerable discretion in determining how they operate. In contrast, the SEC's rules-based approach requires exchanges to comply with numerous and prescriptive regulations. This disparity imposes severe competitive disadvantages on securities exchanges and inhibits innovation in the securities markets. The SEC's rules-based approach leads to substantial and unnecessary delays in introducing new products and making operational changes. Consistent with the administration's recommendation, we strongly recommend that the CFTC shift closer to the principles-based approach.

We have experienced interminable delays in bringing new products to market as a result of disputes over which agency has jurisdiction. These delays, while acutely vexing to the CBOE,
adversely affect our entire economy in the form of lost tax revenues and lost ground to international competitors. For example, the introduction of what is now a very actively traded product, the option on gold ETFs, was placed on hold for three and a half years because the two agencies could not agree on jurisdiction. In another instance, an option on a credit default product was placed on hold for seven months, while Eurex, Europe's largest derivative exchange, was able to introduce a similar product within weeks of announcing it.

There needs to be a quick and decisive mechanism to end jurisdictional disputes. We recommend that the Treasury Department, which is well-versed in the relevant issues, be used as a tiebreaker to resolve jurisdictional disputes, at least until we have a more definitive mechanism in place.

The two agencies also handle margin levels, which is also called performance bonds, for similar products very differently. These differences result primarily in lower margin
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levels and more lenient treatment of margins for futures and futures options, and, therefore, a cost advantage over comparable securities options. Margin levels should reflect the relative risks of the products and not the jurisdictional silo in which they happen to reside. We recommend, therefore, that all equity derivative margins be subject to the same standards and process of oversight.

There are several areas where securities laws are more vigorous than the futures laws in promoting customer protection and market integrity, including stronger prohibitions against insider trading and heightened suitability requirements. There is no policy reason for this disparity. In order to better safeguard investors, we recommend that futures regulations be strengthened along the lines of the securities laws.

In conclusion, we applaud the spirit in which this forum is being conducted. CBOE operates a separate stock exchange and option
exchange and a futures exchange under the
jurisdiction of both your agencies. We comprehend
and appreciate the enormous complexity of the task
ahead. On behalf of CBOE, I stand ready to work
with both of your agencies and staffs in a most
constructive way.

Thank you again for this opportunity to
testify at this important hearing. I'd be happy
to answer any questions you may have.

MR. GENSLER: Thank you. I'm just going
to mention, all of your written statements will be
entered into the record. And Doug Leslie over
here is the man with the little clock there that
will help everybody try to summarize up and know
when the window is.

MR. SHORT: Good morning, Chairman
Gensler, Chairman Schapiro, CFTC and SEC
commissioners. I'm Johnathan Short, senior vice
president and general counsel of
IntercontinentalExchange, or ICE.

We appreciate the opportunity to appear
before you today to discuss rule harmonization
between the CFTC and the SEC. As a global operator of both regulated futures exchanges, electronic over-the-counter markets, and clearinghouses, ICE firmly believes in the proper regulation of markets to ensure that market users as well as the broader public have confidence in our markets, and that instruments with similar economic attributes are regulated consistently.

In summary, we have three recommendations: That the SEC and CFTC should adopt common core principles that govern regulation, that the SEC and CFTC should take a unified approach to dealing with foreign markets, and that the SEC and CFTC should avoid duplicative or conflicting regulation wherever possible.

Given the complexity and continuing evolution of global financial markets, ICE believes that a broad set of core principles governing markets would allow the SEC and CFTC to work toward the common goal of protecting market integrity and reducing systemic risk in markets. Core principles allow financial regulation to be
flexible and prudential. Flexibility is important as it allows regulators to respond to evolving market dynamics and anticipate future problems and -- rather than living by prescriptive regulations that may have been designed to address yesterday's markets and yesterday's problems. To be flexible, regulators must also be prudential, and with an intimate knowledge and understanding of their markets and market participants. Core principles guiding the SEC, the CFTC, and market participants will help achieve these goals.

Furthermore, there should be an active and ongoing dialogue between the SEC and CFTC regarding acceptable practices for implementation of these core principles.

Second, the CFTC and SEC should take a unified approach to foreign markets. Like many of today's businesses, today's financial markets are global in nature. Providing access to our markets abroad and providing access to foreign markets domestically has greatly benefited end users of markets, offering competition, financial
innovation, and more liquid and robust markets.

Against this backdrop, it is important to note that foreign regulators may approach regulation in a different manner than U.S. regulators. And while broad regulatory equivalency should be a requirement for access to United States investors, identical regulation is neither likely to be achievable nor necessarily desirable if true cooperation is to be facilitated. When examining different regulatory regimes for the purposes of recognition, we believe that U.S. financial regulators should focus on whether the regulatory system is comparable, but should not mandate identical regulation. Attempting to impose identical regulation on other countries will only lead to less regulatory cooperation and the potential for retaliation by foreign regulators. Again, a common set of core principles offers the best structure for a unified approach to global regulation.

Finally, we would ask that the CFTC and SEC attempt to avoid duplicative regulation and
Thank you, and I'll be happy to answer any questions.

MR. DONOHUE: Chairman Gensler, Chairman Schapiro, and commissioners, thank you very much for inviting CME Group to be here with you today. We greatly appreciate the opportunity to share our point of view and provide input to you in your effort to seek harmonization of the regulatory frameworks for securities and futures markets. Commissioner Dunn, we hope not to disappoint you in your expectation of historical consistency.

I have a few points I'd like to make, and then look forward to taking your questions. But we agree with those of you who have expressed the point of view that harmonization should be defined by its goal. We certainly support harmonization in areas that will fill regulatory gaps, particularly those that are the result of congressional exemptions. And we certainly support the effort to harmonize in areas
that will cause the two agencies to work better
together and to function better together in the
protection of investors and in facilitating
innovation and competition. In particular, those
areas that relate to hybrid products as well as
the new framework for rules governing the trading
and clearing of OTC derivatives instruments.

CME Group does not favor and support
harmonization efforts that make regulation
identical, given the substantial differences in
the nature and scope of securities and futures
markets. We believe these markets are actually
highly dissimilar in material respects in terms of
their function, products, customers, and the
customer protection requirements that are
necessary to facilitate utilization of these
markets, as well as the basis upon which we
fundamentally compete and innovate in the global
marketplace.

While the harmonization goal as we
define it could be valuable, it is equally
important, in our view, that we be cognizant of
the prevailing regulatory standards in foreign markets in which we compete. Any outcome here should, in our view, ensure our ability as U.S. securities and futures and options exchanges and U.S.-based financial intermediaries to compete in the global marketplace.

Thank you, and I look forward to taking your questions.

MR. LEITNER: Chairman Schapiro, Chairman Gensler, I'm very honored to be here before you today. This is an historic meeting. My name is Tony Leitner. I am unsuccessfully retired, in that -- having worked in this area for 30 years, first at a major investment bank and now for a stock exchange, I think I've been at the heart of many of the issues that you are discussing and addressing in these very historic hearings.

I'd like to forget my remarks and just touch on a couple of key points. First of all, I want to give the intermediary perspective, and also a bit of what I would call the plumbing
The intermediaries, broker-dealers and FCMs, and also clearinghouses, play a critical role in our financial markets. And the point I want to make, very simply, is this, and it relates to so-called portfolio margining. By portfolio margining I really mean the ability for a market and financial intermediary to provide to a customer a comprehensive ability to bring their assets together in one place and to make sure that they are -- if leverage is going to be given at all, that it's done in an efficient and safe way, and a monitored way. Over time, we have not in this country had the ability to create a comprehensive portfolio margining regime for intermediaries. For broker-dealers or banks, for that matter. So-called cross margining, the ability to include futures and securities products together, is one piece of that. It's not the only piece because -- but we've approached this so far incrementally. Right now, we have a portfolio margining regime in this -- federal securities
markets; it does not include futures. I say fix that.

It does not solve the comprehensive problem because we've still got to be able to get more product within an account that's being provided by an intermediary for a customer.

And by the way, we're talking about wholesale business here. When we talk about protection of investors, we're really talking about those folks who really use credit as part of what they do, hedge funds and so forth. That business went to London. And when Lehman Brothers blew up, there were a lot of very unhappy investors who had used Lehman Brothers for their goals and haven't got their money back yet. It is a shame that the United States did not have a regime that could provide a service in a -- so it's, for me, it's a systemic issue, and it's a customer protection issue.

I think that the debate about whether we have a one pot or two pot model, I'm a one pot guy. I think that at the intermediary level, it's
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important to put everything in one place. I think at the clearing level, it's also good to be able to have agreements among clearinghouses so that you can reduce risk to clearing firms that have offsetting positions in these environments.

Finally, hope you'll redesign the table. Because I think that you're going to need more of these kinds of joint meetings in the future. I agree with Commissioner Chilton, it's always a matter of getting the right people in the room to have this conversation.

Thank you.

MS. NAZARETH: Thank you. I'm Annette Nazareth. I'm a partner in the law firm of Davis Polk & Wardwell. And I was previously at the Securities and Exchange Commission as a commissioner and running the division of what is now known as the Division of Trading and Markets.

As you probably know, this isn't the first time that the agencies have been instructed, in the absence of clear congressional guidance, to reconcile the differences in your regulatory
approaches. In the year 2000, the agencies were required under the CFMA to jointly craft rules that would apply to single stock futures, including comparable margin requirements and regulatory filing requirements. But remember that during that period, the CFMA propelled the CFTC towards a more principles-based approach. And at the same time, the SEC, in the wake of Enron and WorldCom, was compelled in a Sarbanes-Oxley environment to extend its more prescriptive, rules-based approach to regulation. So factors outside of your control have contributed to the differences in your approaches.

So though born in the same jurisdiction, the regulatory regimes of securities and futures have distinctly disparate statutory parents. And frankly, until Congress or the administration is willing to make some very difficult policy choices, the SEC and the CFTC, I fear, will continue to struggle to find common ground under some very different statutory mandates and regulatory philosophies.
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My own view is in an ideal world Congress should have reconciled these issues and probably have merged the agencies and let you reconcile some of these differences from within. But that is not where we are today and so I applaud you in doing the best you can in trying to reconcile these differences.

I comment on a number of issues in my prepared statement. The four issues I cover for harmonization are investor protection standards, insider trading prohibitions, customer protection in margining, and fungible products and common clearing. I'll just make a few remarks about each of those issues.

With respect to investor protection standards, I note again the interesting dilemma that we now face in this area. Just as the administration is recommending in its legislation that the SEC raise the standards, the customer protection standards for broker-dealers, from a suitability standard to a fiduciary standard, you're now being asked to reconcile with the
standards of FCMs, which are really quite
different; that really just require disclosure and
do not provide for investor protection standards
in anywhere near the same way. So again, you find
exogenous forces moving you in opposite directions
while you're being told to reconcile these things.

Likewise, I think the insider trading
prohibitions are very important. And given the
plethora of financial futures products that are
linked to securities, I think it's very important
that insider trading prohibitions apply in all the
appropriate instances.

With respect to customer protection in
margining, I certainly couldn't improve on what
Tony Leitner said in that area. But I also cover
that issue in my remarks.

The area that I think is important to
focus on today, and I don't have too much time to
talk about it, is the issue of fungible products
and common clearing. Again, this is a very
important area as we are moving towards the
possible exchange trading and mandatory clearing
of over-the-counter derivatives. We have a highly
competitive securities and options market where we
have a common clearing mechanism where it has
resulted in multiple competing markets.

What we see in the futures markets,
really, in my view, is quite different. These key
features of fungibility and common clearing, or at
least linked and coordinated clearing, are not
found in the futures markets. Futures trade in a
single listing environment. The exchange on which
the particular contract trades controls the
clearing of that contract. And even if contracts
with identical terms are traded in different
exchanges, they are not fungible. So each
exchange operates in a silo with no way for a
member to offset margin obligations by taking into
account positions in correlated financial futures
traded on different markets.

I do commend to you the Department of
Justice comments to the Treasury Department from
2008 that address this issue. And I do think it's
something that the CFTC should focus on as we move
towards even greater exchange trading and clearance settlement of over-the-counter options.

Thank you. And swaps.

MR. BAGGESEN: Good morning. My name is Eric Baggesen. I'm here from CalPERS. Thank you to Chairman Schapiro and Chairman Gensler and all the commissioners for letting us participate in this meeting.

First, CalPERS is obviously a large public investor. We represent 1.6 million plan participants. Our asset size is somewhere in excess of $180 billion, depending on what the market's doing today. And we actually contribute in the form of benefit payments over $10 billion a year to the California economy.

The recent market events and our society's response to these events have demonstrated the fact that we have shifted the risk to society of, in many instances, bad decisions. That shifting of risk requires us, in order to avoid the moral hazard attached to that, it requires us to have much stronger regulatory
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coordination and response. We see no way to mitigate the potential uncontrolled leveraging and risk taking that can spring from this transfer to the general public of the events that have happened.

So if you look at an instance, for example, such as AIG, the government has stepped in with more money to support AIG than was paid to clear up the entire savings and loan mess that happened back in the '80s. And these instances have all sprung from the same kinds of attributes: Excess of leverage, questions on creditworthiness, and duration mismatch between the types of instruments that are there. So we see your institutions as being the regulatory entities that are going to have to walk in to this breach to protect us as taxpayers and just members of our society from the kinds of unmitigated risk-taking that can be demonstrated.

The risk-taking has stemmed from the over-the-counter derivatives market. In this area, the lack of transparency has made it almost
impossible for us as market participants to really understand the risks of the entities that we do business with. So we see this task of regulatory harmonization as one to help us understand that.

So our very first objective for you as regulators seeking to help our society move to a better place is really transparency. If you can create transparency, we think you'll be a success. We are in favor of universal registration of market participants. We think that all market participants need to be able to be identified to your regulatory entities. We also have a great affinity for organized markets, if for no other reason than simply to trade reporting mechanics that are attached to those markets and the transparency that engenders from them.

We also like clearinghouse settlement. The clearinghouses have done an extremely good job of assessing creditworthiness, if for no other reason than their extreme risk-adverse nature. They look at all exposure that is happening in the marketplace and understand exactly the obligations
that they have to meet. And they demand that there is sufficient collateralization to meet those obligations. They understand that moment by moment. They have been extremely effective in that area.

Certainly, when we look at some of the failures of the credit rating agencies in assessing the risk attached to many of the participants in the marketplace, we really see a divergence between how the credit rating agencies and the clearinghouses have been able to deal with it.

Our second objective for your regulatory harmonization would be effectiveness. If you are going to be effective, again, we believe transparency is the very first measure of that. We also believe that the ability to bring together your enforcement actions and registration activities certainly can help with effectiveness.

As a market participant, we transact in the underlying securities markets. We also transact in the futures markets. We see those
economic exposures being one in the same, and yet we are approached by your organizations in the marketplace from two very different regulatory environments. So we believe that you need to be able to look past the instruments that you regulate and understand the economic exposure and the actual purpose of the exposures that are taken by market participants. By doing that you'll better understand what we do in positioning our portfolios, which will help you in that whole regulatory and enforcement regime. And then the last objective that we would have for your organizations is one of efficiency. Obviously, a single point of registration for entities would be extremely useful. There are so many opportunities in front of you to take advantage of the strengths and the differences between your organizations to bring greater efficiency to this marketplace. We would really like to be able to approach the market and deal with one form of registration that seeks to
provide that information across the entire arena
that you cover without having to have redundant
forms of activity.

    And beyond that, we applaud the task
that you have taken on. We think that anything
less than a complete partnership between your
organizations will not bring us to the place that
we need to be.

Thank you.

MR. GENSLER: Thank all of our
panelists. We're going to each take now five
minutes of questioning. So I'm going to try to be
very efficient with my own.

I read all of your testimonies; they
were excellent. I can't tell you whether any of
them are in my daughter's book bag to school
today. It was a very late night. She was up at 1
o'clock anxiously fluttering about her first day.

But there were a number of issues that
crossed all of the testimonies that I saw, and I'm
going to focus on one collection, but hope that
others will get to issues of product approval and
some of the inefficiencies of product approval;
some of the sales practices and insider trading;
many of the key issues of enforcement and so
forth. But I saw it, I think, in five of the six
panelists. I don't know if the Cal.

MR. DONOHUE: PERS testimony had this
about margining and cross-margining and portfolio
margining and related issues of fungibility. Did
I read correctly that all -- at least five, from
Annette down to Bill -- that all of you are for
some form of cross-margining and portfolio
margining if we could work it out and maybe work
with Congress? Is that a -- that's a yes from --

MR. LEITNER: That's a yes from me.

MR. GENSLER: That's a yes from Mr.

Leitner. Craig?

MR. DONOHUE: It depends on how you do
it.

MR. GENSLER: Okay. The devil is in the
detail.

MR. DONOHUE: It always is.

MR. SHORT: My answer would be the same
as Craig's. I think you've got to ensure, you
know, proper risk management at any clearinghouse.
And it could be worked out, but we'd need to see
the details.

MR. GENSLER: Okay, so rigorous risk
management at the clearinghouse.

MR. BRODSKY: I look at it as a national
competitive imperative from the point of view of
the U.S. financial markets, that we are so far
behind the rest of the world in that area.

MR. GENSLER: And is the key issue -- is
this fungibility issue for the CMA? I mean,
that's like at the core of your business. And Ms.
Nazareth would say to have fungibility in the CMA
would probably say not to have it?

MR. DONOHUE: No, not as it relates to
cross-margining. Hopefully, we'll have an
opportunity to talk about the realities of
fungibility in futures versus security markets.
But on this particular topic that you're asking
about, I think it would be very difficult to
achieve a cross-margining mechanism that will
work if we don't first deal with the underlying
customer protection and bankruptcy and capital
computation issues. I think if those can be
solved I think that this becomes much easier. But
I think we'd be probably foolish to think that we
could get easily to a cross-margining regime that
will work well because fundamentally the issues
are customer protection issues given the
differences between securities and futures
markets.

MR. GENSLER: So, is it your point of
view that this relates to making sure that we have
the same segregation rules and how it relates to
those customer protection and the related SIPC?

MR. DONOHUE: Well, what we've proposed,
Chairman Gensler, is that we allow these positions
to be retained in separate accounts so that we can
gain the existing benefits of the separate --

MR. GENSLER: You might want to pull the
mike closer.

MR. DONOHUE: Yeah. What we've proposed
is that these be retained in separate accounts so
that we cannot have to deal with the complexities
of the different customer protection regimes, both
of which have their merits and work well for the
securities versus the futures markets, but that we
effectively allow the cross-margin credits that
would exist to be allocated to the different
accounts on the basis of the differences and the
contracts and the risk management methodologies
that are used. We think it's a very effective,
you know, two pot approach that can work.

MR. GENSLER: At risk of my time running
out, did either Annette or Tony -- I'm sorry, I
know all of you. I mean, Tony, I remember 30
years ago you were teaching me things. You still
are teaching.

MR. LEITNER: I'm still trying. Trying.

Look, I mean, the fact of the matter is that
broker-dealers are in the credit extension
business; that's what they do. And firms that
deal with this at the wholesale level want
everything to be in one place so that they can see
it all. It's inefficient to have two pots because
if you have a client with offsetting positions -- S&P, securities, and short futures -- what you're going to have to do is -- what's going to happen is that the client on a particular day is going to have no exposure, and yet have exposure to the futures exchange. The broker-dealer is going to have to lend the money to make that payment because -- and create a debit.

If you do it in a single account, it is important, still, to protect futures customers at the clearing level. We have to make sure that there is integrity there. But as long as there is certainty of result to the customer and to customers of the broker-dealer in the event of the insolvency of the broker-dealer so that everybody knows what's going to happen.

And by the way, Craig is absolutely right. We need to look at that and be sure that the answer to that is yes, we know what's going to happen. Then we're okay. One pot is better.

MR. GENSLER: Let me just ask as my time is going to be up.
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How much of this relates, in a sense, the difference between the panelists, also to the difference in the cultures that the CFTC -- we've been -- we take the words risk-based portfolio margining to mean one thing. Congress actually wrote that into statute a year ago, that we were to work together to jointly write rules on risk-based portfolio margining, but it may be that culturally inside the SEC the same words mean something different to the SEC. Or is that not wrapped up in this issue?

Annette? And then I'm going to hand over to Chair Schapiro.

MS. NAZARETH: I think it's probably easier to reach consensus on how you perform the portfolio margining, although, admittedly, the exchanges use different methods and have invested in different systems. I think that's a different issue from one pot/two pot, which I see as frankly more of a friction on the system to have two pots and its more Byzantine approach to the issue. I don't see any reason why once you decide on a
methodology for doing portfolio margining why it
couldn't be done in a single place. It leads to
much greater efficiency. You get the benefit of
the offsets and I think two pot would be extremely
difficult to implement, which is why it's taken so
long.

MR. GENSLER: I'm supposed to hand over
to Commissioner Dunn. Actually, Chairman Schapiro
gets to be cleanup hitter here on this.

MR. DUNN: As you can see, we're all
having our own little turf battle up here. We're
not used to being squeezed into this tight place.

I had indicated to Mr. Donohue and Mr.
Brodsky that I was going to ask them to amplify a
bit on the one pot/two pot question which you
opened up, but let's continue in this vein because
I think this is extremely important. So, if you
two would like to go ahead and amplify a little
bit and then continue on.

MR. DONOHUE: I'd be happy to do that.

I think, again, back to the fundamental point of
this being a customer protection issue, you know,
wholesale professional financial institutions that are futures customers don't want an insurance protection regime. What they want is the continuation of their exposures in the market and the portability of their positions and the protection of their positions in a bankruptcy situation or an insolvency situation involving their financial intermediary. So this is a fundamental issue.

We're all in agreement that cross-margining arrangements could be beneficial and useful, but we have to respect the fact that the futures customer base isn't interested in an insurance scheme. We've had a multiplicity of market events over the last 35 years where the futures market has functioned extremely well in terms of central counterparty clearing, largely because they have the ability to continue their exposures without disruption; they have the portability of their positions; and they have the segregation and protection of their funds, property, and positions in bankruptcy.
So, without resolving that, the only realistic way in which you can achieve a cross-margining program that will make sense, unfortunately, is a two pot approach. It is a two pot today. It's no different. So you can argue for those efficiencies, but what you lose in gaining the efficiencies of a single pot is the whole mechanism that makes the futures market work.

MR. LEITNER: Good. Can I just quickly comment?

MR. DONOHUE: I just have one last comment to make and it relates to Bill's comment about sort of global competition. Frankly, I don't think that cross-margining is really the issue for us in terms of our competitiveness on a global basis. It's the margining methodology. We use risk-based margining in futures markets, as you well know and understand, and we still have strategy-based margining largely in equity options and cash index options markets, notwithstanding the fact that the vast majority of foreign options
exchanges that trade cash index options as well as equity options employ portfolio-based risk 
margining methodologies. That's not a harmonization; that's an issue of getting contemporary with the methodology that is prevailing in the marketplace on a global basis. That's a far more important global competition issue than cross-margining in a one pot/two pot.

MR. DUNN: (inaudible) then I'll come back.

MR. BRODSKY: I guess I would say I have a very different view. That is that, first of all, I think that the goal of this hearing and the work that you're doing should be decided from a strategic point of view. What is the best thing for the financial services sector of this country to have? What's in the best interest of customers? And where do we fit in terms of the international competition?

My view is that, yes, it is complicated to reconcile the difference between SIPC 
legislation and traditional futures. But that
doesn't mean it can't be achieved. These things
-- I think if we say this is what we think is the
goal, the question is then how do you solve the
goal rather than saying these are problems,
therefore, let's find a less efficient approach.

I also would add that if you look
outside the country the standard is a one pot
approach; it's not a two pot approach. In fact, I
would question whether there is any place outside
the U.S. where there is even a two pot approach.

The second thing is customers don't have
to have all their positions in one pot if they
choose not to. If they prefer to keep their
futures position in a futures account at a FCM,
that's their business. If they want to keep it in
a new one pot approach, that's their choice.

Secondly, I totally support the concept
of creating portfolio margining as a standard in
the industry. And, again, it's up to the firm and
up to the customer whether they will grant
portfolio margining for any particular customer.
So, I think that there are a lot of flexibility,
but this is a situation where we should be looking outside our borders and understand what exactly is the standard internationally. In fact, I've talked to people who've said to me every bit of these products and positions we can move -- and when I say move, the economics of a customer account that we can move outside the U.S., we move outside the U.S. Do we want to encourage our customers from our brokerage firms to have positions in London or economic relationships in London when they should be here? And the answer is no, but we have forced it away from ourselves.

And lastly, I would say that there's a big difference between the portfolio margin discussion and what I would view as the cross-margin discussion. I think we have to look very carefully from a systemic point of view of having like or comparable positions that offset each other in various clearinghouses be able to maximize the offsets that exist. And I'm talking about positions between a Russell future, for example, and a Russell option at the CBOE and at
the Merc. These things ought to be
cross-margined; some are and some are not. And I
think that when we talk about these concepts
you've got to look at the difference between a
portfolio margining which is a customer account
and cross-margining between one product in one
clearinghouse and a similar product at another
clearinghouse.

MR. GENSLER: If it's brief.

MR. LEITNER: My mike isn't working, but
if I could --

My suggestion in my paper is that the
next incremental step is for the CFTC to say it's
okay for futures customers to waive segregation
and allow the positions to be carried in a futures
account. That will require some legislation to
clarify the role of SIPC in this process to assure
we have certainty at the intermediary level.

I've also suggested, which was an idea
that only recently occurred to me, that we just --
the SEC allow the expansion of folks who can use
the current -- there is a cross-margining and
portfolio margining regime today for professional
option market makers. The capital rule deals with
it. It works. The operations guys love it. It
works even with a single pot at the clearing level
among the clearinghouses. So, the SEC could
expand that.

In any case, these are incremental
steps. It just takes us to the next level and
that allows us to really look at what needs to be
done as you bring in all these other products,
which is going to happen at the next level of
derivative regulation.

MR. GENSLER: Thank you, Commissioner
Dunn. Commissioner Casey?

MS. CASEY: Thank you, Chairman Gensler.
I'd like to kind of step back a little bit and
touch on something that I think Mr. Short
mentioned and others, which is this notion of a
sort of common core set of principles to guide us.
And perhaps it also gets to the specifics of what
we've just been discussing here with respect to
the one pot/two pot approach. But I was just
hoping that each one of you could identify in your view what the key common core principles are that should guide us in terms of how we look to basically regulatory principles. And I want to see whether or not there's a commonality in that first instance because I think that ultimately then gets to the question more specifically.

In key areas we talked about suitability. We've talked about margining. We've talked about registration questions. I'd also like each one of you to identify in some of these key areas where you think that either the SEC or the CFTC approach is consistent with those principles.

MR. BRODSKY: If you're looking to me, Commissioner Casey, I would say to you that the CFTC went through an enormous transformation as a result of the CFMA to go from what I would call the micromanaged approach that had existed previously to the core principles. And I don't have the CFMA in front of me, but I think that as it relates to securities markets and securities
markets structure, we would have to sit down --
I'm not prepared to give you that list right now
-- sit down and design something that is a radical
departure from the way the SEC has operated since
the '75 Act amendments, which required exchanges
to file every single thing they do every time they
want to do it, to a point where we have core
principles on fundamental issues of transparency,
competitive issues, et cetera.

And as I recall, the White Paper
actually tried to strike a little bit of a balance
where they said the SEC should have much more of a
core principles approach and the CFTC should get a
little bit further away from the current
standards. So, the SEC has to go maybe two-thirds
of the way in one direction and the CFTC about
one-third in the other direction.

So I don't have that list for you now
and I think that would be something that we would
have to sit down with the SEC and other SROs. I
would say this, though -- that in the case of the
option markets, which are subject to enormous
competition among themselves, we have to, I think, draw our distinctions between, say, new products and existing market practices because I think there is a bit of a difference in terms of how exchanges make changes to their rules and changes to trading systems that may be different than the new product area. I think the new product area really relates to more is it a security or is it a future and the speed in which things are processed which I think are very different than what I would call trading mechanisms that exist today.

So those are two areas that I think might apply. But I think that's another level of discussion I think we would have to come back to on.

MR. SHORT: I would echo some of what Bill just said. I think a core principles approach is the way to go and I think the CFMA has been very successful in that regard in terms of fostering competition and product innovation. I think in looking at the core principles that should be applied, I think the IOSCO core
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principles are a good starting point because ultimately we're not just talking about a set of core principles that make sense here, but across jurisdictions. Because if you're really going to get at the foreign competition issue, I think a high level of regulatory equivalency is certainly appropriate.

MR. DONOHUE: I would agree with my colleagues that I think if you could find some common principles towards adopting a principles-based approach versus a prescriptive rules-based approach at least for exchanges -- if not also intermediaries -- would be highly valuable. I think that if you could agree on a common margining methodology and hopefully risk-based portfolio margining -- which, again, if you were to look at the methodologies that are employed on a global basis with very successful and highly well-regulated exchanges would be portfolio-based risk margining versus strategy-based -- that could be very useful.

As you're contemplating the rules and
policies and frameworks that you will seek to
jointly apply to over-the-counter derivatives
markets in terms of central counterparty clearing
services, a common set of standards and procedures
that can be used by both registered securities
clearing agencies subject to the SEC's
jurisdiction as well as for derivatives clearing
organizations subject to the CFTC's jurisdiction I
think would be very useful and hopefully without
joint regulation by both agencies of those
entities.

And then lastly, another area that I
think could be useful is for the SEC to move
toward embracing a more globally competitive model
like we have in the futures markets. As you know,
for the last 12 years, I think, the CFTC has
recognized comparable foreign regulation
frameworks in order to allow foreign exchanges to
compete and list products that are traded on
domestic exchanges. While I agree that the
securities markets are highly competitive in the
U.S., they are a national market system. They're
a domestic market. In the case of futures
markets, we have commodities that trade very
actively that are our same products in Dalian,
China. We have treasury contracts that are traded
in Germany; Eurodollar interest rate contracts
that are traded in London; and we have energy and
metals contracts that trade very competitively
with us in the London market as well.

So, that would be another area where I
think we could see an increase in competition in
the securities markets. You can find a lot of
examples of those products trading on foreign
exchanges in the futures markets. You can't find
an example where a NYSE- or NASDAQ-listed security
or call option or put option is traded on a
foreign exchange.

MR. GENSLER: I'm going to ask is there
anything that you're adding that's different?
Just to try to focus on that.

MR. LEITNER: Yeah. Actually, there is.
Two things.

Number one, I think the key area to keep
in mind is, in both harmonization and principles issues, is what are the standards going to be? And by that I mean, for example, in risk management should there be a common approach to how you manage risk both at the intermediary and clearing level?

I think the answer to that is it would be good to do. It's a systemic issue.

The other is it's fine to have principles, but to the extent that in the marketplace each of your regulators are performing what is essentially a referee function on competitive issues there is, I think, a question of whether this is an area where you take different versus common approaches to the referee function. Exchanges compete against each other and sometimes, you know, they will use the other guy as an example of what is bad for the market. And that may be accurate. But those kinds of disputes put the agency in a referee position.

What principle do you apply in being a referee? And are they the same in both markets?
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I think those are -- that's an interesting -- that's actually a harmonization issue. I think that was different.

MS. NAZARETH: I have to say briefly certainly principles such as fostering fair and efficient markets would be key. Fostering competitive markets -- and as I said, I think there are some real differences in how that goal has been applied by the two agencies, certainly from a market structure standpoint. I think the securities markets have fostered much more effectively the goal of multiple competing markets.

Certainly, mitigating systemic risk has to be at the top of the list and investor protection issues. Avoiding regulatory arbitrage is going to be very important in all instances. And I just wanted to clarify that on the portfolio margining front I think it's pretty clear that the SEC has also embraced portfolio margining. It is not just using strategy margining anymore. There are clearly differences in how that is being
applied at the two agencies, and I think those
differences could be bridged. But I don't think
that we're looking at a situation where it hasn't
been endorsed or applied by the SEC.

MR. BAGGESEN: Very short comment.

We're talking about an awful lot of structure
that's down in the weeds. As a portfolio manager
and as an investor in the marketplace, we need you
to move this discussion upstream. We need all of
the derivative instruments brought under your
purview.

The whole issue of, for example, whether
you're margining in the securities market or the
futures market, we as an investor have figured out
how to manage those cash flows and how to deal
with those competing areas. Certainly, the
efficiency of moving to a single system would be
wonderful. You cannot do that if you cannot look
at the entire portfolio of exposure. Without that
ability and without complete transparency this is
a pipedream. So you really need to move this
upstream and make sure that you're somehow
bringing the entirety of my portfolio exposure
under your view before you can even move on to
some of these discussions.

So that would be my short comment.

MR. GENSLER: Thank you, Commissioner Casey for getting all the witnesses. It's very
good.

And we'll try to keep it upstream and
out of the weeds, in one pot and two pot and so
forth.

Commissioner Sommers.

MS. SOMMERS: Thank you, Chairman Gensler. It's hard to decide where to start
because there are so many different issues that
have already been talked about. So I'm going to
start with just one clarification I really am
unfamiliar with and it was something that Mr.
Brodsky was talking about with the international
standards on portfolio margining.

When you talk about what the global
standards are, you talked about they use a
risk-based approach and they all use a one pot
approach. And I think I heard that right. Is
that --

MR. BRODSKY: I think that's a fair
statement.

MS. SOMMERS: Okay. And so what do they
-- how do they approach insolvency regimes? What
kind of insolvency rules? Is it more like an
insurance protection?

MR. BRODSKY: No, I think that's where
we get back to the devil is in the details.

We have a system in the United States
that has existed for many years for historical
reasons. SIPC is a function of the securities
industry and how it decided to handle insolvencies
of broker-dealers. I'm not familiar with the
specifics in different countries. What I'm saying
is, as Mr. Leitner said, if I'm a customer --
whether I'm in France, or Germany, or England --
and I want to put a stock position, an option
position, and a futures position on the same
account, that's the standard. It doesn't exist
the way it does here because of historical
reasons.

So I can't give you the bankruptcy rules. I think the problem is that we are the outlier because of the bifurcated system that has existed here since 1975, at least.

And I think what we have to do is say that we have customers -- as Mr. Leitner talked about -- who want to have their positions all in one account. And I think it's for us to figure out how to rationalize what we have. But again, it only in my view doesn't require that we throw out everything that we have. If someone says, look, I prefer the current system and don't want to have a portfolio -- my account in one place -- no one should deny that of that person. That's not the issue unless somehow you bring the whole thing together.

And, again, I think you need people who can sit down and say what is the goal that we're trying to do? If we're going to keep FCMs and futures accounts as separate and securities accounts and broker-dealers as separate, that's
fine. But if a customer comes in and says I have
a $10 million portfolio and I want to keep it in
one account at one firm and I don't care about the
other issues that exist because I'm making the
decision of how I want my money managed -- the
same way I do it in London, the same way I do it
in Frankfurt, and the same way I do it in Paris --
then I'm saying that you should be able to allow
that to happen.

MS. SOMMERS: Another issue that I find
really interesting -- and whomever would like to
comment on some more details -- is the issue that
Ms. Nazareth brought up about common clearing.
And I'm wondering, from the clearinghouse
perspective what complexities and how you actually
implement being able to clear a number of products
that you either don't trade or are not executed as
part -- talk about how exactly we could implement
that kind of structure.

MR. DONOHUE: Well, I'd be happy to
address that. And I'm thankful for the
opportunity to do it.
I mean, I think this is another case of, you know, the Greeks talking Chinese to the people who are speaking Portuguese because we don't understand each other in terms of the way these markets function. In the securities markets and in the options markets you do have, as I mentioned earlier, a national market system and you happen to have a single clearinghouse for cash equity securities and for equity options and index options. And unlike that market structure in the futures markets, we have a multiplicity of clearinghouses -- not just one -- and that presents a number of complexities for considering, you know, fungibility of positions in futures markets.

We have significant differences as well in terms of the basis upon which we compete. As you probably recognize in cash equities and in equity options as well as index options, there's a fairly low level of kind of innovation and product development in those particular products. We often compete on the basis of distinctions in
products rather than the sameness of the products.

I think a great example of that is the competition that exists between ICE and CME Group in the energy markets. But when you start to contemplate fungibility in futures markets you have to deal -- to your question, Commissioner Sommers -- with the increase to systemic risk potential of, you know, how do you create sort of interoperability among clearinghouses. How do you recognize the credit differences or credit profile differences of a variety of different clearinghouses? How do you deal with the operational risks that are attendant to transferring positions and transferring customer property and funds?

In the world that we operate in, given that 90 percent of exchanges that we compete with are clearing their products on or through vertically integrated clearing structures versus horizontal utility clearing organizations, we have to deal with sovereign risk issues and we have to deal with the competitive landscape issues of we're not operating just -- it's not the Merc
competing with the Board of Trade and NYMEX in Kansas City anymore. We're competing on a global basis and those are very real issues and distinctions, both in terms of innovation, in terms of competition, in terms of systemic risk potential that can't just be waived away because it works different in the securities markets.

MR. LEITNER: If I could I'd just like to make one quick comment. And that's to distinguish fungibility which is, okay, I put on a contract here and there's another exchange trading a similar contract and it's cheaper for me to take that position off so I'm now economically neutral, but I have positions in two different places. And presumably, the market-to-market payments are going back and forth and I don't even see that.

Then there's the issue of what happens if the intermediary goes belly-up, Lehman Brothers goes under, and that situation exists? The systemic risk issue is how do you unwind and net those positions in those two different clearinghouses to cause the least impact to the
system? Okay. So it seems to me we've got to separate what I'd call the systemic risk issues and the issues that Craig Donohue raises are absolutely correct. That is, whenever two different clearing organizations work out some way of kind of common clearing offsetting those positions, they're taking each other's risk.

So, in my paper that I've circulated to all of you there is a detailed discussion of the two different ways that clearinghouses have today sought to be able to modify the risks between them. They're very different. If we had a white board we could get into that. But that's the kind of issue that's going to be a little bit more difficult to resolve, but it does need to be resolved. And it is, I think, necessary to bring, you know, kind of technology and operations and risk managers into the discussion first and then the lawyers and the regulators second. I think that risk management is the key issue.

MR. GENSLER: Thank you, Commissioner Sommers. We'll try to bring a white board next
time for you.

Commissioner Walters?

MS. WALTER: Well, I see that our time -- we're already getting into time trouble so I will restrict myself to one question which I think is unfortunately not likely to get us out of the weeds.

I'd like to talk a little bit about bureaucratic turf battles and whether -- since we're in a situation where we have dual agencies and there are going to be products that seem to straddle the line -- in fact, there are going to be products that do straddle the line -- what suggestions you have as to how best we can cope with those where there are legitimate jurisdictional questions?

MR. BRODSKY: Yes, Commissioner Walter. I tried to make a couple of suggestions, both in my oral testimony and in my written in a little more detail. And that is that there is a proposal in the White Paper that would provide a council that I believe would have some authority to deal
with that. Right now we have no legal way to do that other than the agencies ultimately making -- coming to some resolution or to end up in the federal courts, which is a multiyear process.

I believe that there needs to be something that's hard coated that says if the agencies are going to remain separate and there are differences, that there's a way to resolve it other than through the federal courts. And one way in the short term would be to designate someone -- some part of Treasury to do that, but I think ultimately there ought to be a hard-coated mechanism, be it the council that's proposed or some other mechanism. Because, remember, the report that was put forward was merely a recommendation to Congress; it wasn't something that's going to just happen.

But what my experience has been is that there are times -- and certainly the goal of the ETF issue is probably the most glaring -- where in the recent past we made a submission to the SEC to trade an option on a security that was trading
actively on the New York Stock Exchange and NASDAQ and this thing languished for three and a half years.

And there was no place we could go to get resolution. And sometimes just because, in our case, the SEC is distracted by many other unrelated issues and this never gets to the top of the pile or because notwithstanding memoranda of understanding, the agencies are just not getting along at that moment in time and therefore, nothing gets resolved. The moment that that product started trading, we were trading hundreds of thousands of contracts a day which meant there was a pent up demand; that we denied American investors; and hence, the U.S. Treasury of revenues that they would have gotten had the product been approved two and a half or three years earlier.

So I think that this is something that could come out of this group or out of the Congress. But what I can say is as long as the agencies are separate and as long as we define
securities and futures in a way that doesn't have clarity, there needs to be a resolution process.

MR. GENSLER: You're yielding back time.

Wow.

MS. WALTER: Always being gracious. I'd like to yield it to a CFTC colleague.

MR. GENSLER: Then I believe it's Commissioner Chilton.

MR. CHILTON: Thanks. You got me, Bill, because I had something else.

Shame on us if we can't resolve some of these things. I feel silly because you've been in this industry for decades and played a leadership role. And we've discussed this before and maybe from your perspective we just need adult supervision. But I really hope, and I'm very optimistic with the leadership that we have, that we can resolve these issues without having to have mom or dad step in and help us in the form of the Treasury Department.

Talking about all these things -- you know, the staff -- everybody's talked about what a
great job the staff does -- this is, you know, our
binder and it differentiates a lot of what we're
talking about today between the securities and the
CFTC law. And it sort of reminds me of the title
of that Clint Eastwood movie, you know, The Good,
the Bad and the Ugly. I won't talk about the bad
and the ugly, but some of the good that I like in
our law -- in the statute is the principles-based
approach with specific regard to product approval.
It used to take us, you know, six to nine months
sometimes to approve products that you all as
business people would think would be a good idea.
In the meantime, maybe somebody else on a foreign
soil would come up with that product and begin
offer it. So we were at a competitive
disadvantage and I think that's one of the good
things.

Likewise, I like the SEC's manipulation
standard that it just has to be reckless. We've
got to actually prove intent. We've got to find
an e-mail or a tape of somebody to prove
manipulation. So I wouldn't mind having that at
the CFTC.

The one thing I'm not sure about though is insider trading. Ms. Nazareth talked about insider trading, and to quote from her testimony she said, "The CEA generally contains no such ban. While this disparity may have made sense when most futures were related to agricultural products, today the overwhelming majority of futures are financial futures. Good public policy," she says, "would dictate the extension of insider trading prohibitions to the futures markets to ensure the integrity of each of the financial markets and to prevent regulatory arbitrage."

I'm not so sure I agree with that particular change. I'd like to ask Mr. Brodsky, and Mr. Short, and Mr. Donohue if you'd respond to that specific question.

MR. BRODSKY: I think this is a very complex area. I certainly, from my days at the CME, would understand the difference between insider trading in oil or gold where there isn't an issue or per se, versus securities-related
products.

My concern on insider trading is that as it relates to comparable products -- which in my case would be securities indexes, broad based, narrow based, or whatever -- that you shouldn't have one very strict standard in one area and zero standard in the other. And I recognize that the issue of insider trading could be very different in a broad based index option versus a narrow based index option. But my focus on insider trading would be comparable products. I think that you can carve out and look at pure commodity products differently. On the other hand, the Treasury market could be viewed as different. I mean, there have been incidents in the Treasury market where people had insider information coming out of the Treasury.

So, I think you have to, again, take an intellectually honest approach and say let's clear the table and let's talk about it product-by-product and what makes sense.

MR. GENSLER: Thank you.
MR. SHORT: I think that's right. You know, Mr. Brodsky alluded to the difference between commodities markets and equities markets. I mean, when you look at commodity futures, I mean, obviously I don't think an inside information or insider trading regime would be appropriate. I mean, they're primarily risk management markets. People are seeking to hedge price risk and are trading on inside information that they, you know, that they have. But you can see where if you had "like products," one of which was a derivative and one of which was an equity product that you could get to an anomalous result if you didn't have some sort of standard to govern that conduct.

MR. DONOHUE: Well, I certainly appreciate the distinction between the equity markets and the commodity and other financial derivatives markets where essentially people are using all the time information that they have as commercial participants in the market as they're entering the futures market and they're bringing
that information to the futures market. And so I
don't think you can superimpose the insider
trading regime of securities markets on futures
markets in any way, shape, or form and have it
work.

With respect to the distinction on

equity securities, I actually don't even

understand what the issue or the problem is and

I'm trying to understand why you would want to do

that. Would a mutual fund or insurance company

that has a very large portfolio of S&P portfolios

have to disclose to the market what its long term

intentions are with respect to its actual

ownership base investing in those stocks before it
could effectuate hedging or risk management or
portfolio management strategies in the equity
derivatives market? I would hope not. So I'm not
sure, maybe somebody can explain why we need to do
that. But it doesn't make any sense to me.

MR. GENSLER: Commissioner Chilton,

thank you. Commissioner Aguilar?

MR. AGUILAR: Thank you. In the
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interest of time I'm also going to limit my
question.

As everyone was speaking in the
beginning I heard mostly bullish statements about
the potential for harmonization, except -- if I
misheard, I apologize, but I thought that Mr.
Donohue was a little less bullish about
harmonization because of the difference in
markets. And if I heard that right, could you at
least talk -- not in the weeds -- if we can at a
macro level -- about what those fundamental
differences are in the markets and whether or not
there are abilities to bridge them. Otherwise,
there's probably a day and a half -- I can save a
lot of people's time.

So, if you could address those issues.
That's what I thought I heard. And your remarks
that you wrote, that will be available to everyone
who is interested, do talk about the dangers that
you see for more harm than good. And I'd like to
give you a chance to flush that out and then maybe
have people to either get onboard with you or tell
me why perhaps there is light at the end of the
tunnel for harmonization.

MR. DONOHUE: Well, thank you for the
opportunity to do that. I mean, you know, again,
we do support harmonization efforts. There are
areas where I think it can be useful. We've
touched on a number of them today, but I think
it's important to respect the fact that, you know,
capital formation and risk transfer markets are
functionally fundamentally different in terms of
their purpose and scope.

People use them for different reasons to
achieve different objectives. And so that's a
critical distinction between the two.

Ownership-based investing in the
securities markets is very different than what
occurs in the futures markets. The products are
different; the market structures are different;
the customers are different. We have some
overlap, but we tend to have a very wholesale
financial market orientation in exchange traded
derivatives and over-the-counter derivatives
markets. We tend to have a much larger retail component to the securities markets, as well as the securities options markets. There are many, many, many differences that are endemic to these markets and we've designed regulatory frameworks that respect those differences. Even in other regulatory frameworks, and ours is certainly more bifurcated than many, there's still a need to make functional distinctions between these markets and products for the very reasons of they are different and they function differently.

So that's a challenge that any regulator has, no matter what the structure of it is. There are a lot of different models. Those have been studied by all of you, others in government, the private sector. But those distinctions always have to be made. There will always have to be people deciding whether a gold ETF is more of a security or has elements of futurity and perhaps is more of a futures contract. And what's the right way to regulate it? And it may not be the same approach even within a regulator that's a
consolidated regulator.

So, those are many of the differences.

We respect the fact that there is some value to be gained from harmonization. We're not opposed to that. We're just simply opposed to making things identical just because it would be neat. If it's neat and it doesn't serve the purposes of the market or the customers who use these markets, then it is ineffective.

MR. SHORT: I would just echo some of what Craig just said. I think Washington lately has caught a case of loopholeitis. I mean, there is such a push to make sure that everything is completely consistent and buttoned down that you really do need to start at the high theoretical level of what is the difference between the two markets.

And, you know, I keep coming back to the futures market being about the future. Right? It's a risk management market where people are speculating about what the future may be. And, you know, that's pretty different from a cash
equities market. And I think it's always important to keep those two differences in mind when you're talking about rationalization because, you know, you could end up hurting both markets if you tried to, you know, make a square peg fit in a round hole.

MR. BRODSKY: I have a little different take on that, and that is we are where we are because of the history. And if, again, you go outside the country where there are very vibrant cash markets, futures markets, options markets, they tend to be regulated under the same overall umbrella. That doesn't make it perfect, but I think it helps avoid a lot of the debates that we have. And it probably would be highly instructive for the two Commissions to talk to their counterparts at other countries where they do, in fact, regulate these products through an overarching system, albeit they may look at the risk transfer of products differently than they do the cash ones.

But I would certainly point out, even
though I'm here on behalf of CBOE, that the option markets in the United States certainly have more characteristics of risk transfer than they do capital formation, if you want to slice it that way. And, in fact, the option markets from a volume point of view are as large as the futures markets. So I think -- I don't want to find ourselves putting the fact that the futures markets and risk transfer markets and the securities markets are capital formation markets when, in fact, the option markets are trading 15 million contracts a day and have as many institutional customers as they have retail customers. I think that that may be why I feel that we're kind of caught in between these two worlds.

The other thing I wanted to add, and I think it's critical to the issue of Commissioner Chilton on the insider trading issue, is one of the things that we've all touched on -- and I agree with Craig's earlier comments on the OTC markets -- is that there's a whole world of OTC
derivatives that exist today. And it's not just
credit defaults or other kinds of interest rate
swaps, but in equity derivatives where there's no
regulation. There's no transparency, there's no
reporting, and obviously no effect -- ability to
do insider trading. And I think if you're looking
at the whole picture you must look at and figure
out how to get this under the tent in some fashion
or you have -- forgetting about whether it's done
in the U.S. or abroad, which a lot of our options
trade outside the U.S., meaning OTC equity
options, that completely elude the regulation.

And I think you have to figure out what
you're going to do about that because there was an
opportunity in 2000 and Congress decided to
exclude -- not only exempt, but exclude -- and now
you have a question of what do you bring under.
And I think it's something that has to be looked
at from a point of view of the effect on the
existing markets and what exists -- where they
lean on our markets to hedge, but, in fact, the
regulators have no idea what's going on.
MR. GENSLER: I thank you. And if I could have the opportunity to say I know that Chairman Schapiro and I are both committed to bringing the full over-the-counter derivatives marketplace working with Congress under regulation, as many of the witnesses have said. So I just wanted to make sure we get that once again on the record because that is critical. Commissioner Paredes?

MR. PAREDES: Thanks. One of the topics we touched on a little bit, and I think Chairman Gensler mentioned it in passing in his remarks, is the question of new products. Bill Brodsky spoke to that a little bit in response to a prior question and I think a number of you addressed it in your written remarks.

I just want to go back to that topic and really just throw out an open-ended question, which is to share the thoughts and, in particular, the concern where the inefficiencies are, where the roadblocks are, and what the consequences are. Certainly, there are consequences for those of you
who run businesses that depend on the ability to offer new products and all the rest, but there are impacts for the marketplace, investors' impacts that may be for the better, but impacts, of course, that may be for the worse.

So, if we could perhaps hear in the interest of time from Mr. Short and Mr. Donohue and then others from this end of the table. Ms. Nazareth, I think, has a unique perspective perhaps and, of course, from the perspective of an investor -- that would be great.

MR. SHORT: I certainly think that the CFMA -- the changes that were brought into effect by the CFMA and the principles-based approach to the introduction of new products -- self-certification by exchanges -- is a step in the right direction. It does allow exchanges to be competitive. We have a very healthy competition with the CME's energy markets. And I think having some of the delays that Mr. Brodsky described earlier in the middle of that would be very problematic.
I understand what you mean. There's obviously a tension there between allowing exchanges to compete on an open playing field and speed products to market and having the proper customer protections in place. One of the recommendations we made in adopting core principles was to have a higher level of prudential regulation where the regulator is sitting down with the exchange and the market participants on a real-time basis and better understanding the dynamics of how the businesses operate and what the products do to get that additional level of comfort to address some of the issues that you're concerned about.

MR. DONOHUE: Well, Bill is actually a really good friend of mine so I'm going to show him some empathy on this one, even though I disagree with his solution. But I agree that it's a problem.

And so in this area of hybrid products that are both securities and have elements of futurity, we think the sensible approach is
actually to do -- back to my earlier comments --
what the CFTC has done for 12 years. And so we
have an unusual situation where the CFTC actually
will recognize functionally comparable regulation
by foreign regulators who want to distribute their
products here to U.S. investors. And a great case
in point is, you know, FSA- regulated exchanges,
like ICE Europe, where it's different. They don't
have position limits in the way that we have
position limits. I'm not picking on you, but it's
different.

And we live with many of those
differences. It's not the same, but it's
functionally equivalent.

And I think a great step forward would
be for the CFTC and the SEC to think similarly
with respect to these hybrid products that are
both securities or have elements of futurity and
allow an exchange -- bills exchange, securities
exchange, an options exchange, and a futures
exchange -- to pick the scheme that it wants to
use to bring the product to market. End the
disputes; there will be differences. They'll have
to pick that. There's probably some risk of
regulatory arbitrage, but we live in that world
already, at least in the derivatives part of the
market. We can tolerate those differences, but we
can still innovate and come to market.

So I think that would be a smart way for
you to think about how to expedite the process of
allowing people to bring products to market more
quickly. Maybe you'll have a different margin
regime if he chooses to do it as a SEC-registered
securities exchange; maybe he'll have some
advantage if he does it as a futures exchange.
He'll have to make those choices. But you should
let him make those choices, but you should let him
make those choices and then just have one
regulator, not two. And then you don't need a
tiebreaker.

MS. NAZARETH: Well, I can appreciate
the issues that Bill Brodsky has had. And again,
I think they are rooted in the jurisdictional
disputes, unfortunately, with the industry bearing
the brunt of the, you know, lack of clarity. I mean, it may well be that for some of these hybrid products just as with single stock futures, they should be able to trade in both options and futures markets because it always seemed to me that one of the challenges -- again, because of the differences in market structure -- was why do people passionately care about any of these things? They care about it because there's a lot of money involved. And if the product was on the futures side, frankly it tended to not be competitively traded. It would ultimately migrate to a single market in the futures markets. All the markets -- in the options markets, all the markets had to compete in that space.

And so it seems to me, likewise, let a thousand flowers bloom. If some of these products bear, you know, attributes of both securities and futures, let them trade as both, but let both types of markets trade them. And again, see what works out to be best for investors and where you can get the most efficient pricing.
MR. LEITNER: Just to remind you if I could that on securities exchanges there will be an issuer of the product. On futures exchanges the contract is initiated by the exchange and then it goes directly to clearing. So, that is a difference that, I guess, has to be respected.

MR. BRODSKY: Actually, I don't think that's completely correct, Tony. It would be an issuer if there is actually a corporate issuer. I mean, the case -- for example, one of our greatest recent innovations was trading volatility and VIX options and VIX futures. We traded the futures through the CFTC and the option through the SEC. And the issuer is technically the option clearing corps, but it's really not the same. And the creation of the option clearing corps as the issuer is really a legal fiction that the SEC forced upon the options industry in the early days.

MR. LEITNER: I was thinking more of ETFs than --

MR. BRODSKY: Yeah, but the issuer of
the ETF is also State Street Bank or Barclays. I
mean, I think the concept of issuer in the case of
these new products is really taking, again, a
square peg and putting it into a round hole.

I mean, this is just the way the markets
have evolved. And I don't look at issuer in the
same sense, certainly not from an insider trading
sense.

MR. GENSLER: I think if I might thank
Commissioner Paredes and turn to Chairman Schapiro
for her round of questions as the cleanup hitter.

MS. SCHAPIRO: Thank you. And I am well
aware that we're quite over our time limit, so let
me just ask one question although there are about
a thousand I would like to ask you all.

To what extent do you think the nature
of the different participants in the futures
markets and the equity markets -- we think of the
securities markets as having a lot of retail
participation, certainly more than I think you see
in the futures markets -- to what extent should
the different nature of participants legitimately
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drive differences in our approach in any number of areas, including approval of new products, for example, or approval of exchanges rules, or transparency? It's something we think about a lot at the SEC because we do have this constant focus on the individual investor, as well as, obviously, on institutional investors, who at the end of the day generally represent individual investors. To what extent is that a legitimate reason for us to look to different approaches here?

MR. LEITNER: Sorry. All of my issues were wholesale market issues. I think that the SEC has already made those distinctions. In areas, and portfolio margining being a prime example, the SROs have "harmonized rules" and they have a class of eligible participant who can use a portfolio margining account. We make these distinctions.

In the area of -- Ms. Nazareth suggested that we should have suitability standards, but even there the SROs in the securities land have said, well, you know, there should be a different
standard to institutions than to individuals.

I think that's legitimate. So I think across the board what you're hearing is that from the securities regulators in the institutional context we'd really be rather regulated more like the CFTC does it. And the CFTC guys say when it comes to harmonization, because we have a wholesale market, please do not throw us into securities land where we will be subject to a standard of approval process and so forth that will just, you know, undermine us. So -- and those are legitimate concerns.

MS. SCHAPIRO: But specifically on the context of new products and the process for approving new products, is there any reason to differentiate?

MR. BRODSKY: I don't think there's a need to differentiate because the customer base -- there's a tremendous overlap. I think that other than the fact that the securities markets certainly have a broad retail component -- much larger by percentage than I would expect exist on
the futures side -- the other users are institutional investors, whether they're commercials, whether they're hedge funds, whether they're pension funds, a la CalPERS or mutual funds are the same, but in relation to new products I think that if you hold people to a suitability standard, at a minimum, I think there's a level of protection there.

These products are, I don't think, designed specifically for one class of customer or another. I think it's really the customer or his advisor recommends them. So I don't think that there's a major distinction. And I think what happens is the SEC tends to apply the retail standard to everything they do and I think that's why people say we'd rather be under the CFTC.

MS. SCHAPIRO: I guess what I'm trying to get at is the idea that if you have a more retail base and a product is going to appeal to more of a retail base -- I'm really not talking about sales practices -- ought the process of approving that product be different? Is there a
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different inquiry on the part of the regulators? Is there a different attention the regulators need to pay? Or should you have a more summary process that applies across the board that might be very easy to apply in the institutional context with those big people that can take care of themselves?

So what I really want to get at is should our process be any different in the approval of products if they're geared towards an institutional or a retail base?

MR. DONOHUE: Okay. I'm going to try to help Bill again. I don't think so. I don't think it should be any different. Unless you believe that the CFTC or the SEC is in a better position to judge the product design or whether the product will serve some kind of legitimate investing or other, you know, trading purpose, I don't think there's any value to be gained from higher levels of scrutiny for products that might be traded by a retail investor so long as you feel that the self-regulatory agency or the exchange has appropriately described the product and the terms
and conditions upon which the product can be traded and cleared.

Maybe I'm not fully understanding the question, but I think, Chairman Schapiro, that there's no need for that.

MR. BRODSKY: I thank Craig for his assistance.

MR. DONOHUE: Pay me later.

MS. SCHAPIRO: Harmony everywhere. I think with that, that concludes this panel. Let me thank you all again.

Enormously helpful to us. And we'll look forward to working with you on these issues as we go forward.

And I think we're due to take a small break. I'd be happy to keep going.

MR. GENSLER: The two chairs are happy to keep going. Our fellow commissioners -- are you all right? Keep going?

We're going to ask if the next panel of witnesses -- we want to thank these six panelists, but if you help us move along and we allow Tony --
Tony, please -- help us move along. And I can do that to the old professor. That's all right. So we're now going to move to our second panel. And if I might just introduce -- I don't know -- well, I'll introduce from right to left, just to change a little bit around.

Mark Cooper, from Consumer Federation of America. Good to see you again, Mark.

We have Professor Lawrence Harris from the University of Southern California.

Larry Leibowitz from NYSE Euronext.

Mark Young, representing the Futures Industry Association. I guess we've swapped you around.

I'm sorry that we did that there.

Paul -- I mean, Peter, can you help me just pronounce your last name so I don't --

MR. REITZ:  Peter Reitz.

MR. GENSLER:  Peter Reitz from Eurex.

And then Wayne Luthrisnghausen from the Options Clearing Corporation.

And with that, maybe we'll at this time go from right to left. And this little red light
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MR. COOPER: Thank you, Chairman Gensler, Chairman Schapiro, Commissioners. The
Consumer Federation of America greatly appreciates the opportunity to testify on the important topic of eliminating conflicts in statutes and regulations in the effort to repair the financial system of the United States. CFA has a half dozen people who work on various aspects of the financial meltdown, including investor protection, consumer protection, housing, financial insurance, and commodity markets. I analyze commodity issues and economic theory for CFA so I will lay out some broad principles for this inquiry to follow, and I definitely will not get into the weeds.

In a report entitled "Reformer Financial Markets" issued about six months ago, we concluded that Alan Greenspan's admission that there was a flaw in the theory that financial markets need little, if any, regulation is a gross understatement of the problem. We identified six fundamental imperfections in financial markets
that led to a pervasive market failure: Systemic risk, perverse incentives, imperfect information, agency conflicts of interest, and unfairness.

Financial market reform requires the SEC and the CFTC to address all six if they are to provide a harmonized approach to securities, commodities, and derivatives regulation that both protects investors and promotes market integrity in capital formation.

The purpose of the financial sector is to support the real economy. The effort to harmonize regulation of financial markets between different statutes and different agencies should proceed with one overriding objective in mind: To prevent these market imperfections from once again undermining the important function of the financial system. Any harmonization and approach must be a harmonization upward to provide the highest level of investor protection. Harmony should never be achieved at the expense of the effectiveness of prudential regulation. Financial innovation, which nearly destroyed our economy,
must take a backseat to safety and soundness.

Financial sector reform across all agencies needs to follow a simple philosophy of regulation. Accountability, and therefore effective oversight, must derive from principles of prudential regulation expressed in clear rules that are strictly enforced in a transparent manner. There need be no conflict between principle and rules. Rules should be the embodiment of principles. Principles without rules are likely to be ineffective. Rules without principles are likely to be misguided.

Only after policymakers identify the principles that need to be applied and the rules that should be implemented can they even ask where harmonization is necessary. The inquiry should not start by asking financial market participants how they want to be regulated; it must start by asking how market participants should be regulated.

Only after we know what regulation is necessary can we know which conflicts stand in the
way of effective regulation and should be removed. But we very much agree with the sentiment in the last panel, not every difference is a conflict. Similar things should be treated similarly; different things can be treated differently. Entities providing financial services should be regulated by what they do, not who they are. The extent of regulations should be commensurate with the size, importance, and complexity of institutions and products. The fact that a single entity might be selling different financial products in different markets that are regulated differently by different agencies is perfectly reasonable. It is not a flaw in regulation; rather, it reflects a choice about the necessary level of regulation for the specific product or the specific market and the choice made by the entity in regard to its own business structure and lines of business within which it chooses to engage. If an entity that sells different products does not like the fact that it finds itself subject to different regulation it
should exit one of those lines of business, not
complain about conflicts in regulation. There
will be plenty of single purpose traders who will
take its place.

The bottom line is straightforward.

Harmonization must not be an excuse for inadequate
regulation. Applying these principles, the SEC
and the CFTC should identify which prior statutory
language, regulations, and agency practices
resulted in gaps in regulation that opened the
door to market failure. They should identify the
steps necessary to close those gaps and where
there are conflicts between agencies they should
adopt the approaches of the agency whose statutes
and practices are best suited to get the job done.

Thank you.

MR. HARRIS: Thank you, Chairman. Thank
you, Chairman Gensler and Schapiro, Commissioners.
I'm Larry Harris. I hold the Fred Keenan Chair in
Finance at the University of Southern California.

My comments today concern clearing
systems. They are extremely important now as you
all recognize because they provide an answer to a
direction to solving the systemic risk problems
that have confronted our economy in the last year.
And in particular, they're very important because
we now need to address questions of how to create
central clearing systems for OTC derivative
markets, which is very important.

There are two aspects of clearing
systems that have been introduced this morning so
far. The first aspect was introduced -- actually
it was introduced in second order -- by Annette
Nazareth where she discussed the question of how
clearing ends up controlling marketplaces. And
then the other aspect, which was the one that
you've provided most attention to so far, is a
question of cross-margining and one pool, two pool
issues. I'd like to address the first issue and
time permitting, or perhaps in questions, address
the second issue.

So, the CFTC and the SEC share one thing
in common and this is a tribute to both agencies
and to our system. Both of them have been
extremely strident in the promotion of
competition, and I think it's important to
recognize that. Where they differ is that there
are two competitions that take place in our
financial markets. And the two Commissions have
tended to focus on the different competitions.
One competition is the competition for best price
and that is among traders trying to get the very
best price. And here, the CFTC has shown more
concern -- I don't want to say strength or
leadership -- but concern on that. And the other
competition is the competition among exchange
service providers to provide -- to host the first
competition. And there the competition is among
exchanges, brokers, and dealers to provide the
exchange services that let the system move
forward.

The SEC has not historically -- in its
history was not always very strong in this area,
but it has become very strong in the recent past.
These competitions become very important or the
definition or the lay of the land is defined by
the clearing systems that underlie our exchange
systems. And in particular, those clearing
systems are essentially the plumbing. You can't
do anything without plumbing.

We have three models of clearing systems
that we should be aware of as we think about
regulatory harmonization. One model is the model
that we see in the futures industry where there's
a single clearing corporation.

And that clearing corporation and its
associated exchange are linked together. And as a
consequence, only trades in the particular
contract can be done through that clearing
corporation and through that exchange. And so you
don't see a number of alternative trading systems.
In a sense you have a monopoly or an extremely
strong interest in that system.

In contrast, on the far extreme in the
securities markets you have NSCC, which has
provided a relatively level playing field for all
participants so that a trade in security can be
arranged almost anywhere through a dealer, a
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broker, an exchange, an ATS and ECN, and that
trade will then be cleared in a common format.

In between that there's another market
structure which is the Options Clearing Corps
where they clear for the five or six options
exchanges that we have. The trades have to take
place on the exchanges, but the exchanges compete
with each other to provide exchange services.

The result of this has been an awful lot
of market power in the futures markets for those
markets that control the very lucrative contracts.
And it's essentially impossible for a start-up
exchange or alternative trading system to create a
similar contract and expect for it to become
successful. And as a result there's an awful lot
of profit that is extracted -- for lack of a
better word, and that's probably a strong word --
from consumers and others because of the market
power that those exchanges have. On the flip
side, the search for best price is often
complicated by the fragmentation that we see in
the markets that are regulated by the SEC,
although that has been changing recently.

With electronic trading coming into our markets, the balance between these two types of competitions has changed. In particular, electronic trading has made it much easier to find the best price. And as a consequence, as we search for regulatory harmonization, I think it's time for the Commodity Futures Trading Commission to start considering more carefully opportunities to allow people to create alternative trading systems that would provide some discipline to the fees that the exchanges and their associated clearing agencies are collecting.

MS. SCHAPIRO: Thank you, Larry. I don't think we got a written submission from you, so if you have one we would love to include it in the record.

MR. HARRIS: I did, in fact, send it, but it was late last night.

MS. SCHAPIRO: Oh, okay. Great. Thank you.

MR. LEIBOWITZ: Chairman Gensler,
Chairman Schapiro, SEC and CFTC Commissioners. My name is Larry Leibowitz. I'm group executive vice president and head of U.S. Execution and Global Technology for NYSE Euronext. As our company is regulated under both agencies, I'm pleased to appear before you today to share my views on harmonizing U.S. financial regulation.

It's our belief that smart regulation, when properly administered, add value to financial markets and even our own business at the same time by providing investor protection and increasing confidence in market integrity, while at the same time fostering competition and innovation.

We applaud your agencies for calling these hearings in an effort to improve regulatory oversight. One of the lessons learned from the recent financial crisis is that the exchange trading and clearing model clearly works extraordinarily well, even as unregulated markets faltered. NYSE Euronext supports the administration's proposal to bring standardized derivatives onto exchanges and clearinghouses.
However, as more products come into regulated markets, the need for enhanced collaboration and cooperation between the SEC and the CFTC becomes increasingly more important. Before we identify areas that require harmonization, we must define the objectives of this exercise. The agencies would benefit by agreeing to a set of common principles that define the rules of the road for effective regulation. For example, we can agree that regulation should promote open, fair, and transparent markets so investors can make confident and informed decisions. We can agree that regulation should promote fair and reasonable competition that is consistent with investor protection. We can also agree that regulation should promote a level playing field for market participants based on risk rather than clever legal structure.

Yet, we find that the current rule and product approval process for securities exchanges runs afoul of many of these important concepts. The SEC follows a rule-based regulatory approach
which requires exchanges to file new rules and products and any amendments to those for SEC approval. While a limited number of rules are eligible to be effective upon filing, the vast majority of rules are subject to a sometimes lengthy review process prior to their approval and implementation, resulting in deferral or outright loss of the new unexchanged product innovation to the OTC market.

This approach accentuates the unlevel playing field among different trading platforms for securities, many of which do not have SRO responsibilities. Ironically, these filings often tip off market competitors to business ideas that regulated exchanges are trying to implement, allowing them to freely and quickly benefit from the efforts of regulated exchanges without shouldering any of the burdens.

NYSE Euronext recommends that the SEC amend its rule and product approval regime by either adopting a certification process similar to the CFTC or amending its current system by setting
hard time limits on approvals and increasing the
number of rules or products that are eligible for
the effective on filing status.

Another suggestion that will increase
regulatory transparency in the markets, as well as
fair competition among exchanges, is finding a
solution to allow futures and securities to reside
in the same account. We believe in the concept of
portfolio margining so much that we put our money
where our mouth is. In June, NYSE Euronext and
DTCC announced our intention to form New York
Portfolio Clearing, a joint venture that will
allow firms to hold both cash fixed-income
positions at DTCC and futures positions on NYSE
Liffe U.S. to receive risk-based portfolio
margining. With this venture, regulators will be
able to monitor a more holistic view of the
markets and identify positions of firms with large
exposures. If OTC products migrate to this
clearinghouse, the view of regulators across asset
classes will be even more complete.

While NYPC will be initially available
only to firm house accounts so as not to run afoul
of SIPC or segregation requirements, we eventually
hope to expand this benefit to customers and look
forward to working with regulators to find a
consensus solution that both protects customers in
the markets while providing this risk-based
portfolio margining for investors.

I'll conclude here by restating our
commitment to partnering with your agencies as you
move forward to reconcile and improve the U.S.
regulatory system. NYSE Euronext suggests that
joint advisory committees may be an effective
mechanism to find solutions for many of these
complex issues and we stand ready to assist.

Thank you again for the opportunity to
testify, and I'll be more than happy to answer
questions.

MS. SCHAPIRO: Thank you. Mr. Reitz?

MR. REITZ: Thank you very much. Good
morning. I am Peter Reitz, a member of the
executive board of Eurex. Chairman Gensler,
Chairman Schapiro, I appreciate the opportunity to
be here today. Like many other non-U.S. exchanges, Eurex became acutely aware of the lack of harmony in U.S. trading requirements when we sought to offer our products in the United States. Consequently, I would like to focus my remarks on just two aspects of the regulatory environment where greater harmonization would remove impediments that U.S. residents face with respect to access to markets and products like those that Eurex offers.

U.S. residents have been able to become members of Eurex for more than 13 years. Today, 74 of the 405 members of Eurex are U.S. resident entities, meaning that they can access the Eurex trading platform directly from the U.S. under conditions established by the CFTC. We know, for example, that U.S. members are very active traders in our Dow Jones EURO STOXX Index futures, but these same members are currently not permitted to trade directly in the EURO STOXX Index options contract. However, many U.S. firms find products, like the EURO STOXX 50 Index options, so necessary
to their trading strategies that they set up entities abroad simply to trade them. At the same time, there are a number of well-known U.S. financial institutions which conduct the bulk of their trading on Eurex for both their U.S. affiliates and U.S. customers through terminals located outside the U.S. so that they can trade from a single location.

I would also like to point out that both Eurex options and futures are overseen by the same regulatory authorities in Germany, with an equally robust level of regulation. Furthermore, both types of contracts are cleared by Eurex clearing, which both the SEC and CFTC recently allowed to clear different types of OTC products on behalf of U.S. residents. Current law and regulatory policies cause U.S. participants in foreign stock options markets to incur higher operational risk and cost. And today, trading by such U.S. firms is not as transparent to U.S. authorities as it could be.

These results do not further the public
interest or help protect U.S. investors. As a first step to harmonize U.S. members' access to our futures and stock options, Eurex recently amended its request for an exemption from the SEC registration requirements so that we can provide direct market access to U.S. broker-dealers. If granted, U.S. members would be able to trade index options and options on, for example, liquid German stocks, putting their trade execution on an equal footing with their futures trading and with other Eurex members. Alternatively, Eurex respectfully asks that as a result of this undertaking, the Commissions recommend that Congress codify the current CFTC policies on direct market access and apply them to all exchange-listed derivatives that fall within the Commission's interests.

The other issue that I would like to highlight today concerns the growing gap between the procedures for listing of foreign stock index futures contracts at the CFTC and that of all other exchange listed derivatives. It is not out of the ordinary for approval of broad-based stock
About 10 years ago, the SEC developed a process where a domestic exchange could list products that met certain criteria that the SEC had previously approved for that exchange. This offers a good model for permitting broad-based foreign stock indexes.

Eurex has submitted a petition for rulemaking at the CFTC, which would provide a streamlined procedure for determining whether an index on a foreign exchange qualified as broad based and meets the other criteria to be offered for U.S. persons.

Eurex commends the Commissions for holding these joint meetings. We look forward to working together with you and I look forward to your questions.

MS. SCHAPIRO: Thank you. Mark?

MR. YOUNG: Chairman Schapiro and Gensler, members of the Commissions, I am Mark Young, a partner in the law firm of Kirkland and Ellis, LLP. I am proud to be appearing here today
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on behalf of the Futures Industry Association.

Thank you for the invitation to testify on harmonizing the federal securities laws and the Commodity Exchange Act.

These different laws focus on different forms of economic activity: Cash security, listed options, and futures markets. Each has a unique function and purpose. Capital formation is not price discovery or risk management.

Each system of regulation is tailored to its special economic function. FIA knows firsthand how well the futures system weathered the credit crisis last year and how well it continues to serve the public interest in fair, open, and financially secure trading markets. Given this admirable track record, FIA strongly supports the existing futures system.

You've asked witnesses to identify gaps in regulation, as well as areas of regulatory difference that should be maintained or reduced. In terms of gaps, FIA believes that both regulatory systems generally overlook the
importance of clearing firms. Clearing members provide the capital and underwriting of customer credit risk, which are the lifeblood of the financial integrity provided by clearing systems. Clearing firms, however, have not always had an adequate voice in how the clearing system is operating, who is admitted to membership, or what products will be cleared.

When you review your statutes, we ask that you take this into consideration.

What regulatory differences should be retained? There are many. Public disclosure of material market information should continue to be the hallmark of securities regulation, but not futures. Futures regulation should focus on the price discovery process embodied in the interaction of bids, offers, and executed trades. Insider trading should continue to be prohibited by the securities laws, but not the Commodity Exchange Act where hedgers could be miscast as insiders. FIA agrees with the Treasury's New Foundation Report that the goal of harmonized
regulation is well-served by a clear delineation of agency jurisdiction to avoid any overlap. The Commodity Exchange Act's exclusive jurisdiction provision mandates that CFTC regulation is the sole standard applicable to virtually all futures trading. That fundamental public policy has worked well to prevent duplication and inconsistency; it should be retained.

What could be harmonized? There are differences in product and SRO rule approvals, margin setting, as well as access to foreign markets and products. FIA agrees with the administration's call for a better process for CFTC approval of SRO rules. Otherwise, FIA strongly favors the futures model in these areas. FIA has long supported fair competition among execution facilities. One aspect of the administration's proposed swaps legislation is a step in the right direction by requiring clearing systems to offset positions established on multiple trading platforms. In our view, competition can lead to innovation and better
Portfolio margining is an important issue. A market neutral risk-based system should be adopted that would enable market participants to use their capital more efficiently while preserving customer protection and financial integrity.

FIA knows you are embarking on a very challenging undertaking at the president's direction. We look forward to working with you on this effort and to answering any questions you may have today.

MS. SCHAPIRO: Thank you, Mark. Wayne?

MR. LUTHRINSGHAUSEN: Thank you. Excuse me. Chairman Schapiro and Chairman Gensler, thank you. And Commissioners, thank you for inviting me to participate today on behalf of Options Clearing Corporation.

I think it's important -- I kind of listened to the first panel from outside on the television and the differences, I think, are important in terms of what we're structured to do.
OCC, on the securities side, is a national utility, if you will, that clears all of the listed securities options traded on the exchanges in the United States. As such, we create the fungibility that exists in those markets. If you imagine users can open a transaction in an IBM April 110 on one exchange and that individual has six choices to liquidate and that all clears net zero when he does liquidate -- he or she does liquidate.

What this has done is not always to the hurrahs of the exchanges, but what it's done is it's created fierce competition among the exchanges to put up better prices, to lower costs, find ways to get order flow into their markets.

What we think the cycle has done over the last 30-plus years in this listed options market is to create this cycle, which is fungibility starts it off. From fungibility there's competition which leads to lower cost. Lower cost leads to greater volumes. Greater volumes leads to greater liquidity.
 Greater liquidity leads to even greater volumes. And if we, in particular, in exchanges hold your costs in line, those even greater volumes lead to even lower costs. And that's been the experience from the OCC perspective from the beginning.

We are trying to bring that form of clearing to the futures side. We clear for a couple of organizations over there now and it's a very small piece of our business, but we remain optimistic going forward. Where margins are concerned, I think we learned last year about the whole importance of margins and risk during a time of crisis or stress, we think -- actually think all of us did markets in clearing organizations and the risk models work very, very well. We were fortunate that we had redone all of our systems for risk three years ago, installing what we call STANS, which is, I think, the only true Monte Carlo simulation system for determining margins. I look back at that from last year. It makes us feel pretty good about how that system was put
together and how it operates.

Having said all that, I notice in the other panel that comment as well that where risk is concerned -- and I'll get into this in a second -- but where risk is concerned, keep in mind that we've had a cross-margining system in the S&P complex and the index complex with the Chicago Mercantile Exchange since after the '87 market events. That's worked uninterrupted fabulously well for professionals, market professionals, over all of those years and reduced the dollar value of margins that have to be put up because we've reduced the risk with offsetting spreads of futures against options.

And it's worked extremely, exceedingly well. I'd like to comment, if I may, mostly because I think -- first on the issue of putting up new products. If I don't comment, Bill Brodsky will shoot me when I walk out of here. The fact is though that the whole experience with a gold ETF product and trying to put options up on that under the securities side -- I think it took a
total period of time of about three years to get
that put together between the SEC and the CFTC. I
think that really should be fixed in some way.

From OCC's perspective, however, we look
at it -- because we're the issuer, because we're
the other side of every trade, we look at it from
the point of view of we're trying to get statutory
assurance. The problem we always have is that if
it's not on this side, on the CFTC side, and it's
not on the SEC side -- and we list it under one
that we presume it is -- we wind up in no-man's
land from a statutory point of view with grave
potential financial consequences to that. So we
need that. We need clarity with that.

The other one I'd mention is portfolio
margining. I think regardless of what any of us
say, the fact is that smart folks using financial
markets to hedge their risks or to build certain
kind of portfolios use futures, use options.

And when the underlines or security
types, they put them together. And at the end of
the day it seems to me that the system that we
have in this country ought to allow for portfolio
margins in one account for an individual, a large
investor, or an institution. And we need to do
that. We need to change SIPC to allow a future in
there, and we need to have the CFTC tell us that
we can now put it in that account and be relieved
of the segregation requirements because it's in a
securities portfolio margining account.

With that said I thank you for the
opportunity to appear today and I also stand ready
to answer any questions you might have.

MS. SCHAPIRO: Thank you very much. Let
me go ahead and ask the first question to get us
started and then I'll call on my colleagues.

A couple of you -- Mr. Luthringshausen
and Professor Harris, in particular, but others --
have talked about the really, very big differences
in market structure between the securities markets
and the futures markets, and, in particular, the
very different models of clearing that we have.
And I guess I'd like to ask each of you to what
extent these really fundamental differences
represent major hurdles in our ability to achieve harmonization of the basic regulatory structure?

In other words, in order for us to make progress -- the two Commissions up here and really getting to a point of harmonization -- do we have to change the market structure on one side or the other or both in a very fundamental way?

MR. HARRIS: There are several paths you can take as you think about harmonization. One path would be to grandfather all existing structures so that harmonization only applies to new developments. And then to go back at some point and revisit existing structures to see whether they're in the best interest of the public. That's a function, of course, that both Commissions should be doing independently right now, but as we think about harmonization, as a focal point for moving that forward.

A more challenging model, of course, is to try to do it all at once, which is to say if we're going to harmonize we really ought to have a single set of rules that's going to apply to
everybody from the moment that we pull the switch. If that's the approach to be taken then we'll be talking about at least 10 or 20 years of arguing. And those arguments will be vociferous because of the amount of money involved.

If you have any question at all about the importance of this issue in terms of money, compare the capitalization of those corporate entities that are running futures markets versus those corporate entities that are running securities markets. The difference in capitalization has everything to do with market structure, and in particular, the consolidated control of the clearing corps and the exchange system.

MR. YOUNG: I don't think any of us here would advocate that we have to harmonize everything because first of all, if we do that we'll be waiting until we're all retired. I think what we can do is be pragmatic and have a couple of basic principles. So I think that you shouldn't be able to, by virtue of a
different instrument being a future or security, take advantage of quirks or loopholes. I mean, I kind of laugh when I hear that insider trading shouldn't apply to futures. I mean, the reality is if it's possible to have material, non-public information and take advantage of that, why does it matter whether it's a future or a security? Now, what I'll tell you is it's more likely that in a broad-based future or a broad-based security like an ETF on the S&P 500, it's less likely that insider trading would take place. On the other hand, there was an insider trading case several years ago -- Goldman Sachs and the fixed-income market -- where they knew that a particular security was being discontinued. That was prosecuted. I apologize there, but the point is it didn't matter whether it was a future or a security.

MR. GENSLER: I left that firm 12 years ago. Let the record show.

MR. YOUNG: It didn't matter that it was a security or a future. The point is it doesn't
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matter what the instrument is; the point is what's
the effect of the information. Just like --
security markets are just as global as futures
markets. We fight every day for listings against
the London Stock Exchange. We fight against
regulation and other things that are going on in
other markets that affect us. And so I think we
just need to agree on a couple of basic principles
and then pragmatically figure out which things to
harmonize.

MR. COOPER: Chairwoman, I think the
solution to your dilemma is to frame the question
of harmonization with respect to what the harmony
we're seeking is with respect to the outcome of a
particular regulation, a particular commodity or
market. Honestly, I don't care whether the two
agencies treat what they regulate the same way.
If they regulate different products and different
markets, then there does not have to be harmony
between the regulation. In fact, trying to
harmonize is going to either under regulate one
market or over regulate the other market.
So, the critical question, and as I understand the charge from the president, is to identify the areas where the conflicts are frustrating the public goals versus the area where the difference is simply a means to achieve the end. And I think that's very important. We've heard a lot of examples here of particular things that one type of actor does not like about -- would prefer to be regulated by the other guy. But the real question is what is the nature of the product and which is the agency that should be regulating that product. And, again, I'm a person who does physical commodities, farm commodities, and energies. And energies in particular, the physical commodity is so dramatically different than the piece of paper that the SEC regulates that the notion that they have to be regulated identically to the paper products is absurd, frankly. Because the underlying physical commodities have traits of storage and transportation, production and consumption -- I used that example in my testimony -- that make
them a completely different world.

So, my caution to you is, yes, harmonization, elimination of conflicts is important, but let's keep in mind the underlying goal of the regulation. And if in the end you tell the President these energy commodities have to be regulated completely different than the financial commodities because that's the way we get a well functioning real economy, then so be it. Don't be afraid of differences because they're not conflicts.

MS. SCHAPIRO: Thank you. I'm out of time. Commissioner Casey?

MS. CASEY: Thank you, Madam Chairman.

I wanted to go back to a point Mr. Hans made with respect to -- I thought it was very helpful actually to hear your analysis with respect to the different competition models. And to focus on risk management, in particular. There has been a lot of discussion here about support for cross-margining, particularly you have the one pot and the two pot models. From a risk management
perspective and broader systemic risk concern, are there benefits to one versus the other?

MR. HARRIS: For systemic risk management it's essential that you have some entity that is fully aware of every risk that can be characterized by each entity that's under its umbrella. And so for that purpose you need a great deal of coordination, if not a single entity. So, a single entity will have that responsibility and if you put everything into a single entity, and that really means everything -- all these futures, the clearing corps, all the securities clearing corps, and even to some extent things that are going on in the banking system -- if you put that all under one umbrella, then presumably you'll at least allocate all the responsibility in a single way and probably provide authority as well. The danger of doing that is that if any of the people running that organization are brain-dead, then the entire economy suffers.

Now, in our current system we have lots
of different clearing corporations, each one of
which is primarily concerned with managing the
risk of the ultimate members who are responsible
for performance of the trades. They have a lot of
value at risk. It's very important for them to
know with whom they are sharing those risks and to
whom they're being exposed to the risk. And
that's a system that has worked extraordinarily
well to prevent widespread performance failures
with some notable exceptions in the -- frankly,
where the clearinghouses haven't existed. It's
absolutely impossible to have portfolio margin
without the type of coordination that we've talked
about. You cannot have two pots where the two
pots aren't coordinated. And the reason why is
that if somebody puts a position -- a long
position on one side and a short position on the
other side, we recognize that they're well-hedged
and that's wonderful. But if for some third
reason that entity goes bankrupt or perhaps
because the market has moved very quickly, then
one side has profited and the other side is in a
losing position and has no claim on the profits on the other side.

And so if you're going to have any two pool margining system, there has to be some way where simultaneously a claim is written between one clearinghouse and the other clearinghouse so that in the event that that circumstance that I just described takes place, there will be an appropriate allocation of the resources.

That's very difficult to do, but there is an alternative that will work with the proper enabling legislation and regulation. And that alternative is to allow portfolio margining to take place underneath the clearinghouses, either at the broker level or at the intermediary level between the brokers and the clearinghouses so that you have some entity that is basically in the business of doing margins or -- a clearinghouse is in the business of ensuring that its clients perform. And so you could have some entity like a brokerage doing portfolio margining as many of them are, and they deal separately with the
different clearinghouses. And they still have to deliver a lot of money to the different clearinghouses, but to the extent that one client of theirs is long and another client is short, they offset in this intermediate entity. And so there's less money that goes out to the clearinghouses.

That's a proposal that ought to be enabled. The way to enable it is to address the problems that we have with segregation of accounts and SIPC. With those problems, then many of the issues that we've discussed today will go away. But with that you will also have to increase the capital requirements that we have for the brokers and the supervision of the brokers to compensate for the loss or the erosion of the protections that we currently have through SIPC and the segregation of accounts.

So, you can't do one without compensation in some other way, but as the world changes, of course, we have to change accordingly and it may be that we can substitute a little bit
additional capital requirement -- money at risk at the brokerage level or intermediate level -- and then provide for the needs -- the very legitimate needs of the industry participants.

MS. SCHAPIRO: Thank you. Commissioner Dunn?

MR. DUNN: Thank you very much. I apologize for the rest of the panelists, but my bent is towards consumer protection so I'm going to kind of focus on Dr. Cooper. But you're going to have to answer some of the questions that he raises in his testimony, if you will.

Dr. Cooper, you say in your closing paragraph -- and I'm kind of paraphrasing this -- what we really need to do is to identify the statutory language, identify the regulations, and identify agency practices that resulted in gaps that opened the door to market failure. Is that -- I think I got the gist of it.

I am going to ask not only this panel, but all panels to try to identify those things. And then the second part of what Dr. Cooper puts
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in there is that we need to identify steps to
close those gaps. And I think it's important --
if we don't do anything elsewhere -- is to
identify what the broad sector of the universe
feels are the culprits in raising those gaps and
how we close them.

Dr. Cooper also states in his piece that
financial innovation, which nearly destroyed our
economy, must take a back seat to safety and
soundness. Can't we have both? Can't we have
innovation and safety and soundness? And I'd like
all the panelists to address that.

MR. COOPER: I think Mr. Harris just
gave you a perfect example of how you need to keep
this in perspective.

So, he identified a financial
innovation, portfolio margining, and he asserts
that it will improve the functioning of the market
in some fashion, but he then also immediately
identified the risk that that would entail and a
regulatory response to balance the new, innovative
product. He said you would have to raise the
capital requirements on those entities because you had altered the underlying risk.

So it's a perfect example. And frankly, for the last 10 years we've had a lot of innovation without the responsibility and it got us into trouble, and so for me, that's the perfect example. The key thing is that someone says this product's innovative, they sort of end the sentence, and, of course, that's their job as the industry to think of things that they want to bring to market. Your job as regulators is to do exactly what Mr. Harris suggested -- or Dr. Harris suggested, that is you have to look at this implication on risk, you have to figure -- and its implication, in my view, on all six of our market imperfections. Systemic risk and risk is important and the mispricing of risk has got us into trouble, but so is perverse incentives. Does it create a perverse incentive for that actor in some way to take advantage of a difference between the exchanges? You have to -- is there an agency problem, a conflict of interest problem? How will
it be disclosed? Is there an information problem?

So, I think that you can have both, but the part that we didn't have for the past decade is the balancing part of responsibility and oversight and I take it the charge here is to say, how do we let innovation take place without undermining the possibility of having a sound system, and this is a perfect example.

MR. REITZ: Commissioner, in the Congressional Purposes section of the Commodity Exchange Act, it is true, Congress says, innovation is one of the purposes. But Congress says that innovation should be responsible innovation and that's the balance that I think you're trying to strike.

I don't necessarily agree with the idea that there has been a market failure in the futures markets or the securities markets or the listed options markets. I think if we leave that impression with people from today's hearing, we're leaving people with the wrong impression.

The question I think you're trying to
wrestle with today -- and I believe with Bill Brodsky, it is a question of enormous complexity -- the question you're trying to wrestle with today is, how do you take the best from two very good systems of regulation to make something better? I think that's a separate question from the question of, how do you deal with the regulatory gaps that have been addressed in the Treasury Department's legislation?

MR. LEIBOWITZ: I'd like to echo that. I mean, I think what we showed is that both the futures and the securities markets functioned quite well during the recent crisis. The problem was that a gap had arisen that no regulator really felt they had a purview over and by the time anybody realized it, it was too late. So, in some ways what we need is a super structure that can spot these gaps as they arise and then say, okay, well what are we going to do about this before it gets to be too late.

I think you're right, that innovation and competition is something we all want and we've
seen it with reckless abandon at times in the securities market, in fact, people really wrap themselves in innovation and come -- and say that anything that's innovative is good, but we can't lose sight of the more important principles of investor protection, what's good for the public and for the public markets. And I think it is that balancing act that is the responsibility of the CFTC and SEC and whatever harmonization takes place.

MS. SCHAPIRO: Thank you. Commissioner Walter?

MS. WALTER: Thank you, Chairman Schapiro. I'd like to direct my first question to Mark and bring you back to the point I think Larry raised about insider trading. You said in both your written and your oral testimony that hedgers can be miscast as insiders. I'd like to ask you to explain that a little bit more and explain why under the appropriate circumstances extending those principles doesn't just fill a gap in abuses that are occurring today.
MR. YOUNG: I believe there are abuses that are occurring today. There are people who are using the futures markets to hedge price risk based on information that they have from and about their individual businesses and there's nothing in the Commodity Exchange Act that requires disclosure because the Commodity Exchange Act is not built on a disclosure regime. Unlike in the federal securities laws where you were an insider and you have a choice, you can either disclose the information or you can abstain from trading, there is no disclosure of market information under the Commodity Exchange Act. In fact, the CFTC under section 8 of the Commodity Exchange Act itself is prohibited from disclosing material information about business transactions. The place where insider trading under the Commodity Exchange Act does occur or does occur in the statute and does apply in the regulatory regime, is on this side of the table. There's a -- it's a felony for anyone on this side of the table to engage in insider trading based on the information that they have from
their government position about what's going on in the marketplace, but it is not possible to apply that same standard to a hedger without prohibiting a hedger who is trading on the basis of inside information, from taking advantage of commercial information for the good of the company and its shareholders.

MS. WALTER: I guess, to me, you're answering a different question than the one I intended to ask. I understand what the legal structure is today, but it appears to me that the concept has a place in the futures world the same way an insider -- classic insider of a corporation can abuse his or her position by trading in straight stock or options. There are hedging instruments that can be used to be abused that way and I hear a resistance on your part to bringing those concepts appropriately. I'm not suggesting that they don't have to be tailored to the circumstances, but the question is, is there no place for those types of consequences in the regulatory structure?

MR. YOUNG: Well, other than -- I'm
sorry if I didn't answer the question that you asked.

MS. WALTER: It was the articulation of the question.

MR. YOUNG: But in the futures world there are insiders, they run exchanges, they run clearing houses where they work as CFTC, they have inside information and they can't trade on the basis of that information. For the rest of the marketplace, for the actual market participants, for people who are at a company and know there's going to be a large grain sale that's going to be made, the company can hedge that sale before it is made public. That's been a founding principle of sound risk management for many, many years.

If you apply insider trading concepts to the futures markets, our concern is that you're going to take those people and treat them as if they were felons and we think that's wrong. The Commodity Exchange Act is designed to promote those people and their risk management activities in the futures market.

MS. WALTER: Well, let me, in the
interest of time, move on to another question and
you and I can debate this at some other point, I'm
sure, at great length.

I want to go back to a question Chairman
Schapiro asked earlier about the distinction when
you're talking about, particularly in the product
approval area, but I think it can come up
elsewhere as well, in cases of approving either
new products or changes at exchanges between
products that are geared or markets that are
geared institutionally as opposed to retail. It
seems to me that if our recent past experience
over the last two years shows anything, it
reaffirms that human beings are human beings and
left to their own devices at various points in
time, they're going to push the edge of the
envelope in terms of showing good judgment and
prudence.

What I hear people urging, for which I
have a great deal of sympathy, is that
particularly on the SEC side of the equation, we
have to be more flexible in terms of letting
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people make changes, either in their market structure or in offering new products, act in a speedier sort of way so that we don't get in the way of appropriate innovation and competition and I agree with that. On the other hand, I think we also appropriately have a statutory responsibility to make sure that these things are appropriate and particularly when it's going to affect retail, that to me is a very important issue and I wondered if some of you want to talk about grappling with that tension.

MR. YOUNG: I will. I think that it's unwise to distinguish among products according to whether they are retail or commercial or otherwise and the reason is that the institutional entities will use retail products if they want to and quite frequently, retail can have access to institutional products if the products have nominal values that are within their reach.

If you want to regulate in a differential way, you have to regulate not the products, but the sales practices and the responsibilities of the
intermediaries that are introducing the products to
the customers. So I think that the proper place to do
the regulation is in sales practices and at the broker
level, not at the product level.

MR. COOPER: I'm agreeing with this fellow so let me pick that up. Going to get in
trouble here, but I think the key here then is to
recognize that customers are different and we
obviously support a consumer protection agency
that will in fact do exactly what the professor
has suggested. It's a class of customers who,
even though the so-called sophisticated actors
didn't prove to be so sophisticated in the last
couple years, here's a class of customers who are,
in fact, unsophisticated, in need of consumer
protection. And so for us, rather than do the
distinction on the supply side, it should be on
the demand side. And we think the principle here
should be that consumers, the retail customer in
particular, need an agency that is focused on
their needs in the marketplace and that expertise
will go across products so that whatever the
product being sold to those consumers are, or
customers are, that's where the regulation should
give us the protection.

MS. SCHAPIRO: Thank you. I think we're
out of time. Commissioner Sommers?

Ms. SOMMERS: Thank you, Chairman
Schapiro. I'm going to ask a question of Peter
because I think you have a unique perspective on a
different regulatory model. As we look towards
the goal of harmonization and perhaps to the
examples of other regulatory models globally, I
was wondering if you could elaborate on the
structure in Germany. And the way I understand
the differences that the operations of the
exchange are regulated by one entity, your
intermediaries are regulated by someone else, your
clearinghouse is regulated by someone else. But
are there differences in the way that you regulate
futures and options and securities or different
mandates, differences in the way that you look at
the sophistication of the customers or those sorts
of things that we are, you know, talking about in
other questions here?

MR. REITZ: Thank you for that question.

I think if you look at the regulatory structure in Germany and also other countries in Europe, there's not a single market where you have differentiation between options and futures regulation. In fact, they're actually traded in the same environment, I think, across Europe. The difference in terms of regulation in the German market is really between regulation of exchanges and regulation of market participants, intermediaries.

The clearinghouse is a little bit of a different animal in the sense that it's also regulated by the same entity that regulates intermediaries because it has a banking license and therefore it falls under the regulation of what in Germany is called the "BaFin." But the exchange authorities, exchange regulation, is one that doesn't distinguish between securities market, options markets, or futures markets. It's the same regulator. In fact, it's the same -- it
could be the same exchange trading off three
instruments.

MS. SOMMERS: Thank you for that. Just
to follow up a little bit with regard to the
sophistication of customers, are there differences
in the way that BaFin looks at that issue?

MR. REITZ: In terms of customer it
pretty much follows the approach that was just
suggested here. It's not on the product level
that it is distinguished, but it's on the sales
process, so the exchange regulation doesn't have
any elements of customer -- distinguish between
customer groups or anything. It does come into
play when it comes to the regulation of the
intermediaries.

MS. SOMMERS: Thank you.

MS. SCHAPIRO: Commissioner Aguilar?

MR. AGUILAR: Thank you, Chairman

Schapiro. I'd like to direct a question to
Professor Harris, Dr. Harris, Mr. Harris,
Professor Harris, and try to get some of your
knowledge about how the market data regimes differ
and compare under the securities regulations and
the commodities futures regulations and whether or
not in your views the different ways that they are
-- that the (inaudible) how they can be
harmonized. And is there a model that in your
view is better for customers and for competition?
MR. HARRIS: So, I missed the first
sentence, it was market data?
MR. AGUILAR: Yeah.
MR. HARRIS: Ah, you go to a difficult
question.
MR. AGUILAR: That's why I went to you.
MR. HARRIS: Thank you for that. Very
quickly, we have two different regimes for market
data and actually more than two even within the
SEC side. So on the securities side, there is a
minimum level of market data that has been defined
to be public data and it's collected in various
networks and it's sold on a regulated basis based
on the number of terminals. The money that is
collected is then distributed to the exchanges in
proportion to some very complex formulas. Those
formulas are designed to reward people for -- or exchanges and ultimately the people who provide good, high-quality prices. The formulas are designed to reward people for quoting aggressively.

On the futures side, each of the futures markets, to the best of my knowledge and I'm not quite as well as informed, basically is selling their data and on terms that are regulated by the CFTC, but largely their own.

On top of this you have value-added products where both agencies have decided that they're not going to exercise a lot of supervision.

The problems in all cases are similar here. It would be very difficult to argue that one's an institutional market, another's a retail market, or that one's got issuers and the other's a contract market. This is all market data that's all about who's willing to trade or what willingness is present in the market, it doesn't have to be who, at what trades did things take
place.

So if there were a single place for harmonization without concerns about the underlying differences, this would be a sensible place. It's all about market structure and it's ultimately all about regulating power relationships between insiders to the markets and the people who are using the markets. So, those people who know more, end up being more profitable, and those people who know less are at a disadvantage.

And then the final issue is, who should bear the costs of providing those systems and who should benefit from being able to sell it. It's my opinion, which is not shared by all, that the people who produce the information that's ultimately of value, ought to have some claim on its value. The people who ultimately produce the information are the traders themselves, through their quotations and through their trades, and as a consequence I'm quite sympathetic to seeing that if market data is being sold, that they are the
ultimate beneficiaries of those sales.

MR. AGUILAR: Anyone else have any thoughts? I'd like to ask one question, then if I could change to Mr. Luthringshausen. Since your organization has experienced working both with security option exchanges and commodity future exchanges, from an investor/customer perspective, can you give me a point of comparison about perhaps dealing with the offsetting schemes and the fungibility of securities options and commodities futures contracts? Is there one methodology that works better for investors than others?

MR. LUTHRINSHAUSEN: Actually, you know, we don't have any criticism of the future side of the street, if you will. I mean, the clearing works just as well on that side as it does on our side. We think the way we do it is a better way. It produces different results that potentially would have lower cost in the hands of public investors who are dealing in those markets. On the other side of the equation, though, it's
hard to ignore the scale and size of the Merc and
what it's done for bids and offers in terms of
getting transactions off and the levels of
liquidity. So, I think that it's hard; that's not
our suggestion for harmonization. Our thought is,
is that both systems have worked quite well, the
risk systems have worked well, the processing
systems have worked well, and it seems to me there
are a lot of clients flocking to both systems.

Our issue is where things are similar,
products are similar in the systems that the smart
folks decide how they want to manage their risk or
create a certain investment situation and they're
the ones that need to be satisfied. It's the
client that needs to be satisfied on that front
and that doesn't mean you have to tear down one
system in favor of the other to accomplish that.
Harmonization can accomplish that.

MS. SCHAPIRO: Thank you. Commissioner
Chilton?

MR. CHILTON: Thank you. I talked
earlier about, you know, there were sort of a menu
of things that were good and bad about the
different agencies and what we have. I wanted to
talk now, specifically, about something that
neither of us have. Commissioner Aguilar has
talked about this and I have and I know
Commissioner Dunn's talked about it specifically
in the past, and that's criminal authority for our
agencies.

For the CFTC, two-thirds of our criminal
referrals, whether or not it's to the Department
of Justice or local or state law enforcement
agencies, are rejected. A lot of times, I think,
it's because they're very complicated laws and
they don't have the expertise. If you're going to
New York or Chicago or Washington, they have that
expertise, but they may not in other places in the
country, and I understand resources, human capital
resources, et cetera. But of those two-thirds of
the cases that are rejected, 100 percent of them
we prosecute successfully, but nobody goes to
jail. Remember Baretta? He said, you know, do
the crime, do the time? Well, now they pay the
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And so my question, specifically for Mr. Cooper, we had a hearing that Chairman Gensler called back in August, and Public Citizen, your brother in consumer advocacy organization, supported this and I know you have supported additional regulatory reform in the OTC market, et cetera, but I'm curious if the Consumer Federation of America had a view on giving the SEC and the CFTC criminal authority to actually put crooks in jail?

MR. COOPER: We actually supported that well before Public Citizen did. You can go back to my testimony in June when we were looking at what I think is a clear market failure, a horrible commodity bubble on the CFTC side, and we advocated criminal penalties, arguing specifically that the sums of money available in these markets has become just so huge that the fines do not -- are not a sufficient disincentive to engage in abusive behavior. So, absolutely. If we don't criminalize clear violations of the law that harm
the public, we will not get them out of these markets.

MR. CHILTON: Thank you. You know, we -- you're absolutely right on the deterrent, which particularly as we're talking about potentially getting new areas of oversight, ensuring that people know that we're carrying a big stick, I think, is more important. We had a case earlier this year, it's a forex case where three years ago we fined the wife. This year, the husband did it. So, I don't think there's much of a deterrent.

One of the reasons that, you know, people raise, and I have a lot of sympathy for this, against taking that approach of criminal authority, is simply the staff resources that we have here. And I certainly understand that, so it would have to go hand-in-hand with additional resources. So we don't take away from our general market oversight and enforcement functions, but I'm curious if any of the panelists have a reason that I haven't heard of why this would be a bad idea.
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MR. HARRIS: I'm extremely sympathetic with the idea, but have the following concern:
That if the SEC and the CFTC had these powers, it would bring them closer to looking a lot more like the Executive Branch. I think it's very important --

MR. CHILTON: Well, what are we now?

MR. HARRIS: You're independent agencies.

MR. CHILTON: But we're not the Judicial Branch and we're not the Legislative Branch--

MR. HARRIS: That's correct.

MR. CHILTON: -- so we're an independent agency. But --

MR. HARRIS: You're totally independent, but so far the criminal prosecutions has been reserved for the Executive Branch. And while I might be sympathetic to even taking that out of the Executive Branch and putting that into an independent agency, my fear is that if you put (inaudible) powers into the independent agencies, it will make it easier for the independent
agencies to become -- brought into the Executive
Branch, which I think would not be beneficial.

MR. CHILTON: That's a good point.

Thank you. Talk about a four letter word: Turf, and going to DOJ for something like this. That
makes these issues look miniscule, but I don't
think that the argument that we have never done it -- I'm not suggesting you're making it that
simplistic, but the argument that we have never
done it, that it's -- is not convincing to me. I
think you're right about the continued need to be
independent, but I just think it's about time that
we did this.

MR. HARRIS: Probably the way to do this
is to figure out how to fund DOJ's efforts because
you do have a separate source of funding and I
suspect that a lot of their reservation is a
resource constraint and not a value constraint.

MR. CHILTON: Yeah, to be honest, I just
care about putting people in jail who violate the
law and rip off consumers.

MR. HARRIS: I agree with you.
MR. CHILTON: Amen.

MS. SCHAPIRO: Thank you. Commissioner Paredes?

MR. PAREDGES: Thanks. Professor Harris, you had mentioned earlier a third option on margining as compared to the one pot/two pot, if I recall correctly?

MR. HARRIS: The third option on the margining? So, I'm not --

MR. PAREDGES: I guess my question is, if you could just refresh our memories for 20 seconds to make sure we all have it top of mind, I'm actually curious to get the folks to your right to respond what their thoughts are on this other way, getting at the question of margining.

MR. HARRIS: Okay, so I'm not sure what you're referring to, but I'll try to do a quick -- a very quick summary.

The whole margining system, the whole clearing system is about the construction of a pyramid where at each level of the pyramid, the people above have responsibility for what's
happening to the people below. And we currently
have a fragmented system where responsibilities go
up through different chains, so that effectively
you have multiple pyramids. And our desire is to
have some sort of consolidated margining system of
some sort so that everything is in one pyramid,
but the problem with that is that concentrates an
awful lot of power.

It works quite well in the securities
side because the risks involved are rather short
term. In clearing on the securities side, you
only have basically three days of risk until a
security settles. On the futures and the options
side, the risk is very long lived because it lasts
as long as the contract is alive and some of those
liabilities become very great. They're mitigated
by variational margins and so forth.

So I think the third possibility that I
had mentioned was the creation of intermediary
entities that can do some of the consolidation on
their own accounts for their clients, and then
based on that consolidation and the natural
tendency for long positions to offset with short positions, they then relate to the existing clearing agencies as clearing members. But the only way that would work is for them to have capital at risk.

The whole pyramid, or the multiplicity of pyramids, this system only works because at each level people are responsible for the people below them, and there's enough capital at each level so that the responsibility is meaningful, so that people take seriously their responsibility to make sure that the people for whom they are guaranteeing, are actually going to perform.

MR. PARADES: Exactly. That's what I was getting at. I was curious if other panelists had any reactions or responses to that as a way of thinking about it?

MR. LUTHRINSGAUSEN: I'm not sure I totally understand the level. I mean, I've come to understand one pot/two pot, as the simple fact that it's what Larry in NYL and DTCC are doing. We see it today, specifically in the Treasury and
the Treasury futures, the Treasury cash market, repo market, and the Treasury futures.

There is a two pot approach between clearing corps for clearing members and it doesn't work. It doesn't work because the reality is, is if you take this pot and you look at the assets and liabilities in this pot, then you go over to the other pot in the other clearing and you look at it in that pot, you're using up assets that would better fit in the other pots. And it's partly because we trade futures over here and clear it over here, and we trade cash and repos over here and clear it over here. So the reality is, is that we're losing the value and particularly in times of stress, it helps to create more risk in the system because you don't have assets that mitigate against the liabilities over here. You've got them being wasted in other systems. And at the end of the day, I don't hear many users that see this as an issue, proposing that we have two pots or any other kind of pot approach. The one pot approach solves the
problem. And I don't know if that's responding adequately.

MR. HARRIS: Perhaps a very simple example of how this would work. Okay, so see imagine you've got a large institution, has a very large securities position and a very large futures position, and the two positions offset each other and right now those two positions have to go into two different pots. And suppose instead of sending those positions immediately into two different pots, you had a third entity, like a bank, that was going to stand as a guarantor of the performance of that institution. So, both positions go into the bank and then the bank stands and the positions go from that bank out to the two clearing agencies.

Now, the bank has many other clients. This particular client is long the securities and short the futures, but some other client might be short the futures and long the securities, and so the bank is able to net those two positions within the bank allowing -- providing portfolio margining
for the clients and essentially solving the
problem to the extent that the positions met.

MS. SCHAPIRO: Yeah, let's take one more
minute. Yeah.

MR. LEIBOWITZ: I don't think that we
have any religion on how we accomplish this.
We're all going for the same goal which is allow
offsetting positions to increase capital
efficiency while still maintaining investor
protection and risk mitigation. That's sort of
the goal here.

The challenge is really just because the
different insurance methods are different in the
two markets, right? It's the SIPC versus seg. In
the -- you know, we're calling ours a one pot
approach, but it's really not. It's one pot for
firm accounts where there isn't SIPC and there
isn't those issues, but when we go to customer
accounts it'll have to be more like a virtual one
pot because they are still sitting in the
different insurance methods. What we want to do
is work with the regulators and the others in the
industry to figure out a better way to do this.

We don't really care how it happens. We understand what the underlying goals are and the balances to be struck.

MS. SCHAPIRO: Thank you. And I will turn the podium back to Chairman Gensler.

MR. GENSLER: Thank you, Chairman Schapiro. I have three questions, so I'm going to ask, if we don't get to them, at least those representing the exchanges, if you wish, to follow up with at least two of these in writing, if that's possible.

One question is, I'd like to know whether we have consistent or inconsistent approaches to co-location issues and flash trading, where both of our agencies right now are seriously looking at exchanges. I know we are in the exchanges we regulate, but I'd like to understand if we have differences and how you co-locate the -- you're familiar with the issues and flash trading.

Secondly, I'd like to know, anybody can
comment, since the SEC has an approach to funding
which charges, and this is a congressional mandate
that has a -- funds the agency in part and the
CFTC doesn't, just your views on whether that's a
difference that makes sense in our history and
statute.

But the one that -- the third question
that I'm certainly looking a little bit to Larry
and Peter on, but I'd like Wayne's view is this,
something that's happened in the last eight years
is fundamentally shifted in the marketplace, is
that you all are for-profit enterprises now:
NYSE, Eurex CME, so forth. The OCC is sort of a
public utility function.

And when we grapple together on issues
of fungibility, whether to make products fungible
in the clearing, when we've grappled with
cross-margining, the self-regulatory organization,
or even product approval, how much does that -- do
you think that changed that you all are
for-profit, sort of shift a little bit how we
should take a look at this? Ms. Nazareth said we
should go to fungibility, but it goes to the core
of the business model. It's how one exchange, I'm
sure, is followed by the markets. You all have in
front of us credit default swap clearing and you
all want to compete in something that might end up
being a natural monopoly one day, the clearing
model.

So, I'm curious, how do we grapple as
regulators -- we're not looking after your
shareholders, by the way, we're looking after the
shareholders called the American public?

MR. LEIBOWITZ: Yeah, I mean, I think
it's a very good point. I think what you have to
do is return back to your first principles, which
is what's the best for the market? It's our
challenge to -- what we want is consistent and
fair regulation, meaning across different entities
and different instruments so that we're not facing
uneven regulation, for example, in rulemaking, in
the securities side, or a difference between
futures versus securities. We understand that we
have to deal with whatever regime we have and we
I understand that there's no sympathy for the profits of exchanges, and rightly so. I think what you've got to figure out is, is it a fair, transparent market? Is it offering the right amount of investor protection? And then within that, allowing sufficient competition that brings innovation to those investors.

MR. GENSLEER: But should we go as far if we jointly thought the right thing was to accept some of the recommendations, whether it's on cross-margining or fungibility? I mean, in 1974 or '75, there was a public utility model set up in options clearing, but now we're in a context where everybody's for-profit and they're trying to have derivatives clearinghouses that are for-profit. We have got four or five that are competing.

Peter?

MR. REITZ: I think when it comes to harmonization and regulation, I think you need to set the standards and then let people compete and let people compete on all levels.

I mean, the CDS clearing example is a
very good one, I think. In the futures market, especially, like it was mentioned on the previous panel, competition is on the product more than on, you know, market model, so the whole concept of fungibility always implies that you have standardized products that are all exactly the same across exchanges. That's not necessarily the case in the futures market and, therefore, this whole concept of shall we also change the market structure, will not work or it will come at a very expensive price of innovation and customization of products that then will have to be agreed for the whole market as a structure.

So, I think setting the right environment in terms of the market regulation approach and then letting people compete both on the trading layer and also on the clearing layer, is certainly the right model for the futures industry.

MR. GENSLER: But Wayne, I mean, how do we square yours and Ms. Nazareth's recommendation that we were -- others would say you have to let a
lot of competition go on in clearing?

MR. LUTHRINSGAUSEN: I think that history shows that it's not -- the issue isn't so much about competition and clearing, it's the way you think of competition and clearing. We had competition and clearing in the stock clearing world for years and years in this country. The Midwest Stock Exchange had a clearing corporation, the Philadelphia Stock Exchange, the Boston Stock Exchange, NSCC, in New York, which is the survivor. And what we found is over a period of years, competing for orders and having locals be very close to those individual clearing corporations, at the end of the day, we wound up with NSCC and the reason is, is that one or the other of those winds up with an economy of scale. So, I don't know that opening it up to that kind of competition achieves much of anything. I do know that from our perspective and from the board of directors that I have to deal with, going public is a no-no. It's a no-no because why charge me higher fees so that you can
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have earnings, so that you can pump the stock, which you have to deal with the analyst? And we don't want you, Luthringshausen, and your management team dealing with analysts every quarter or whatever. We want you worried about cross-margins and risk and processing the stuff every night.

So I'm not sure that -- I know that our system does what it does. I'm not -- I don't stand ready to criticize other systems for being inadequate. I think the other systems are adequate and I think -- it's just not that separation.

MS. SCHAPIRO: I think we are out of time. I wonder if it would be all right if we promise not to overburden panelists if we could submit just a few records to -- questions to you for the record and ask you to provide us some written thoughts on maybe some of the areas we didn't quite get through, which would be most of the areas today? And I guess we're going to take a break now?
MR. GENSLER: We're going to take a break and convene promptly at 2 o'clock in the chairs, if that's all right. And we thank all of you for your forbearance and this panel was terrific. And I thank my fellow commissioners and chair.

MS. SCHAPIRO: Thank you.

(Whereupon, at 12:50 p.m., a luncheon recess was taken.)
MR. GENSLER: I think we're going to call this back to order if we can. I thank our panelists. I hope everybody had a good lunch.

And fellow Commissioners, Chairman Schapiro had something come up and is back over at the agency. I don't want anybody to think that we just went under some emergency authority and just merged our two agencies, but --

MR. DUNN: Do we refer to you as Supreme Chairman?

MR. GENSLER: No, no, no. But Commissioner Casey is going to help me here, I know. So, I thank you and let me just introduce our panelists very briefly. Getting to the right panel, Panel Three.

Is Ed over there? Good, I'm going to go from left to right this time, if I might.

MR. NIGITO: Right to left.

MR. GENSLER: You want me to go from right to left? Oh, all right, I didn't know which
right you were talking about, Ed. But Ed Rosen from Cleary Gottlieb, Yvonne Downs from Newedge, Stephen Merkel from BGC Partners -- it's still Cantor in my mind -- Brandon Becker from TIAA-CREF. Stephen, can you pronounce just so I --

MR. LUPARELLO: I'll take a shot.

Luparello.

MR. GENSLER: Luparello. I believe an alumna from both agencies, but from FINRA. And then Brian Nigito from GETCO. So, we thank you all and the little lights will help you. The yellow will tell you you're getting close.

Ed, if you want to go first?

MR. ROSEN: Thank you. So, why do we want to harmonize the --

MR. GENSLER: You might want to touch the button there and --

MR. ROSEN: So why do we want to harmonize these regulatory regimes? One answer, perhaps the somewhat politically sensitive answer, is that you can put two agencies in the same
building, put a single name over the front door.

But you will not have accomplished very much, possibly you will have accomplished a tiebreaker for jurisdictional conflicts. But without harmonization, you can't effectively integrate the statutes and accomplish some of the other objectives that are available.

And that presents some difficult challenges, but also some very significant opportunities. I mean, questions like, do we ultimately want to retain FCMs and broker-dealers as separate regulatory categories or do we want to have a single category of brokers and then maybe qualify employees based on the activities that they engage in and the policy issues and expertise that is relevant to that activity? Same question with investment advisors and commodity trading advisors. Is there a reason to retain two different regulatory regimes for them? We regulate funds under the '40 Act and we regulate pool operators under the Commodity Exchange Act, and there are very significant and, in some cases,
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consequential differences that arise from that approach, from those two different approaches.

And you can ask similar questions with respect to the range of registrant. Now, those are obviously, if there is a political appetite to do that, much longer term objectives, but there's a lot that could be accomplished in the near term.

There are equally obvious limits to harmonization. Some rules and policies are driven by product differences although I suspect that these are really in the distinct minority. People often talk about price bias and price neutrality as differentiating characteristics, but I think neither product category should defy the laws of gravity, certainly not as a result of regulatory engineering.

But on the other hand, there is no futures analogue to the capital raising formation function that the SEC oversees and corporate governance as well. And corporate insiders do raise unique issues that do and should drive differences in what intermediaries can do with
information and the capital market's orientation
of the securities law generally has driven some
consequential differences. Since the '70s,
there's been no bias favoring exchange trading
under the securities laws, but the CEA does tend
to favor exchange trading and indeed require it
and pending legislation, as I'm sure everybody
here knows, would further that trend.

And these differences do have -- lead to
differences in the treatment of financial
products. Think about warrants, index notes,
passive funds, the trick asset categories and the
like, you can obtain very stark differences in the
two regimes with respect to very closely related
products. Take a warrant on Treasury yields that
can be issued as a securities in the capital
markets, distribute it on a retail basis. But if
you do a warrant on a rate that is abstracted from
any security, that may be a commodity option, and
if it's a commodity option, couldn't be offered at
all without some specific relief from the CFTC.
And you have to ask yourself whether the
differences in those products justify the
different outcomes.

Commissioners obviously are all aware of
the commodity ETF issue and I think measures need
to be taken to eliminate these kind of regulatory
discontinuities on a more systematic basis not
just on an ad hoc basis. These products should be
allowed to be sold and sales forces and
distribution channels should be able to be used
that are appropriate for the relevant products.

Obviously harmonization means more
efficient use of resources and lower costs for
registrants and also better use of the limited
resources that the agencies have, but it is more
than just cost savings. We have too many
disparate regulatory regimes and too many rules
and too many rules that are addressed to the same
policy objectives, but that prescribe different
approaches and very specific approaches to
compliance and these require different policies
and procedures and they require different systems
to implement, and they require large numbers of
expert, highly specialized compliance staff. And this costs more than just money, although money's not a trivial part of it. This is the recipe for what we witness daily in the industry press day after day, firms fail in ways small and large to comply with bread and butter regulatory obligations and more frequently than not, it's not willful. The number and complexity of rules, the nuances and their interpretation, is itself a source of a serious challenge to the ability of firms to manage their compliance risk.

Opportunities exist to reduce the number of differences. They begin with things as simple as harmonized registration requirements, even registration forms and processes, entitlements to exemptions, record keeping requirements and formats, reporting, filing and noticing allocations, capital computations, order handling and customer property rules. There's so much that could be usefully done to eliminate historical differences in the rules even before wrestling 500-pound gorillas like market structure and
clearing.

In this process, there will be a temptation to achieve reconciliation by aggregating rule requirements and this temptation needs to be resisted. I think the goals of the Commissions should be not just to reduce costs, but also to come up with harmonizing solutions that are likely to increase effective compliance, not to make it ever more challenging to comply.

There's an old aphorism that the most complex solution to a problem is probably not the best solution.

Just a quick word on margin. Everyone is aware that the statutes adopt different approaches to margin. Pending legislation will increase the importance of a coherent approach to margin, but the starting point is that intermediaries are in the business of providing financing to their customers and capital deductions exist to account for those credit exposures. The Commissions and Congress need to decide what their margining objectives are. Is it
to dampen speculative pressures --

MR. GENSLER: You might want to

summarize.

MR. ROSEN: Okay, one last point beyond

the need to decide what the objectives of

margining levels are is insolvency. This is not a

harmonization issue; this is just something that

needs to get done. Dual registrants are subject

to potentially conflicting insolvency regimes.

And if there is a major insolvency of a dual

registrant and both regimes apply, we do not know

how their assets are going to be allocated across

the customer claimants. That needs to be handled.

MS. DOWNS: Thank you. I'm Yvonne

Downs, senior director of Newedge USA. It's an

honor to appear before this important assembly.

As you may know, Newedge has consistently

supported efforts to harmonize CFTC and SEC rules

and has been an advocate for the creation of a

single financial services regulator.

Given the political reality that a

single regulator will not be created,
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harmonization of the CFTC and SEC rules is the next best thing.

In our opinion, it is an important step in the management of market risk. In addition, it's good for business in the U.S. Currently, too much of our institutional business needs to be directed to the U.K. and elsewhere where the regulatory environment is less complicated, but requires portfolio margining of multi-asset accounts.

As background, Newedge was created through a merger in 2008, and we are now one of the world's top derivatives brokers handling directly or indirectly all types of financial assets for our institutional clients across more than 85 different markets worldwide.

From this global viewpoint, we are able to think about the potential harmonization of U.S. financial regulations with a unique perspective. Although we do not handle retail clients, we at Newedge have always been struck with the idea that in theory we might be required to decline a
customer under (inaudible) rules as unsuitable, to
buy or sell shares in an ETF like U.S. soil, but
could offer that same customer the opportunity to
buy and sell crude oil futures or options.

Generally, we operate in the U.S. as if
we have only one set of regulations, namely the
toughest of the applicable rules of either
regulator. However, just because a rule is the
toughest does not mean it's the best.

In our opinion, the most critical area
for harmonization is portfolio margining. Newedge
has been a leader in providing this service on
equities and options to its customers under
various SRO rules. It has reduced our customers' risk to us, to themselves, and to the markets. It allows customers to maintain both their equities and options positions in one account and to obtain the benefit of any offsets. However, in the U.S., true portfolio margining combining futures and securities products in one account has not gained traction because the CFTC and the SEC have not recognized each others' good customer funds
location. This has prevented the advance of a program that is beneficial for both the customers, the brokers, and perhaps most importantly, could reduce systemic risk.

Comprehensive portfolio margining is critical to encourage some brokers such as Newedge to participate in the clearing of credit default swaps and other OTC products. CDS products are anticipated to have higher margin requirements than traditional futures, thus holding them out right over the long term for customers would generate significant capital requirements for the firm. This is because our capital requirements are driven by our customer's capital requirements as we operate under the futures model today.

The higher these requirements are, the more capital we must maintain. And in a near zero interest rate environment, the opportunity cost of maintaining a large amount of capital is not attractive. However, with true portfolio margining, holding credit default swaps with their offsetting hedges, could potentially moderate our
customer margin requirement, could reduce our
customer's overall risk with us, and could reduce
our potential capital requirements. Thus we hope
the CFTC and the SEC will expedite the resolution
of any issues that have prevented comprehensive,
multi-asset portfolio margining.

There are several other areas that we
believe harmonization should occur. In the area
of books and records and disclosures all
requirements should be simple, consistent and
identical across both agencies. Client type
definitions, there are too many types of
sophisticated and institutional definitions under
both the SEC and CFTC. For example, ECPs, QIBs,
accredited investors. These should be simplified
to two or three types and made consistent for both
agencies.

In the area of customer funds
protection, we've already addressed this in the
context of portfolio margining. There should be
one way the customer assets are protected, this
one (inaudible) the fair and prompt distribution
of customer assets if a combined broker-dealer FCM
were to file for bankruptcy.

And access to foreign markets, the
institutional clients -- again, institution
clients should be given the equivalent access to
non-U.S. traded products. This should be through
overseas brokers who are subject to comparable
regulations, whether the products are securities
or futures.

In addition there are two areas driven
by public policy considerations and they include:
manipulation and anti-fraud. Policy in this area
needs to be harmonized. However, new rules should
not inhibit transactions done for bona fide
hedging or risk management purposes.

And lastly, suitability. All private or
retail clients should be protected from brokers
selling unsuitable products no matter what type of
product.

I'd be pleased to take any questions,
and thank you for providing this forum and for
seeking input on this important discussion.
MR. MERKEL: Good afternoon. I'm Steve Merkel and I'm pleased to be here today to share my experiences as general counsel of BGC Partners and Cantor Fitzgerald.

I wanted to point out that I'm also a founding board member of the Wholesale Markets Broker's Association, Americas, which represents the largest global interdealer brokerage firms that operate as intermediaries in North America.

I am supportive of the legislative and agency initiatives to more effectively oversee the over-the-counter markets for financial products. To that end, I see the administration's proposed Over-the-Counter Derivatives Markets Act of 2009 as an important step in bringing additional regulation to the over-the-counter derivatives markets and believe that many of its requirements will integrate smoothly with the current practices of many interdealer brokers.

I would like to leave you, hopefully, with the following impression: Everything that the CFTC and the SEC seeks to accomplish in
connection with reduction of systemic risk caused by uncollateralized bilateral transactions, enhanced price trade, and regulatory transparency for swaps, and market oversight, can be achieved utilizing the OTC market structure. The interdealer brokers are prepared to help advance that cause.

I think the example of the United States Treasury securities market makes the point perfectly. It is an over-the-counter market. There is no exchange trading. On the wholesale level, it has long operated as a central counterparty cleared system in which the over-the-counter trades are novated within minutes of execution. The clearing corporation becomes the counterparty to the trades, with the ability to require margin payments to secure the pre-settlement mark to market risk. This system accommodates multiple competitive execution platforms, interdealer brokers, such as my firm, which provide varying levels of electronic, voice, or hybrid execution. Also the market, still
entirely over-the-counter, is well overseen with a high level of transparency.

Finally I note, and this will come up later, the central counterparty clearing facility does not operate a competing execution platform. It is a neutral site providing such services with non-discriminatory access.

I have four brief thoughts on the proposed legislation that I would like to share with you. First, the existing interdealer broker networks and execution platforms are ideal, innovative, and competing existing pools of liquidity for swaps which currently and in the future can meet the objectives of the legislation in the form of alternative swap execution facilities, or I'll call the ASEFs.

Second, it is crucial that CFTC and the SEC ensure that any implementing or regulations do not prohibit voice or broker interaction in the trading process as we use both electronic and broker-assisted means to effect transactions.

Third, the proposed legislation
creations, ASEFs, can be many things, but may not be the proper entities to undertake the enforcement or SRO, self-regulatory organization, type responsibilities if we want to see ASEFs operate as multiple competing execution platforms.

Finally, a vertically linked derivatives market, or a central counterparty providing clearing services, also provides trade execution services would be uncompetitive and ultimately hurt market participants. To be clear, this is not a product fungibility point; this is an execution platform point.

I strongly urge you to consider a more horizontal structure that fosters competition. I believe that both the proposed legislation and subsequent regulation must ensure non discriminatory access to open and neutral clearing facilities which are unaffiliated with execution platforms that arrange transactions in the same financial product being cleared. The U.S. Government securities and equity and options markets are strong and pro-competitive models to
follow.

I very much appreciate your invitation to take this opportunity to share my thoughts on this subject. Thank you.

MR. BECKER: Good afternoon. I am Brandon Becker, chief legal officer for TIAA-CREF, an organization dedicated to serving those who work in the academic, medical, and cultural fields. Previously, I served as director of the Division of Market Regulation at the SEC.

I would like to thank the CFTC and SEC for affording us this opportunity to share our views regarding how the current regulatory structure might be better harmonized to facilitate efficient trading by investors and improve market integrity.

TIAA-CREF is one of the world's largest retirement systems with $363 billion in combined assets under management and 3.6 million participants. As a large institutional investor and provider of defined contribution retirement plans for over 90 years, TIAA-CREF is an active
participant in the derivative markets in the United States and elsewhere. TIAA, as an insurance company, is regulated by the New York State Insurance Department among others. CREF is a registered investment company.

We support efforts to harmonize the regulatory structure for the derivative markets both because we believe it will enhance market efficiency, but, more importantly, we believe it will strengthen market integrity and insist in mitigating systemic risk. We note, however, that harmonization efforts have been ongoing for decades. As long ago as the Futures Trading Act of 1982, Congress called for a joint study by the SEC, CFTC, and Federal Reserve of derivative markets. The study concluded in 1984 that there is a need for close harmonization of federal regulation of derivative markets. Accordingly, we welcome the current efforts by the Commissions to jointly focus on these issues.

Nevertheless, in view of the difficulties over the last 25 years to achieve
meaningful progress toward harmonization, we believe future progress will require sustained and detailed attention at the commission level to make the difficult decisions necessary to find a way forward. In this regard, while there are many significant issues concerning intra- and inter-industry competition that arise under the rubric of harmonization, we urge the Commissions to concentrate their time and energy on those issues that address systemic risk such as margin clearing and bankruptcy.

As an institutional investor, we use derivative markets for a variety of perhaps most commonly for managing various kinds of financial risk such as market and credit risk. In that regard we find the customization and flexibility provided by over-the-counter products to be very valuable. Indeed, because of the individualized tailoring provided by OTC products, such products are enormously valuable for various portfolio management purposes. Accordingly, while we support efforts to mitigate systemic risk and
enhance transparency, we also believe it is important to maintain the significant benefits for investors that flow from the customization available through OTC products. Specifically, we believe that the various prudential reforms that are under discussion, such as enhanced transparency and clearing, can be achieved without precluding the use of OTC products.

More broadly, as an investor, we find the inefficiencies that result from the disparities between and among markets largely a cost of doing business. Efforts to minimize those costs will enhance market efficiency. Of course, from an investor protection perspective, we generally expect intermediaries to provide us a comparable level of service. In this regard, as the events of the last two years have highlighted, clarifying margin and bankruptcy regimes not only will improve prudential oversight, but also mitigate systemic risk.

TIAA-CREF, on behalf of its participants, appreciates the opportunity to
participate in this hearing. I am happy to answer any questions you may have.

MR. GENSLER: Just before we go forward, I don't think I have your statement or Mr. Rosen's. It may, again, be in my daughter's book bag, but to the extent you wanted the public to see it rather than her friends, if you could still submit it and then all the commissioners probably would get the benefit of seeing that, too.

MR. BECKER: Certainly.

MR. GENSLER: I think that's probably true.

MR. NIGITO: I was going to say, Mr. Chairman, the only excuse I can offer is that my son is also starting kindergarten this week if you'll accept that one.

MR. GENSLER: It's an excuse that works with me, for sure.

MR. LUPARELLO: I have no kindergarten-related jokes so I'll just get -- thank you, Mr. Chairman, I'm Steve Luparello, vice chairman of the Financial Industry Regulatory
FINRA is the primary securities SRO for U.S. firms conducting a business with the public. We regulate over 4,800 firms, 600,000 registered representatives, and 173,000 branch offices. We brought around 11,000 disciplinary actions in 2008, and are on a pace to exceed that number this year. Of our 4,800 firms, approximately 230 are duly registered as FCMs.

Despite the well-known differences in the underlying statutes, securities and futures SROs historically have found ways to work together through both formalized mechanisms and outreach on particular issues and areas of concern. And FINRA enjoys a strong working relationship with the primary futures SRO, the NFA.

That said, certain inefficiencies will always exist in such a bifurcated structure. A timely example of both the risks inherent in fragmented regulation and the benefits of functioning cooperative relationships involves the recent increase in the number of firms actively
marketing retail foreign currency trading. Retail forex, especially in its current form, includes opaque pricing, high leverage, and non-transparent activity and is an area ripe for fraud and customer harm.

In 2008, Congress, at NFA's request, increased capital requirements for FCMs that conduct an off-exchange retail forex business creating the possibility for a significant migration of forex business to FINRA-registered broker-dealers. In no small part thanks to a series of meetings between NFA and FINRA staff, FINRA has been able to stay in front of this issue.

In November 2008, we issued a regulatory notice reminding broker-dealers that a number of our rules apply to that activity irrespective of the fact that it was not securities activity and, in June of this year, we proposed changes to our margin rules relative to the product. Those changes, still pending, would require a customer to post a substantial amount of the notational
value of the forex position.

Each SRO has taken aggressive steps to limit customer harm in this area and we have appreciated the willingness of NFA to share with us some of their lessons learned. Nonetheless, this is a useful example of how our current regulatory system creates the potential for gaps and arbitrage that can be exploited as participants move almost effortlessly from one statutory scheme to another.

The differing regimes also complicated efforts this year by market participants pursuing efforts to move clearing of credit default swaps onto centralized clearing facilities. These efforts were impeded in part because transactions affected by broker-dealers would not, absent specific rule making, be subject to the same margin levels as those affected by FCMs.

After much discussion and some delay, FINRA launched a pilot program establishing margin requirements for firms affecting transactions and CDS contracts that are cleared through a central
counterparty clearing service ensuring the transactions affected by broker-dealers are subject to margin requirements comparable to those of the clearing facility.

I appreciate that Brandon's been quiet during that little section.

Another significant challenge presented by the current bifurcated system of regulation and securities and derivatives is overseeing the trading activity on these markets. Chairman Schapiro noted again last week that regulators need increased access to data across cash and derivatives markets to conduct more meaningful surveillance.

The review of trading activity across cash markets and futures markets generally has not been integrated. Where there has been a need to share information, either on a product specific basis or to assist in reviews and investigations, there has always been good cooperation between futures and cash regulators, but ad hoc approaches to market oversight will become increasingly
inadequate in the light of new trading patterns.

While there has yet to be a proven case of manipulation based on an allegation that swaps trading, move the market in the related equity, there can be no doubt that such a fact pattern is possible. With the increased standardization of OTC derivatives as well as the clear linkage between the derivatives and the cash markets, it is obvious that audit trails of different quality are restricted to certain types of products will no longer reveal the full picture of trading activity that affects the marketplace and will interfere with our ability to combat illegal activity.

Other panelists today will cite examples of how dual regimes interfere with or layer costs onto the products and services they offer. These are legitimate issues and worthy of your attention and we strive to ensure that any costs we impose do not unnecessarily contribute to that burden, but our primary focus has been and will continue to be ensuring that we have the tools, knowledge,
and information required to ensure investor protection.

Thanks again for the opportunity to be here and I'm happy to answer any questions.

MR. NIGITO: Thank you, Chairman Gensler. I'm happy to be here with the distinguished group of panelists. I would also like to thank Chairman Schapiro as well as the SEC and CFTC commissioners for inviting us to take part in this discussion.

Regulatory harmonization is a laudable goal worthy of both the SEC and CFTC's efforts. I thought I would begin by providing a brief overview on GETCO, the Global Electronic Trading Company, and my own professional background. Mine is in market technology and quantitative investment strategies having worked at some of the largest ECNs and proprietary training firms. It is my sincere hope that amongst this esteemed panel of legal professionals I may answer some of the more mundane nuts-and-bolts questions of how these different markets
operate and make both my own and GETCO's
experience available to you.

If you are already familiar with GETCO,
please indulge me for a brief moment as I give a
bit of our background and the role we play in our
capital markets. GETCO is just over 10 years old,
and the firm's primary business is electronic
market making and liquidity provision. We have
offices in Chicago, New York, London, and
Singapore. As active, bona fide market makers,
GETCO makes two-sided markets, bids and offers, on
over 30 markets in North America, Europe, and
Asia.

We trade in four major asset classes --
equities, fixed income, commodities and currencies
-- in the cash, futures, and options markets.
Though GETCO does not have any direct retail or
institutional customers, per se, we are registered
as a broker-dealer and regulated in accordance
with the SEC and SRO requirements.
GETCO also operates our own SEC
registered alternative trading system, GETCO
Execution Services. As such, GETCO has significant experience operating under a rules-based regulatory framework. GETCo also has extensive experience trading on venues that operate in a principle space regime, such as the CME and the Intercontinental Exchange, and have had a very positive experience operating in this arena as well.

Over the past few years, GETCO has worked to share our global perspective with regulators through comment letters and increased engagement over critical market structure issues such as the options penny pilot, short sell requirements, and the now infamous flash order type.

Whether it be on principles or rules-based regulatory regime, GETCO is core trading strategy remains constant. We engage in market making and liquidity provision to help investors efficiently transfer risk.

To unpack the last statement somewhat as the concept of efficient risk transfer is not
something you hear every day, it is GETCO's view
that one of the functions of a financial market is
to allocate risk to those persons or entities best
able to bear it. As those entities do not always
meet in time, GETCO commits capital and assumes a
variety of financial risks until a natural
counterparty is found.

GETCO has invested heavily in technology
and human capital to create a platform for
liquidity provision at low cost. By continuously
providing two-sided markets, GETCO and its
competitors facilitate price discovery, reduce
volatility, and help maintain orderly liquid
markets for investors.

Market and regulatory structures play an
important role in our ability to provide this
service effectively. It is our view that
regardless of the regulatory approach, be it rules
or principles, the overall objective should focus
on several fairly simple, but essential core
values and philosophies: Efficiency,
transparency, innovation, fairness, and above all,
competition; all principles that I think everyone here agrees make up the core underpinnings of a healthy, vibrant market.

And the good news is that here in the U.S., it's been our experience that even though our market structure has dramatically changed over the last decade, the differing regimes of the SEC and CFTC have matured and adapted to foster growth, promote transparency, product innovation, and competition. They have coexisted quite effectively and given investors the ability to transfer risk even in times of significant stress and volatility.

Last fall during the financial crisis, opaque and complex over-the-counter derivatives caused panic in credit markets. While it's hard to overstate what the financial crisis did in terms of harm to investor confidence, it is important to highlight the fact that both our SEC regulated cash markets and the CFTC regulated futures markets functioned exceptionally well in times of great uncertainty, anxiety, and
volatility.

Securities and futures markets opened every day with firm prices and liquidity. In past instances of market stress communication broke down, markets stopped functioning, and it was difficult, if not impossible, to trade. By contrast, asset prices may not have been what any of us liked, but the markets themselves held up remarkably well.

One of the great attributes of the U.S. capital markets is that we routinely scrutinize our structure and regulations for ways to improve and make them more efficient, transparent, and competitive. This segues nicely into our topic today, SEC and CFTC harmonization.

GETCO often experiences firsthand the costs and burdens associated with duplicative and inconsistent regulations. As a firm that places great value on efficiency, competition, and innovation, the prospect of regulatory harmonization is something GETCO warmly welcomes.

We understand, however, that harmonizing...
elaborate regulatory structures covering complex
and very different products can be more difficult
to accomplish than is probably realized.

To that end, the simple question
remains, what should be done to make our
regulatory structure more harmonized? In the
broadest sense the most direct thing to do is
simply collaborate more as both agencies bring
expertise that can complement the other. The
current environment will likely produce new,
innovative products that address the many facets
of risk investors face today and a good example is
commodity-related products. A smooth
harmonization will prepare the SEC to understand
the nature of these products --

MR. GENSLER: If you can just --

MR. NIGITO: -- and assess their
suitability for retail investors. While the SEC
--

MR. GENSLER: The whole thing will be
submitted into the record.

MR. NIGITO: Sure. Fair enough --
prepares for the pressures that come with enhanced retail participation. Thank you for allowing me the time to provide this insight. I look forward to your questions.

MR. GENSLER: I thank you and I'm going to turn to Commissioner Dunn and I guess I get to play wrap up at the end.

MR. DUNN: Good, I'll take all your great questions. Steve, I'd like to start with you, and I'm sorry that we don't have NFA on the panel here as well because I've got a little ambush for Dan Roth as well, but let me start with you.

When I was acting chair, I received a referral from FINRA that was over a year old and I think all of us agree that that is too much of a length of time and to sort through these referrals, who they should go to, and you've talked about meeting with our staff. How can FINRA, NFA, SEC and CFTC enforcement work together to ensure that we have a quick referral of these particular leads?
MR. LUPARELLO: I think you raise a great question. I'm happy to take the bullet for Dan or at least give him a little time to prepare before tomorrow.

I think we always strive to make sure we do our investigations as expeditiously as we possibly can. And if we don't have jurisdiction, to get them to folks that do have jurisdiction as quickly as we possibly can.

That said, sometimes it's hard and I don't know the specifics of the one you're talking about, but it is especially in areas where it's not clear what the jurisdiction is or what the product is, that it sometimes gets -- it takes a long time to get to the point where you've decided you in fact don't have the jurisdiction because all of us, whether it's on the government side or the SRO side or on the futures side or on the securities side, we want to bring our own cases. We want to find any way possible to claim jurisdiction if we can and it's only when we realize that at the end of the road, we can't,
that referrals become sort of a second
alternative.

I think, you know, I hate to say it, but
I think, you know, more meetings and more
cooperation across, not just futures and
securities, but government and SROs would allow us
to sort of flesh out those issues earlier and make
quicker decisions on fundamental jurisdictional
issues, which I think gets those referrals into
the hands of people with the jurisdiction sooner.

MR. DUNN: I hate to preempt my fellow
Commissioner Chilton, but I have long advocated
for Justice to have a liaison person with the
Commissions for criminal. What has been your
experience of working with Justice on criminal
cases?

MR. LUPARELLO: Our experience has been
good in isolated circumstances and other times
it's been hard to get our issues to be on the list
of the many, many things that a given U.S.
attorney is interested in. So we've had some real
great successes where we have found fact patterns
that were outside our jurisdiction, we were able
to get both the SEC and the Justice Department,
the FBI or the U.S. Attorneys Offices interested
in it. But it is, frankly, episodic and it is
case-by-case. And I think adding some structure
around that, that allows us to develop the working
relationships on a routine basis as opposed to
just on a fact-specific basis, where you're trying
to get a U.S. attorney who's got a thousand other
things to think about interested in a specific
case, I think would really facilitate that.

MR. DUNN: Again, I'm picking on you.
Could you elaborate a little bit on the difference
between NFA's "know your customer" and the SEC's
investment suitability?

MR. LUPARELLO: Well, it's our
suitability rule. I think the basic difference
between us is that the "know your customer" rule
makes these determinations on a customer-
by-customer basis while on the security side, the
suitability rule, is either on a
product-by-product or strategy-by-strategy basis,
so it is a more frequent analysis on the
securities side than I think traditionally it has
been viewed on the future side. I think there are
arguments to be made that given the breadth of
products that can be offered in the context of a
securities relationship requiring it on that
discrete a basis maybe makes more sense than in
the futures context.

MR. DUNN: And now for the big one, Steve. What's your thought on the creation of a
customer protection agency?

MR. LUPARELLO: I think at this point, the FINRA has not taken a position on the pending
legislation and I think we are supportive of any
way customers can be protected. I think the
current legislation speaks about non-securities
products, which makes me, I think, a dilettante
and not an expert, and on that I'd probably decide
not to answer.

MR. DUNN: Thank you. I'm about to run
out of time, but I did want to ask about
collocation and flash trading of some of the
members of this panel, but I'll do that in a
written follow-up.

MR. GENSLER: Thank you, Commissioner Dunn. Commissioner Casey?

MS. CASEY: Thank you very much, Mr. Chairman. I actually would just like to follow up
on the line of questioning that Commissioner Dunn
was directing to you, Steve, and actually I would
courage other panelists to jump in if they would
like as well.

In recognizing the differences between
the customer protection regimes for broker-dealers
and FCMs, suitability standards for
broker-dealers, "know your customer" risk
disclosure approach for FCMs, obviously this is an
area where there has been a discussion about
whether or not you should have a harmonized
standard. And I guess I would ask the question
whether or not this should be one standard and, if
that's the case, whether the suitability standard
is appropriate. And if it is, what kind of
considerations should we take into account to
reflect the differences between the market,
functions of the markets, and the market participation, particularly institutional versus retail?

MR. LUPARELLO: That's a complex question. We clearly are -- believe that the suitability standard works well in the securities distribution chain. I think it's something that can always be improved. I think we have made the point recently that there is -- we believe that if there's not, that there should be a fiduciary overlay in that relationship and that we continue to look at our suitability rule to see whether there are certain ways it needs to be enhanced and strengthened and I think sort of clarifying that it extends to a variety of things, including strategies, has been an important part of what we've done. We've also opined a lot over the years in terms of things like institutional suitability.

So, we think suitability is an organic thing. It's something that we try to take either
new products or new structures in relationships
and make sure that the suitability structure is,
is one that is designed and the guidance is there
to ensure investor protection.

Whether the "know your customer" regime
on the futures side is -- would be considered
similar to or appropriate if you were extending
the suitability analysis to FCMs and their
customers, I think is an interesting question. I
think there is a lot about the "know your
customer" rule that is very similar in terms of
how it provides customers the information they
need and how it provides guidance to FCMs working
with customers to make sure that they're making
the right analysis.

Again, I think the timing issue is the
one issue that continues to be something that is a
fundamental substantive difference and I think we
would probably think that that ongoing assessment
on a product-by-product basis is one that would
make sense.

MS. CASEY: Do any others have comments
as well on this topic?

MR. ROSEN: Yeah, I think one of the differences -- I don't mean to be crass about it, but when you look at the range of securities investments, there are significant differences in terms of investment objectives and results between high yield bonds versus investment grade bonds versus government securities versus highly speculative equity as opposed to equity that is more stable and dividend producing and so making judgments about aligning those individual types of categories, of transactions within customers' investment objectives makes more sense. You also have to layer in the fact that the suitability obligation only attaches when you're making a recommendation, it doesn't attach in the abstract.

And I think that, on the other hand, on the futures side and on the options side, you're talking about a category of investment activity that is inherently highly leveraged with a very significant likelihood of loss. And as a result of that, it's almost as though your betting are
the circumstances of this client such that they ought to be invested in this kind of an instrument. Not so much whether or not, you know, if they're okay to invest in equity index futures, are they okay to invest in interest rate futures? I think that's one of the product differences that does inform the differences in approach.

MS. DOWNS: Yeah, I think we've used suitability more as a retail or private client issue. We think institutional investors are smart enough and sophisticated enough to be able to make better judgments about the nature of the product and the strategies being deployed. So, I think we as firms and FCMs and broker-dealers who operate in both, we view that more as a retail issue and, yes, the suitability or "know your customer," more suitability is okay on the retail side. But, again, I would distinguish it at the nature of the client as opposed to just product.

MR. GENSLER: Thank you, Commissioner Casey. Commissioner Sommers.

MS. SOMMERS: Thank you, Mr. Chairman.
I'm going to go back to an issue that we talked about in the last panel, but I think almost every one of the witnesses and the five panelists have included in their written statements a recommendation to urge us to find a way to accomplish portfolio margining, so I'm going back to that issue.

In trying to resolve some of the comprehensive issues that have prohibited us from moving forward on this issue in the past, I want to ask this panel if you could talk specifically about some of the operational issues that may prohibit futures from sitting in securities accounts, securities from sitting in futures accounts, and to get specific about how we can look at those issues to find resolution.

MS. DOWNS: We're a big proponent of portfolio margins because our clients, which are institutional in nature, we need to see the different aspects they're trading and what their offsets are. So whether we do a CDS with a future and an option component or various combinations
thereof, it's important to be able to look at all
three of those components and know what their
overall exposure to us is. And, therefore, it's
not so much whether it's a securities account or
futures account, it's more that it needs to be so
that you can see both sides of it and look at the
overall exposure of that client.

The systems that have been set up,
everybody's got older systems, but even now,
today, if we have a client that's trading equities
options and futures, we give them a statement that
looks almost identical. It lists their futures
then it lists their equities, so they too get that
same perspective that I'm looking for as an FCM
and broker-dealer and that is to look at
everything they're trading with us and what's
their exposure.

So, although there are two pots, from a
customer perspective, they want to see it as one.
Yes, there's mechanical issues of flowing it
through either system. I think the technology has
evolved that more and more you can put it just
about anywhere, you just have to walk through. It's more the money and where's the money, to be honest.

MR. NIGITO: As market makers, we do take advantage of some of the strategy-based margining and would support the expansion of portfolio margining for our customers that we provide liquidity to. I will point out though that there are definitely some issues around settlement with returns to the staggered settlement where some things will settle T plus 1, some T plus 3, and so the amount of cash necessary to clear products is sometimes a little awkward.

And if you want details on that, I think we can follow up another time with the more comprehensive list.

MS. SOMMERS: I just wanted to -- you know, more specifically and, Ed, if you have thoughts on well, to be specific. There are -- if I'm understanding Yvonne's answer correctly, there are not, you know, any plumbing issues that would prohibit one solution over the other --
MS. DOWNS: More and more everybody's developed their systems to be able to do so many things that it's less of an issue than it used to be a few years ago.

MR. GENSLER: Commissioner Sommers, thank you. Commissioner Walter?

MS. WALTER: Thank you, Chairman Gensler. I guess the first thing I'd like to ask about is market surveillance and what I would call not quite the best of all possible worlds. And one of the reasons that I had supported the politically infeasible merger of these two agencies is my very strong feeling that excellent market surveillance really requires real-time information coming from across the markets.

We're not there and I wonder if any of you has pragmatic advice about how we can do the best job possible in the next best of all possible worlds where we're willing to harmonize to the greatest extent possible, cooperate to the greatest extent possible?

MR. LUPARELLO: I figure I'll go first.
We are absolutely not there. We're not there on the securities side as far as we'd want to. We're not there between cash derivatives and cash equities and we're certainly not there on the issue of futures versus cash. And there is, clearly, much greater interrelation between those markets now than there ever has been historically. And there's also, as Brian, I think, well knows, many more locations for basically the same economic bet, and we have been moving expeditiously on the cash side to come together. We've done so in the context of insider trading and certain other upstairs activity to consolidate all equities activity, irrespective of where it is, into single surveillance systems. And we need to take the steps that are then the next steps after that in terms of the derivatives to make sure we're aggregating information at the surveillance stage not at the investigation.

MS. WALTER: But would you say, Steve, that it's really a question more of working through the pragmatics of it? There really aren't
any legal impediments that are insurmountable in terms of getting there.

MR. LUPARELLO: Well, I think that's right. And by the practical, I think it's the technological. It's also exactly how do you share information, how once you've made your determinations you route them back out for investigations. But those can all be -- all of those practicalities can be solved with agreements among the different participants.

MS. DOWNS: Can I just say that the cost of sending information back and forth to the Commissions, though, it's not a small effort to be able to integrate all your systems and report them in the different formats. And so if you're going to collect more information to do this, there needs to be some coordination on the information that needs to be collected. Because right now, they're not saying we report to both and the ability to produce the information is difficult if you keep going through different situations for each regulator.
MR. LUPARELLO: Well, Yvonne raises a
great point. Not only is there different types of
information, but it's often information in
completely different formats. So I think one of
the key things that a centralized regulator would
have to accomplish is how do you take information
that is coming in in its native format -- that
native format has been developed for a variety of
reasons, including the business the people are in
-- and get that data to look alike for the
purposes of surveillance? I think that's
obviously something we've been thinking about for
a while and I think that's one of those essential,
practical next steps that has to happen.

MR. NIGITO: Commissioner, I would just
suggest that you speak to the brokers and such
that offer sponsored accesses. They need to track
their customers' activity in real time across a
multitude of venues. And so this is probably a
problem that they deal with and would be very
familiar with the practicalities of it.

MS. WALTER: I guess, Brian, I've got a
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question that I want to at least direct in the
first instance to you with respect to high-speed
trading and, in particular, with respect to the
latest hot button issue, namely flash orders,
which we are looking at very closely at the SEC.
My question is whether you find that there are
comparable potential -- I'm going to use a loaded
word -- inequities in the futures market that
ought to be looked at as well or whether that's a
difference between the two markets and whether are
there consequences in one market that will slide
over into the other market?

MR. NIGITO: Well, I would say there are
substantive differences. I think that the
enhanced retail participation has put additional
pressures on the equity side that has manifested
itself in pre-routing display facilities, like
flash and that level of competition. Without the
fungibility and the ability to internalize, a lot
of those pressures aren't there and so there may
have been inequities, you know, as a result of
floor processes. I think that as more of the
futures go electronic you don't find the same
market structure elements there.

MS. WALTER: One other quick question.

There is a regulatory structure distinction in the
way our two agencies treat introducing brokers,
and, on the one hand, clearing brokers and, on the
other hand, FCMs. And I guess my question is, is
that a real distinction with two categories of
registrants at the CFTC and one with the SEC and
with FINRA, with an allocation of
responsibilities, but -- an allocation of
function, but not necessarily responsibility? Is
that a real distinction or is it really more an
apparent distinction?

MR. ROSEN: I'll respond to that,
Commissioner. The important thing, obviously, is
that the oversight and the requirements are
appropriate in light of the scope of the
activities that distinguish an introducing broker
from a full broker or clearing broker that's
accepting customer funds and engaged in a broad
range of interactions that give rise to a whole
set of other issues. It is more a difference of
form over substance, but it is one of the things
which it would be worthwhile harmonizing on
because there's not -- there's no compelling
reason to treat them differently under the two
regimes. But I would agree that at bottom it
becomes more a question of form than substance,
one having its own category and one being a subset
of broker-dealers that's regulated under somewhat
different requirements.

MR. GENSLER: Commissioner Walter, thank
you. Commissioner Chilton.

MR. CHILTON: Thanks, Mr. Chairman. Mr.
Nigito, congratulations on your success. You're
one of the few companies that can boast
significant profits last year.

You know, I think we're both -- both
agencies are, you know, looking at flash trading
and algo trading. And to be honest, I'm not sure
I quite get it like I should, so maybe you can
help educate me.

I understand what you say in your
testimony about bringing liquidity into the market, but you're really in for a short period of time. You're making -- you're getting a differential on tiny price moves by arbitraging between different platforms. Is that generally right or -- I mean, you're not staying in overnight, you're not in it for the long term. These are quick inputs of liquidity, right?

MR. NIGITO: Well, I don't think that that would be an accurate characterization, no.

MR. CHILTON: How would you characterize it?

MR. NIGITO: You have about -- you have several different questions, I think, in there. And so for me to separate flash, algo trading, and liquidity provision I think is necessary.

MR. CHILTON: Well, you said you added liquidity to markets. Are you in the markets long term? Are you in overnight?

MR. NIGITO: Dictated by the products.

I mean, for example, for options where you have people demanding liquidity across a matrix of
strikes and terms, we carry those positions from
day to day through expiration. In a very, very
liquid stock, you know, we have no fundamental
position. So if we have the ability to trade in
and out and maintain a position near zero, we'll
do so. In those positions that we do carry
overnight, and we do, our aim is not to take any
particular bet. We're trying to hedge ourselves
perfectly. We really have no position on that
company.

And so I would say that our holding
period is dictated by the liquidity in that
instrument. And as our business grows, we tend to
go down towards products that are less and less
liquid.

MR. CHILTON: If you had to equate
yourself with other traders, not that you know all
of their business models, but you've been around
the industry for a while, would you say -- is it
fair to say that you're in it for short -- in
these markets for a shorter period of time than
most other traders?
MR. NIGITO: No, I wouldn't say that. I mean, given my experience at ECNs, I'd say that it's a comparable holding period to people who engage in similar levels of liquidity provision. And I would also point out, I mean, somewhat selfishly, we have shared with the Commission and we'd be happy to share it with the Securities and Exchange Commission, we'd be happy to share with you as well, some of the reports we put showing our market share and the amount of liquidity provision and our depth at the inside through last year. And to counter some of the criticisms of high-frequency liquidity or electronic market makers not being there, our share of liquidity provision and trading actually increased over that period.

MR. CHILTON: That's helpful and we'd appreciate getting that.

MR. NIGITO: Certainly.

MR. CHILTON: So accepting what you say, and I do, are there new rules that we need to -- at either commission, but specifically (inaudible)
in CFTC, are there new rules that we need to put in place to ensure that when there's bursts of trading activity that are computer-generated, that isn't a guy on the trading floor making this, but it's an electronic trade that these certain attributes are in place and then a large trade is made, that that doesn't move markets? I talked earlier in the other panels about how I like the SEC's definition of "manipulation" because it is "reckless." And I'm not suggesting that you're reckless. And that ours you have to prove intent. Well, it's pretty hard to prove the intent of a computer-generated program. That doesn't mean that you couldn't theoretically make a trade based upon these certain programmatic data that could move markets. I'm not saying it's illegal under our laws. But are there new rules that we need to put in place or consider to ensure that there's not inordinate price moves from this sort of trading?

MR. NIGITO: Well, I certainly don't presume to know the strategies of all market
participants out there. I mean, only a few. To the extent that you want to explain them to me, everything you learn, I'd be happy to gain any insight.

No, I will say that, you know, the majority of what we're doing is trading counter market moves. You know, we're posting passive bids and offers. And it's pretty hard to push the market when one is, by nature, non-marketable. Is that conceivable? I suppose it is, but I think anybody who would attempt to do that in some of these, you know, liquid futures products and such would be running tremendous risk, and I think that it is somewhat self-policing in that regard.

To the extent that you have specific behavior price moves that introduce, you know, market impacts that very quickly reverts, I think statistically you could devise ways to search for extreme instances of that. But it has not been my experience that that is a rampant problem.

MR. CHILTON: Thank you.

MR. NIGITO: Certainly.
MR. GENSLER: Thank you, Commissioner Chilton. Commissioner Aguilar.

MR. AGUILAR: Thank you, Chairman Gensler. I want to revisit some grounds from a different perspective that was trotted by Commissioner Walter's questions about markets surveillance and that is the -- which I view as sort of proactive. And my question has to do with the audit trail and maybe some discussion as to the, you know, current audit trail and how they differ in the securities world, securities intermediaries, and future intermediaries, from order receipt to execution to clearing and, you know, how they could be harmonized. And I'm not sure who to go to. I'm looking at Steve, I'm looking at Yvonne who's sort of nodding. It's a jump off. Somebody get to it.

MR. LUPARELLO: I'll start and ask you to bail me out.

MS. DOWNS: Okay.

MR. LUPARELLO: I can speak to the securities side. There is still some
inconsistencies on a market-by-market basis in
terms of audit trails. The equities audit trails,
as a general matter, are very robust. They
include all the pre-trade transparency, all the
post-trade transparency down to the executing
broker. For NASDAQ listed stocks, there's also
basically an on-the-run order audit trail. That
doesn't extend to the New York Stock Exchange or
AMEX listed stocks, and so there is that little
bit of a discrepancy. And then there's the
aggregation of the equities audit trails across
all markets, but at somewhat of a higher level.
So there's something called the Intermarket
Surveillance Group, the ISG, that serves as the
aggregator of audit trails. But when it does so
on the equities side, it does so with less of a
level of detail than each of the individual
markets do themselves.

So you've got each of the markets with
wonderful comprehensive information about what's
happening on their markets, but not necessarily a
full picture of what's happening on the other
markets as they trade in the same instruments.
The options markets parallel the equities markets
and they share information, again, at a higher
level, but not at a detailed level.

I'm going to sort of look down the Panel
to see how that compares to the futures audit
trail, but I can also say that there is only, at
basically the investigative level, routine
information sharing between the securities side
and the futures side.

MS. DOWNS: Because we're a
broker-dealer FCM, we run different electronic
models in-house to look at our own trading
activity. I'm a little more familiar with this
than some because that's one of the things I do at
Newedge, but the audit trails are very different.
And it's not so much that they're different -- and
ultimately, if you collected all the pieces of
information from all the different systems along
the path, you ultimately would get to the same
audit trail. But the actual fact is none of that
information flows down the path in the same manner
between those two.

On securities, for example, we routinely get blue sheet requests. Those blue sheet requests mean that on the audit trail that generally is out there for the securities regulators you know who the firm is and you know the trade that was done, but you can't get all the way down easily on a more real-time basis, down to who actually placed the trade and who the owner is behind that trade. On the futures world, we do know who placed the trade, who the ultimate account number is, and so it's more -- it's generally more readily available to me to look and see exactly who placed that trade down the chain. So the audit trails ultimately are the same; they come from different places.

One of the things that's also missing sometimes on the audit trails is the timing information. A lot of times, for me, I need to know when an order was placed, when it was executed, and all the component parts. For me to go get that information from even the futures side
today, generally the exchanges and their
clearinghouses can tell you exactly what the time
the trade was executed, but they don't all capture
all the way through the trail when the trade was
originated.

So some of those component part
differences make it just very simple components
that make it hard to follow this path on both
sides together in one place to know what you're
doing from a market surveillance perspective. I
used to work at exchanges as well, so I'll just
tell you that I'm familiar with it from both
sides.

MR. LUPARELLO: And again, the other
point is that each exchange or, in our case,
(inaudible) for the over-the-counter markets,
have built unique surveillance systems that rely
on their data. And so each of their systems is
independent and each of their systems has been
structured somewhat differently based on the
unique components of the data as it comes to them.
So aggregating of data and aggregating of
surveillance is something that we consider to be very important. But given that it's more than just getting all the data in the same location, it's getting surveillance systems to look at that consolidated data in a single way is a fairly complex endeavor.

MR. MERKEL: I was just going to talk a little bit about our experience with respect to a product that is currently not a focus of either agency, which is -- or one that has a hell of a lot of enforcement investigation, namely credit default swaps. We'll see what we may say a year from now, but, at the moment, it's just not an area that has been the subject of much agency action. And our experience has been in the wholesale market that we have been called upon by all sorts of regulators: By the SEC, by FINRA, by various state attorneys general to provide the information. And it is my sense that the wholesale markets have been able to provide a great deal of information that's been useful in connection with those various investigations,
notwithstanding the fact that they're -- those markets are currently not regulated and there were no recordkeeping requirements for the most part.

MR. AGUILAR: I think my time is up.

MR. GENSLER: All right. Earliest on this round and this panel. Thank you, Commissioner Aguilar.

Commissioner Paredes.

MR. PAREDES: Thanks. Brandon, if I have this right, in your remarks you highlighted a few different areas of key concern: Margin clearing and bankruptcy. I was curious if you could perhaps dive down a little bit deeper on those and perhaps, in particular, focus on if there's something concrete that you think is the right thing to do to address what you see as the concerns in each of those areas.

MR. BECKER: Well, thank you for the invitation. I think it's fair to say that you've heard this morning the conversations on margining, the portfolio margining effort to try and get that resolved, strikes us as a very sensible approach.
I won't try and get in the middle of the one pot/two pot issue. But as an individual investor, if I have one pot, that seems enough pots for me.

With respect to clearing --

MR. GENSLER: There's the headline.

MR. BECKER: You always have to be careful when you go for the joke.

With respect to clearing, certainly the cross margining exercises that have been put in place have provided some benefits, but we think that you could strengthen the ability to bring greater prudential oversight by moving more products into a clearing environment. What we're worried about is taking them not only into a clearing environment, but also into exchange trading. So that the benefits of centralized clearing seem well-founded to us. We just don't think that you necessarily have to take exchange trading with that because we have found that the customization from OTC products is to benefit in managing our portfolios.

The bankruptcy regime issues I would, of
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course, defer to Ed and his colleagues on. But as a practical matter, one of the difficulties with the accounts and what ends up in either account, as Ed's testimony highlighted, are that we don't have good bankruptcy answers if any of those large firms go down. And as much as, you know, we would like to think that those aren't realistic alternative, the last two years have just brought that to the forefront where we now have to put, as it were, for lack of a better description, bankruptcy risk and the uncertainty related thereto into counterparty assessment in a way that you'd like to think, in a mature legal structure, you didn't have to take -- at least you would know what your outcomes were as opposed to the level of uncertainty.

So I will pause there and see whether Ed wants to chime in. I'm sorry.

MR. PAREDES: I was going to ask it anyway, so.

MR. ROSEN: No, I agree with those remarks. And I think one of the things that I
think is important and I noted in your -- in Chairman Gensler's follow-up letter on the legislation, the focus on insolvency. But in connection with the pending legislation and increased clearing, I think it's very, very important to make sure that we have the insolvency analysis right. That seems to me to be relatively non- controversial. Your only objective is to try to make sure that it works the way the rules approved by the Commissions have articulated the result, and I don't think we have that level of certainty today. And I think if we're going to be in a world where the volumes of transactions and relationships that are cleared are going to expand significantly, it really behooves us to address those issues.

MR. PAREDES: So do you have any concrete suggestions on how to achieve the kind of certainty that's important?

MR. ROSEN: Well, I think it's a question of modifying a range of existing statutes, basically, that would deal with --
eliminates some of the problems that have arisen because of the new paradigms that are being created, new kinds of products being traded by non-conventional market participants, perhaps in clearinghouses that they haven't historically cleared through. And you need somebody to look at the permutations that will arise and parse through. It'll be a function of FIRREA and FDICIA and Part 190 and the bankruptcy code and SIPA, all of those will need to be reviewed to make sure that we get the results that we're engineering for and not a surprise because of a clever litigation strategy and insolvency.

MR. PAREDES: I see I have the yellow light, so in the interest of not asking a question and not having a chance for the answer to be offered, thanks a lot.

MR. GENSLER: Thank you, Commissioner Paredes. I wanted to associate myself with a couple of comments and then ask a question that you all need a pen for. I don't know if Ms. Downs has a pen, but. So I wanted to associate myself,
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Stephen, you mentioned about FX, retail FX. I do think that we need to do a better job, probably both Commissions, but certainly the CFTC. This is foursquare in our jurisdiction. Probably working with Congress as well to better protect the public against retail fraud in the FX markets.

I'm associating myself a little bit with Steve Merkel and others who think that in a new world of over-the-counter derivatives that we should have a non-discriminatory clearing that accepts open access to competitive exchange models. I've sometimes used the word "fungibility." Sometimes people say that's a fighting word, but I think that that's an important thing.

I'm not sure I would associate myself with Ms. Downs earlier when you said institutional clients are smart enough to take care of themselves. I think last year's crisis, with all respect, showed that maybe smarts wasn't always running strong on Wall Street. So I do think that we have to, as regulators, protect against
manipulation, fraud, and other abuses, even at an institutional level, may be different than the retail public.

So here is my question, not with those three points in mind, but the question is: If you can write down areas -- and I'm going to quickly do it because I still have a green light -- but I recognize that some people think these are evergreen issues. I think that there's no sacred cows. I think we have to have open discussion as to what we should change and what we should leave as differences, but 12 things I've heard today.

One, product certification or approval. Two, rule certification or approval, different than product certification. Three is this whole topic of cross and portfolio margining. Four is fungibility; still a green light. Five, segregation/solvency. Six, there was some discussion about market structure/national market system, so forth. Seven, manipulation standards. I remember Commissioner Chilton raised this a number of times. Seven, insider trading; the SEC
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has it, we kind of don't. Eight, suitability
versus disclosure regimes, where the SEC has one
and we have a different thing. Next I have
fiduciary, you know, the difference between
investment advisors, broker-dealers, and CTAs and
so forth. Another one is mutual recognition.
CFTC does more of that than the SEC.
Principles versus rules. I don't know,
I meant to have 12, but if it's not, it lists 12.
My question really starting with Ed and
we're going to go straight across the Panel, so
all six of you, which of these would you rank as
the first two or three that you say, look, the SEC
and CFTC's got a golden opportunity. The
president's called for it. We just lifted the
worst crisis in 80 years. Rahm Emanuel said, you
know, not to waste a good crisis. But if we can
address some of these things and actually do
benefit for the American public, and which, on the
other end of the spectrum, where you say it either
should be different or don't pursue it. So -- and
if you have two or three on one end, what are the
two or three on the other end?

MR. ROSEN: I think sometimes

(inaudible).

MR. GENSLER: Your mike. Hit your --

MR. ROSEN: I'm sorry, fungibility in

national market structure, I think the

reconciliation of those is very important. I

think the cross-margining, portfolio margining, is

something that also needs to be done, but I see

that as part of insolvency reform. And I think

mutual recognition is very important. If we're

going to have a coordinated global approach, we

have to have standards that enable us to recognize

each other because a siloed approach just isn't

going to work.

MR. GENSLER: We're going to need to get

across the hold. Any of those you wouldn't hit?

Any of the issues you looked at and said those

should stay different?

MR. ROSEN: Well, no.

MR. GENSLER: Okay. Yvonne?

MS. DOWNS: Cross-margining, portfolio
margining I think is number one. We think principles versus rules, but principles should apply to intermediaries, not just the markets themselves since we compete with them. Mutual recognition, we do think that we've got to recognize other markets and not be identical on all of them.

Those are my top three.

MR. GENSLER: Any that you would just leave different and say that's a good thing, to leave them different?

MS. DOWNS: No, I think they all need some modifications, so.

MR. MERKEL: I would say at top would be fungibility and market structure and sort of getting that right. The fact that we have just completely different ways of operating, clearing and the securities head options field that we have in the futures area, is a very important issue we have to wrestle with. And if your going to now get to derivatives, which are in either world, you have to figure out which one makes more sense in
terms of harmonization. I advocate strongly
towards the security side and to ultimately
rationalize all of them.

With respect to suitability and
disclosure issues, I think I would ask the
Commissions to consider pulling it back from the
SROs and looking at it anew. It has pretty much,
to a large extent, been an area outside of fraud
that the agencies have stayed away from, and
they've given it to the SROs. And it may be time
to look at it in our own right.

MR. GENSLER: With permission from my
fellow commissioners, we'll just hear what you
think are the top ones.

MS. CASEY: No, I think it's a very
important question. I think we should allow the
panelists to take their time to answer it.

MR. GENSLER: Oh, all right, good.
Good. There, you're getting more time, so -- all
of you. And if we cut you off, you just keep
going.

MR. BECKER: Segregation/solvency as
part of a bankruptcy regime assessment would be my
number one because I think it most directly
correlates to systemic risk issues on a
going-forward basis. Then cross-margining and
portfolio margining because, again, I think that
goes to risk issues that are important across the
board. And finally, fungibility and market
structure, I think, will have to do with
competitiveness and the ability to bring out new
products in a sensible way and maintain innovation
in the over-the-counter market.

I, oddly enough, would leave principles
and rules for another day because I think it's an
empty vessel. You need both. But what I would do
is urge the SEC to figure out how to get new
products approved faster. That's not a
harmonization issue so much as it's an internal
bureaucracy issue within that commission.

MR. LUPARELLO: As a regulator on the
Panel, the intermediaries all give the regulators
answers.

Market structure and, I think, in that,
the market surveillance structure is an important and fiduciary standard. I think those basic, you know, market integrity issues I think are the ones that are most -- we would most, I think, benefit from, from getting some level of harmonization on. And the ones I would be quickest to leave on the wayside, not that they are on -- all aren't where they would -- I agree with Brandon, principles versus rules and mutual recognition.

MR. NIGITO: I think personally it seems like product approval is tractable and laudable. Cross-margining and portfolio margining, I think, is a constant amongst everybody.

Market structure I think is a hard one to disentangle unless you solve some of the fungibility issues and you deal with some of the pressures and the competition.

The competitive aspects, I don't see a lot of ease there. And as to what to leave on the table, I would certainly have to defer to some of my colleagues around things like principles versus rules-based.
And mutual recognition, I wouldn't want to let it go, but if we give it up, we give it up.

MR. GENSLER: Some children just don't get as much. But we may have cut Ed or Yvonne off, so was there anything? No?

MR. ROSEN: No, that's fine. I actually share the consensus of the Panel.

MR. GENSLER: Well, I want to thank my fellow commissioners, both from the SEC and the CFTC and Chairperson Schapiro. I think it's been a very full day and excellent witnesses. I thank you all.

For those of you who have not yet submitted written testimony, please do because we'd like the public to get benefit from what you've all shared with us.

We're going to reconvene tomorrow morning at 9:00 a.m. at the SEC's hearing room, which I believe, as you go into the building, then you go down into the basement. And we, again, have three panels tomorrow.

And we thank you all and we thank the
commissioners and everybody's staff here at the CFTC and SEC staff. Thank you and see you all tomorrow.

(Whereupon, at 3:20 p.m., the PROCEEDINGS were adjourned.)

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I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

/s/Carleton J. Anderson, III

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