UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

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

Washington, D.C.

Thursday, December 9, 2010
PARTICIPANTS:

Commission Members:

GARY GENSLER, Chairman
BART CHILTON, Commissioner
MICHAEL V. DUNN, Commissioner
JILL SOMMERS, Commissioner
SCOTT D. O'MALIA, Commissioner

Presentations:

Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets and Swap Execution Facilities and Additional Requirements Regarding the Mitigation of Conflicts of Interest
ANANDA RADHAKRISHNAN
NANCY SCHNABEL
End-User Exception to Mandatory Clearing of Swaps
DAN BERKOVITZ
GEORGE WILDER
Business Conduct Standards with Counterparties
PHYLLIS CELA
VINCE MCGONAGLE
PETER SANCHEZ
ANANDA RADHAKRISHNAN
PARTICIPANTS (CONT'D):

Issuance of Interim Final Rule for Reporting Certain Post-Enactment Swap Transactions

SUSAN NATHAN
RICK SHILTS
DAN BERKOVITZ

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CHAIRMAN GENSLER: Good morning. This meeting will come to order. This is a public meeting of the Commodity Futures Trading Commission to consider issuance of proposed rulemakings under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Today we will be considering end user exception to mandatory clearing of swaps, business conduct standards with counterparties, governance requirements for derivatives clearing organizations, designated contract markets and swap execution facilities. In addition to those proposed rulemakings, the Commission will consider an interim final rule for reporting certain post-Dodd-Frank enactment swap transactions. The public might note that we had calendared for today discussions of swap execution facilities. I've also always said to the press that we're human so that as Chair I've decided this morning that we're going to take that one up next week. I think we'll have some good further
discussion among the Commission and staff on that
one. This probably is not going to be the last
time that we recalendar something and need an
extra week to get our work done.

Before we hear from staff, I'd like to
thank Commissions Mike Dunn, Jill Sommers, Bart
Chilton and Scott O'Malia for all of their
thoughtful work. I say this every week. As we
get into the holiday period it is remarkable how
much they are doing and their able legal
assistants are doing to help us through all of
this. I'd also like to welcome members of the
public, market participants and members of the
media today as well as to welcome those listening
on the webcast.

This is our seventh public meeting to
consider Dodd-Frank rulemakings. We will have
another meeting on the 16th and we're planning two
additional meetings on Dodd-Frank rulemakings in
January and we'll continue to announce our
proposed rulemakings and which topics we're taking
up 1 week in advance, and this is 1 week in
advance so I'm going to do this. I think we're also going to put it on our website. But next week as I say, we're looking to take up swap execution facilities as I just mentioned. We're also going to hear in I think it's our third round about clearinghouse rules. These will be the risk-management rules on clearinghouses. At what I'll call our third round we will conduct discussions on internal business conduct with regard to confirmations, portfolio compression and portfolio reconciliation and also on position limits. And I wanted to make a few comments if I might on position limits. What I've asked staff to do is to pull together two components, it might be in one vote but I think it will probably two rulemakings, one on spot month and one on what we call other months or all months combined. We've had a long tradition at this agency or setting position limits. We have spot month limits right now on pretty much if I'm not mistaken all of the physical commodities and some financial commodities, we've put out proposals this past
January on energy products and we think that we can move more expeditiously with regard to the spot month period and it would be my hope that we could vote on something and then finalize something on the spot month area within the next few months. With regard to all months combined and other months as that is to data intensive, that too hopefully can be completed expeditiously but there is the challenge of doing it and the data that's so necessary for it so that I've asked staff to make a presentation and try to bring both rules up next week. I think that's what we're calendaring for next week. As of right now, Commissioner Chilton's staff has been very involved and I think very forthright publicly about our need to move forward on position limits. I share that view. Congress did set different dates for us on that, 180 and 270 days rather than 360 days so that we're trying to work with that and we'll take more of that up and I'm sure our other Commissioners will have views on that and maybe share that even today at the end of our
I want to thank staff for working on all the draft rulemakings. I thank them for their thoughtful recommendations. We look forward to receiving public comments on all that we're putting out today. There will be fact sheets and Q and A's put on our website. Before I turn to the presenters, I turn to fellow Commissioners. Commissioner Dunn?

COMMISSIONER DUNN: Thank you, Mister Chairman. You'll recognize that we all are talking funny. I don't know if that's because we've had so much discussion or if the Chairman is sharing a cold with all of us, but it isn't indicative of the hard work that staff has put in putting all of this together, but more importantly, the Commissioners working together to try to find some solutions to things.

CHAIRMAN GENSLER: We have been in close quarters.

COMMISSIONER DUNN: He's been in my face a lot. I want to thank you all for joining us
today in this important meeting regarding the  
implementation of the Dodd- Frank Act. The  
business conduct standards for swap dealers and  
major swap participants is of particular interest  
to me because I believe that strong standards for  
swap dealers and major swap participants are  
necessary to prevent another financial crisis. By  
implementing strong business conduct standards,  
the Commission can establish meaningful protection  
for counterparties and hopefully prevent the types  
of behavior that necessitated the passage of Dodd-  
Frank. To me, Mister Chairman, this is the heart  
of what we're supposed to be doing.  

An inherent conflict of interest exists  
when a swap dealer acts as both an adviser and a  
counterparty to his customers. The business  
conduct standard proposed today provides  
meaningful protection to counterparties and I  
support them, but I believe more can be done. I  
am particularly interested in public comment on  
this rulemaking, specifically, whether the  
proposed rules go far enough in protecting
counterparties.

Dodd-Frank requires the Commission to consider whether to expect small banks, savings associations, farm credit institutions and credit unions from the definition of financial entities in its clearing requirements. I welcome public comment on whether any of these groups should be expect and if so why. Specifically with regard to farm credit institutions I would like to know if the $10 billion cap on total assets meets congressional intent. I am concerned, Mister Chairman, that a decade ago Congress told the CFTC not to look at swaps and over the counter. In that period that industry has developed and it's quite different from the futures industry. I am concerned that as we who know and understand the futures industry and our staff has been working on that and fully appreciate differences that have developed. I hope that we're not trying to take what has worked well in the futures industry and say that has to be in the swap industry without taking into account how the swap industry has
developed. When we get to that point I look forward to comments from the public on what we're doing if we are in fact going to achieve the purpose of Dodd-Frank and are we going about it right. I've said before that I think it's important that we get these rules out in time because Congress has mandated it, but it's not an easy task and what we get out, it's imperative that we get it right so that the public has got to give us comments in regard to these proposed rules so that we get that final rule right. But I think also inherent in that, Mister Chairman and my colleagues is a duty for us to follow-up to ensure the efficacy of those regulations that we pass, and I've said before that I think in 12 or 18 months we need to review what we've done and what that impact has been. Again I want to thank staff for the great work that they've done on getting things together. I get changes in the middle of the night from staff so that I know somebody is up there working and I appreciate it.

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

COMMISSIONER SOMMERS: Thank you, Mister Chairman. I too want to say thank you to all the rulemaking teams this morning for all the hard work and the rules that we have in front of us or thought we were going to have in front of this morning. A lot of these rules are complicated and we really do appreciate all the time that all the teams put in to making these rules be in a place for proposal stage where we feel comfortable getting public comment. So thank you all for all your hard work.

Last week I expressed concern about a number of the Commission's proposals that I felt were too broad or overreaching what I felt the statute directed us to do. This week my concerns go the other way. Even though we're not considering the SEF proposal, one of my concerns this week is that we were defining SEF too narrowly. It's also a concern that I have regarding the end user exemption proposal because I believe the statute directed us to consider
whether we should be exempting some of these small institutions. And although we asked questions with regard to that subject, we don't propose a framework for how we would go about exempting these small institutions so that in that area I believe we have read the statute too narrowly.

My opening statement today is almost solely with regard to the definition of SEF so that I will forego subjecting you to my concerns about the SEF definition until next week, but just say that I hope in the 7 days that we have to reconsider this rule that we will address some of the concerns about looking at that definition too narrowly. I will follow-up by saying on the end user exemption that I think that we need to consider whether or not the $10 billion limit is appropriate and if there are other criteria that these institutions may have that would make them qualify for this exemption. I think that this is something that we really do need to look at. I would have preferred a framework be proposed in what we're doing today but since we did not do
that I would suggest that the public and all of
those who are concerned about this really do give
us suspect comment about how we could consider
putting that kind of framework in a final rule.
Again thank you to the teams today and I look
forward to hearing about these proposals.

CHAIRMAN GENSLER: Thank you,
Commissioner Sommers. I look forward to that
also. I think I know much of what's in your
written statement, but we have 7 days and it might
change by next week.

COMMISSIONER SOMMERS: Many of these
things you have heard before.

CHAIRMAN GENSLER: Yes, I'm sure. On
the end user side, I thank you that for once you
want us to be more prescriptive.

COMMISSIONER SOMMERS: I suppose there
is another way of looking at that, maybe follow
what the statute says.

CHAIRMAN GENSLER: Commissioner Chilton?

COMMISSIONER CHILTON: I'd like to if
it's okay with the Chair defer to Commissioner
O'Malia first and then go.

CHAIRMAN GENSLER: Absolutely.

Commissioner O'Malia?

COMMISSIONER O'MALIA: Happy day. How often have I complained that I always have to go after Mr. Chilton, and now I get to go before him?

The holidays are upon us and as many of you know, I have three daughters which therefore means I have three wish lists. My youngest daughter Macie spent the weekend scouring the catalogues in search of the perfect gift to top her list. Do you know what she came up with? A towel warming rack. She had no idea why she wanted it, but it was in the catalogue and thus had an equal opportunity as many of the other items to make the list. I didn't think much of the towel rack until I read the proposal relating to the swap execution facility, namely, the part that aims to further define what a SEF is and I thought to myself that this SEF rule is very similar to the towel rack episode, no reason, just because. I'm not buying a 7-year-old a towel
warming rack and I'm not supporting the proposed
rulemaking on SEFs as it was drafted today.
Unlike Commissioner Sommers, I am going to expound
a little bit on the SEF even though we haven't.
This is an important issue and I think we're going
to have a good robust debate about it and I'm just
going to share my views on where this thing is
going and my views on it.

CHAIRMAN GENSLER: Absolutely.

COMMISSIONER O'MALIA: We obviously had
a lot of time and options before interpreting the
statutory language with the goal of providing
greater pretrade transparency and the Commission
chose a limited two-tier approach that relies on a
narrow reading of the statute and a broad reading
of an aspiration that if adopted will actually
diminish the overarching goal of promoting the
trading of swaps on SEFs. The rulemaking mandates
that SEFs either take the form of a central limit
order book for any product that trades for more
than 10 times a day or transparent requests for a
quote or RFQ approach. The so-called transparent
RFQ approach will require all bids and offers to be firm and provide a first-in-bid, first-in-fill approach and that's it. Staff has interpreted a minimal statutory requirement that in a manner that entirely strips away the unique characteristics of swaps that has been bandied about by the Commission for the last 20 years and requires swaps to trade like futures in my opinion. Looking over the history of the Commission's treatment of swaps, it remains abundantly clear that while swaps contain some features similar to those of futures, they remain sufficiently different in their purpose, function and design. To limit swap trading to a central limit order book exchange might be unnecessary to mitigate systemic risk, protect the public interest and in fact may inappropriately burden commerce. That is, if swaps possess the same characteristics as futures, then Congress would not have needed to create a SEF definition to accommodate them. End users and buy-side participants are understandably wary about being
forced into unfamiliar and inhospitable environments where high-frequency traders can undermine their ability to trade sizable positions and nascent illiquid markets threaten to divulge the positions through bidding alone. Like a 7-year-old wanting a towel warming rack, it just can't the right, but at least buying a towel rack helps commerce. I can't say that for this proposal.

I want to be clear. I am in favor of increasing pretrade transparency as the Chairman is so passionate for and bring more transparency and bringing more swaps to swap execution facilities and relying less on block trades. To achieve this we must permit a broad arrange of venues to inspire market innovation, competition and improve transparent market pricing. Congress' open-ended language is clearly intended to permit flexibility across all trading venues. I ask that we interpret the statute broadly to permit the various RFQ and transparent voice broker systems already serving the industry to continue to
operate with at most minor alterations. This I believe I will allow market participants to ultimately determine what levels of pretrade transparency and liquidity they require to manage risk. I checked back with Macie this morning about her list. She admitted that it was a little long, she's being reasonable and she is cutting out the towel rack. I hope we can get comments and input necessary to cut out list as well.

Mister Chairman, I shared with you an amendment that I thought was appropriate to broaden the definition of SEFs. I appreciate your willingness to pull the proposal and reconsider and possibly give this amendment some consideration. I've talked with my colleagues about it. I think it's a great opportunity to expand the definition to give ourselves some optionality in what SEFs are going to be allowed and I appreciate your willingness to work with me on it and I hope that we can come to an acceptable solution because I think we all agree that the goal of this objective is pretrade transparency
and flexibility for trading in the SEF environment.

From my experience working in the Senate, I do know how it feels to be in the host seat and I would like to thank Reva although her rulemaking got pulled and her team for their efforts. They've worked long and hard. And I would also like to thank the other teams headed by Phyllis Cela, Nancy Schnabel, George Wilder and Susan Nathan. I appreciate their unwavering commitment to responding to my questions, comments and criticisms with thoughtful consideration.

Similar to my colleagues, I commend the end user exemption team for drafting what overall is a very thoughtful and well-written proposal. However, I'm concerned as to why we are failing to fully address the issue of excluding small banks, farm credit institutions and credit unions from the definition of financial entity. This is unreasonable. Section 2(h)(7)(C)(ii) directs the Commission with their ever-important word shall to consider whether to exempt these entities, and as
pointed out by House Agriculture Committee Chairman Collin Peterson, "The regulators will have maximum flexibility when evaluating the risk portfolios of these institutions for consideration of an exemption." All we're going to do today after almost 5 months with this language is punt it. While I can appreciate staff's decision to pose a series of questions aimed at further informing their consideration of the appropriate criteria for such an exemption, we are too far into these rulemakings to start from square one. As we move forward on the rulemaking I encourage staff to keep in mind that many of the affected institutions pay a critical role in economic development of small communities and rural areas. It is my hope that a final rule will ultimately permit the bulk of these institutions to avail themselves of an end user exemption. As for the proposal for business conduct standards for swap dealers and major swap participants in their dealings with counterparties and especially counterparties who are special entities, I believe
staff has demonstrated an extraordinary ability to
effectuate the statutory mandates through
consideration of congressional intent and in the
manner in which market participants actually
conduct their business. This proposal is
especially timely as the Bank of America has just
agreed to pay more than $137 million in
restitution to federal and state agencies for
their participation in a conspiracy to rig bids in
the municipal bond derivatives market. However,
the rule strives to ensure that counterparties
dealing with sophisticated swap dealers and major
swap participants are fully informed and of course
have recourse if they are not prior to entering
into these complex instruments I support. I will
say I am not entirely sold on the broader proposal
to apply execution standards for all Commission
registrants transacting swap available for trading
on DCMs and SEFs. These standards are designed to
ensure fair dealing and further protections
against fraud and abusive practices and these are
good things. However, the proposal in part
requires an execution ultimately to be in terms of a "reasonable relationship" to the "best terms available" for such a swap on a DCM or SEF. While it is better to require absolute best execution, the requirements of this proposal are somewhat vague and may ultimately become another rule in the book only relied on in the most egregious circumstances. I am keeping my mind open, however, and look forward to reviewing the comments from a diverse population of Commission registrants who may ultimately be affected by this proposal.

In closing I'd like to thank dedicated staff who have worked night and day to preserve and make these changes in these rulemakings, and by all means do not interpret my views to mean you should never request a towel warming rack. However, in making your wish list please consider whether these items you choose are reasonable for the markets. Thank you.

CHAIRMAN GENSLER: Before I turn to Commissioner Chilton, I want to mention that I
know we're spending a lot of time together and
maybe there was an illusion that I was like your
daughter Macie or something, but I'm going to take
that as the glass is half-full because I know you
love your daughter Macie.

COMMISSIONER O'MALIA: I love all three
of my daughters.

CHAIRMAN GENSLE: If the Chairman is in
any way being alluded to in having a wish list at
least you're saying it in the context of your
daughter Macie so that I'm feeling good about
that.

COMMISSIONER O'MALIA: You should.

Thank you.

CHAIRMAN GENSLE: Thank you. We do
work well together even if we have a little bit
different view on what the statute says about
transparency and pretrade transparency. I'm going
to save my thoughts on swap execution facilities
until next week because I think that all of us are
really working with this statute. It's a very
detailed statute about swap execution facilities
and what it means to be made available for trading. In the proposal today because Commission O'Malia didn't mention it, when he mentioned these two tiers, there is a third tier in the proposal that anything that's a block trade, anything that's an end user out of those commercial end users, anything that's not made available for trading, would have been pretty much whatever the market wanted to use such as voice or limited requests for votes and things like that so that I as augmenting what you were saying. But I look forward to working with everybody throughout the next 7 days on it. Commissioner Chilton?

COMMISSIONER CHILTON: Thank you, Mister Chairman. For a couple of years I've been supporting position limits. We had the authority to impose those prior to Dodd-Frank but weren't able to get the support to do it and now we have the law, and we just had these new speculative data that I talked about yesterday in New York where we've seen more positions coming into markets than ever before and there is certainly
disagreement about the impact of speculators on prices, but any impact isn't acceptable. We've just seen gas prices raise 10 cents and crude is around $90 and raised $7 in 2 weeks. I read a quote in a local paper that said there's no reason that it's delinked from supply and demand. I'm not saying that it's speculators, but our job is to try and do what we can and now we have the law on our side on position limits and I'm pleased with that. All of us have seen it, and this is public information, large concentrations, we've seen more than 20 percent in the crude market at times, more than 20 percent concentration by single trader in gas, roughly 40 percent by an individual silver trader and these are issues that demand us to deal with. I had a proposal that I was going offer today as my colleagues know because I emailed them very late at night, but I really appreciate the Chairman's commitment to taking this up next week and looking at this in a slightly different way perhaps on the things that we can do expeditiously with regard to the spot
months swaps and then as soon as possible on the 
other months and on the aggregate months. It's an 
important proposal and I want to get it right. I 
appreciate some of the concerns that my colleagues 
have and quite frankly I have too about making a 
fulsome decision on what the levels are. A bad 
rule is not good. We want to have a good rule. 
So I appreciate the Chairman's commitment and I 
look forward to next week.

I did want to say just a brief thing on 
the SEFs. I was prepared to support the rule that 
we are considering. I did add some questions. I 
think Commissioner Dunn may have added some 
questions too. I want to make sure that we take 
into account both of the things that are in the 
law. One is promoting transparency as the 
Chairman has eloquently spoken about and I support 
it, but transparency isn't absolute and the other 
test, and it's not a secondary test, it's not a 
lesser test, but the other test in the law is to 
promote SEFs so I want to make sure that our 
proposal does that. I think the proposal as we
had it, the questions allowed us any flexibility that based on the comments that new could change it, but I look forward to taking it up next week and I think Reva and everybody else for their work on that and all the other rules today. Thanks very much again for your commitment, Mister Chairman.

CHAIRMAN GENSLER: Thank you to all my Commissioners and again for their commitment to getting this very important project for the market done and done well and done right. With that I'm going to hand it over to Ananda Radhakrishnan and Nancy Schnabel. Nancy, it's good to see you back here again. They're going to present an additional rule on governance and mostly it's regard to reporting on governance and there are some fitness standards provisions as well. Nancy and Ananda?

MS. SCHNABEL: Commissioners, Chairman, today staff is presenting the second rulemaking on governance and conflicts of interest which I really hope is not like a towel warming rack.
Before I start discussing the rulemaking, I wanted
to thank you and the Commissioners and staff for
very constructive comments. I would also like to
thank my team members for working very hard on
this rulemaking.

Back to the second rulemaking. The
second rulemaking further the conflicts of
interest core principles that each DCO, DCM and
SEF have. Additionally, the second rulemaking
implements core principles with respect to
governance fitness standards as you said and the
composition of governing boards for DCOs and DCMs,
and also diversity with respect to publicly listed
DCMs. On October 1, the Commission approved a
proposal proposing certain structural governance
requirements and certain limitations on ownership
of voting equity and exercise of voting rights.
These proposals were meant to implement Section
726 of the Dodd-Frank Act which requires the
Commission to promulgate certain rules to mitigate
conflicts of interest. Staff believes that the
notice of proposed rulemaking today will
complement any final rule that the Commission
contemplates adopting with respect to Section 726
of the Dodd-Frank Act.

First with respect to the conflicts of
interest core principles, these core principles
require a DCO, DCM or SEF to establish and enforce
rules to minimize conflicts of interest and to
establish a process for resolving conflicts of
interest. To further implement such core
principles, staff is proposing requirements on
reporting, maintenance of a regulatory program,
transparency and limitations on use of nonpublic
information. With respect to reporting, staff is
proposing to mandate that each DCO file a report
with the Commission whenever its board of
directors rejects a recommendation or supersedes
an action of its risk-management committee or
whenever its risk-management committee rejects a
recommendation or supersedes an action of its
risk-management subcommittee. And also staff is
recommending that each DCM or SEF file a report
with the Commission whenever its board of
directors rejects a recommendation or supersedes
an action of its regulatory oversight committee or
its membership or participation committee.

Further under reporting staff is proposing that
each DCM, DCO or SEF provide certain reporting on
the composition of its board of directors within
30 days after the election of its board of
directors, and also staff is proposing to require
that the regulatory oversight committee of each
DCM or SEF prepare an annual report assessing the
various components of the DCM or SEF regulatory
program and such a requirement generally parallels
current acceptable practices under DCM Core
Principle 15.

Moving on to the regulatory program
staff is proposing to require that as part of its
regulatory program each DCO, DCM or SEF establish,
maintain and enforce written procedures to
identify on an ongoing basis existing and
potential conflicts of interest and to make fair
and nonbiased decisions in the event of such a
conflict of interest. With respect to
transparency, staff is proposing to establish minimum standards for transparency of the governance arrangements of relevant DCOs, DCMs and SEFs, and transparency would be transparent to the public as well as to the Commission; that the minimum standards require each DCO, DCM or SEF to make available certain information to the public and relevant authorities with respect to governance such as charters, nominations process descriptions, identities of public directors, et cetera, and also ensure that the information that they make available is current, accurate, clear and readily accessible; finally, to disclose summaries of significant decisions. Significant decisions involve those areas in which conflicts of interest may be most manifest. With respect to a DCO or a SEF, significant decisions will relate to access, membership and disciplinary procedures. With respect to a DCO, significant decisions will relate to open access, membership and the finding of products acceptable or nonacceptable for clearing, and staff wants to make very clear that
they do not recommend and they do not require that
DCOs, DCMs or SEFs make public any nonpublic
information as that is defined within this
rulemaking.

We move to limitations on use of
nonpublic information so that each DCO, DCM or SEF
staff is recommending to establish and maintain
written policies and procedures on safeguarding
nonpublic information. These procedures and
policies must at a minimum preclude each
registered entities' members, directors, certain
officers and certain affiliates and also members
of the disciplinary committee and disciplinary
panel if there are not also members of the board
of directors to not disclose any nonpublic
information absent prior written consent.

Finally, staff believes that these written
policies and procedures are important because they
would prohibit those in positions of power at a
DCO, DCM or SEF from leveraging such power to
benefit themselves or to the detriment of their
competitors.
Second, in addition to implementing the conflicts of interest core principles, the rulemaking today implements certain core principles with respect to DCO or DCM governance fitness standards and composition of boards of directors or other governing bodies and the DCM core principle on diversity of certain boards of directors. With respect to governance fitness staff is proposing to require each DCO or DCM to specify and enforce fitness standards for its members, directors, members of any disciplinary panel or disciplinary committee, persons with direct access with certain affiliates and these proposals generally codify acceptable practices under current DCM Core Principle 14 and extends such practices to DCOs. And with respect to composition of boards of directors or other governing bodies, staff is proposing to require each DCM to design and institute a process for considering the range of opinions that market participants hold with respect to functioning of an existing market as well as new rules or rule
amendments. For DCOs staff is proposing two
alternatives, alternatives that the Commission
will adopt in its entirety rather than an
alternative that a DCO can choose in and of
itself. The first alternative is that the DCO
would be deemed in compliance with the core
principle on composition of the board of directors
or other governing bodies if it has 10-percent
customer representation on its risk-management
committee which is what staff had recommended on
October 1, 2010. The second alternative is they
would be deemed in compliance if they had
10-percent customer representation on their board
of directors. We are seeking public comment on
this proposal because this proposal would keep the
question open with respect to customer
representation until after the 180-day
implementation period for the first rulemaking.

CHAIRMAN GENSLER: Is there a motion on
the staff recommendation?

COMMISSIONER DUNN: Move to adopt the
recommendation.
COMMISSIONER SOMMERS: Second.

CHAIRMAN GENSLER: I support the proposed rulemaking. I will have one question on the last thing that you said. I think it builds upon a proposal that's out there and we're looking to try to finalizing that 180-day period of time. And importantly, it builds on reporting to regulators and a little of reporting to the public related to fitness standards. I had a question on the last point you just went through, Nancy, keeping the comment period past the 180 days.

Could you walk through that again?

MS. SCHNABEL: We're definitely going to adopt rules to implement Section 726 or I guess we hope to adopt rules.

CHAIRMAN GENSLER: You mean staff would be recommending.

MS. SCHNABEL: Exactly. What's what I meant. Those rules will have certain board compositions or staff will recommend perhaps that those rules will address board composition or other governing body composition. But with
respect to customer representation because we have received opposing comments, we're seeking more public input on this one specific issue and we intend to implement customer representation requirements if you all agree with the final rulemaking on the second rulemaking, so the final second governance rulemaking.

CHAIRMAN GENSLER: So that you're saying public please keep telling us about the customer representation piece, that the piece is in essence being cabined off a little bit?

MS. SCHNABEL: That's right.

CHAIRMAN GENSLER: I think I now understand it. Commissioner Dunn?

COMMISSIONER DUNN: I'm in agreement with this proposed regulation. I think staff has done a very good job on it. But I want to follow-up, and I know there is news out about appropriations and what we might be getting in that area and I thank you, Mister Chairman, for going to the Hill yesterday or was it the day before?
CHAIRMAN GENSLER: I seemed to be there many days. I can't remember all of them. I do thank the House of Representatives and what they've done, but we're not there yet, Commissioner Dunn.

COMMISSIONER DUNN: But it does bring me down to the fact that what we're asking is for DCOs to write a report on what they're doing on conflicts of interest concerns and I would like to know how the division is going to review that and what types of actions are going to be taken when we get these types of decisions.

MR. RADHAKRISHNAN: If all goes well and the Commission does get the appropriation that it seeks and if the hiring process goes as smoothly as we hope it does and we would be in a position to hire sufficient staff to look at these reports, and if we find that there are certain things wanting we'll of course go back to the DCOs to find out why it is they weren't able to comply fully with the aspects of the law. So I guess the answer is if we do get staff that we had asked for
then we'd be in a much better position to review these reports.

COMMISSIONER DUNN: Do you have a timeline in mind in which the division would review these reports as they've come in?

MR. RADHAKRISHNAN: The report is supposed to be annual?

MS. SCHNABEL: This one is whenever there is a conflict.

MR. RADHAKRISHNAN: Whenever there's a conflict. I can't predict when we'll get these reports because it's event specific if I'm not mistaken. But if you're asking how long it is we will take, it depends on the length of the report. Hopefully we can review reports I'd say within a week, but again it depends on what it is we get.

COMMISSIONER DUNN: It's too late. You said 1 week.

MR. RADHAKRISHNAN: I beg your pardon?

COMMISSIONER DUNN: I said it's too late. You said 1 week. I think it's very frustrating for somebody who says that they think
there has been an injustice and they go through the internal process and then they look at us as the court of last review on this and I think we owe it to them to try to get out and say we're going to respond in such a such a time and I think with a week you're shooting from the hip, but I do want to make sure that we have a mechanism set up within the division to review those in a timely manner.

MR. RADHAKRISHNAN: You're right. I'm shooting from the hip because I don't know what I'm going to get so that that is the issue.

CHAIRMAN GENSNER: You're estimating?

MR. RADHAKRISHNAN: I am estimating. I'm always conservative because I don't like to overpromise things to the Commission.

CHAIRMAN GENSNER: Commissioner Sommers?

COMMISSIONER SOMMERS: Thank you, Mister Chairman. Nancy, I have a couple of questions with regard to our coordination with other regulators not just domestically but internationally. In the preamble you talk about
certain elements that we have included from both
the European Commission proposal and CPSS-IOSCO
and if you could walk us through that.

MS. SCHNABEL: With respect to the
European Commission proposal, we took various
elements. One element would be the reporting
requirement that we just discussed which is
whenever there is an overrule by the board of the
risk-management committee then the CCP which is
the terminology that they use for DCOs under the
European Commission proposal would have to file a
report so that that is definitely one place. With
respect to CPSS-IOSCO, there are two different
CPSS-IOSCO principles. There are the ones that
are currently in effect and then there are the
ones that will hopefully become in effect next
year. The ones that are currently in effect with
respect to governance arrangements not require, I
would say suggest or recommend, greater
transparency and also clear organizational
structure so that we took some of those proposals
from CPSS-IOSCO with respect to transparency to
both the public and to the Commission.

COMMISSIONER SOMMERS: I want to clarify because I think I heard this when we were talking with the European Commission with regard to their proposals on this that conflicts of interest may be one area where we are not fully on the same page.

MS. SCHNABEL: That's correct.

COMMISSIONER SOMMERS: What about the SEC? Have they already proposed their entire conflicts-of-interest rules?

MS. SCHNABEL: They've proposed some of their conflicts-of-interest rules. I think that they have some requirements that may be coming up in their entity rulemaking such as the SEC rulemaking or their swap-based SEF rulemaking so that they're nearly done but not completely done.

COMMISSIONER SOMMERS: Are we consistent with what the SEC is doing?

MS. SCHNABEL: We are mainly consistent. There will be differences here and there, but we are consistent.
COMMISSIONER SOMMERS: Can you highlight any of the differences that you think are meaningful?

MS. SCHNABEL: I don't necessarily want to speak on behalf of the SEC and I'm not sure what part of our discussion is necessarily public. For instance, with this rulemaking some of the provisions here the SEC does not have similar core principles so that whether or not they're going to implement some other provisions this rulemaking in its entirety is unclear. But I really can't speak for them so that I think that those might be the areas where there would be some discrepancy.

COMMISSIONER SOMMERS: Thank you.

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

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

CHAIRMAN GENSLER: Commissioner O'Malia?

COMMISSIONER O'MALIA: It's a beautiful day. Nancy, I just have one question. The proposal requires that summaries of significant
decisions implicating the public interest, things like membership access and discipline which would include a rationale for the decisions and the process for reaching these decisions would be made available to the public. How are we going to protect appropriate business confidential or other items that should be held privately?

MS. SCHNABEL: I thought I took those two provisions out of the proposal because of questions that were raised with respect to protection of nonpublic information, but if somehow they were not taken out I will now take them out. We've inserted a provision that states that the requirement does not extend to nonpublic information that a DCO, DCM or SEF has.

CHAIRMAN GENSLER: I'd help out there to ask by unanimous consent if they're not out yet that they be taken out. Are there any objections? I'm not hearing any objection by U.C. just to make sure that you have the authority to take them out in case you hadn't.

COMMISSIONER O'MALIA: Thank you, Mister
Chairman, and thank you, Nancy, for your sensitivity to these issues.

CHAIRMAN GENSLER: Not hearing any further questions, I want to call the roll on the staff recommendation as possibly amended by the U.C., but you may have already done that. Dave Stawik?

MR. STAWIK: Commissioner O'Malia?

COMMISSIONER O'MALIA: Aye.

MR. STAWIK: Commissioner O'Malia, aye.

Commissioner Chilton?

COMMISSIONER CHILTON: Aye.

MR. STAWIK: Commissioner Chilton, aye.

Commissioner Sommers?

COMMISSIONER SOMMERS: Aye.

MR. STAWIK: Commissioner Sommers, aye.

Commissioner Dunn?

COMMISSIONER DUNN: Aye.

MR. STAWIK: Commissioner Dunn, aye.

Mister Chairman?

CHAIRMAN GENSLER: Aye.

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

CHAIRMAN GENSLER: Thank you. Thank you again Nancy and Ananda for your excellent work and we'll see you back in January when you're proposing something on the first final rule. Now we're moving on to the end user proposed rule and George Wilder from the Office of General Counsel. I don't know if somebody is coming up to the desk with you. Dan Berkovitz as well maybe. They will present rules related to end user exemption for mandatory clearing of swaps. As they're getting situated, Congress said that nonfinancial end users hedging or mitigating commercial risk would have a choice in that they get to decide whether to use a clearinghouse, and what we're hearing from staff on today is that proposal as well as Congress says we shall consider exemptions for smaller financial institutions of those less than $10 billion, farm credit institutions, credit unions and insured depository institutions with a list of questions to help us do that. George and Dan.
MR. WILDER: Let me begin by thanking each of you and your staffs, each of my teammates and each of our SEC staff colleagues. Everybody has been very helpful and I am very grateful.

I will address three topics, credit risk, commercial risk and financial entities. These three topics are key to understanding our proposal. First is credit risk. As you know, credit risk is handled differently for cleared and noncleared swap so that for noncleared swaps, 10 disclosures about meeting credit risk will be required. These are not burdensome disclosures under our proposal. We propose an easy-to-use system that uses a check-the-box approach that covers 10 items or boxes to check. These boxes ask whether a written credit support agreement is involved; whether pledged or segregate assets are involved; whether written third-party guarantee is involved; whether the end user will rely on its own resources; and whether other means of meeting credit risk are involved. There are also four identity questions, the identity of the electing
counterparty under the rule; whether a financial
entity is involved; whether a captive finance
affiliate is involved; and whether an SEC filer is
involved and if so whether the board approval
requirement has been met. There is also a tenth
question, whether the swap is being used to hedge
or mitigate commercial risk, and this leads me to
my second topic. Not all swaps are eligible for
the end user exception. Only swaps used to hedge
or mitigate commercial risk qualify. How does an
end user know whether its swaps qualify? We
provide guidance in our proposal. There are three
ways to qualify. If the swap is eligible for
hedge accounting treatment, it qualifies; if the
swap is eligible for a hedge exemption from
position limits it qualifies; and if the swap
reduces risk relating to the end users assets,
liabilities or services it qualifies.
In our proposal we also provide guidance
about which swaps do not qualify. Swaps used for
speculation, investing or trading do not qualify
for this exception. Nor do swaps used to hedge
another swap unless that first swap itself is used as a hedge. This leads me to my third and final topic, financial entities. As a general rule, financial entities cannot use the end user exception, but the Dodd-Frank Act permits the CFTC to consider whether to allow small financial institutions to use the end user exception. Accordingly, we propose that the Commission invite comment on its options here and how it should proceed.

Before closing, there is one more topic that I'd like to discuss. With what we propose here, our system uses reporting to SDRs as the end user's way to comply with the Dodd-Frank Act's requirement for notice regarding noncleared swaps so that the Commission's oversight and enforcement effort for end users will depend upon this SDR database. Thank you. That's all I have.

CHAIRMAN GENSLER: Thank you, George. Do I hear a motion on the staff recommendation?

COMMISSIONER DUNN: So moved.

COMMISSIONER SOMMERS: Second.
CHAIRMAN GENSLER: I support this proposed rulemaking on the end user exception. Congress decided that nonfinancial entities mitigating or hedging commercial risk will have a choice whether to submit their transactions through a clearinghouse. If they want to they can, if they don't want to they're out. The reason I support the rule is in essence this proposal says that if a company, a nonfinancial company, is using a swap to hedge an asset, a liability and input a service that it currently has or uses or even if it just anticipates having the asset, the liability of the input of the service and it's hedging that, it would qualify for the end user exception. It also says very specifically that this could be a currency risk, an interest rate risk or a physical commodity risk and so forth. In addition, if that wasn't clear enough, if does say that if the swap meets generally accepted accounting principles as a hedge or is used as a bona fide hedging which is under the Commodities and Exchange Act another
concept of hedging, the transaction would qualify for the end user exception but it's not reliant on a generally accepted accounting principle or a bona fide hedger, it's much more expansive again hedging an asset, liability input or service current or anticipated. Thus I think that it complies with congressional intent in terms of the nonfinancial entities. George also went through as he said 10 questions on credit risk and we're only doing that because Congress mandated that there had to be notification. Many people don't focus on that so that we've tried to make that a check-the-box approach to make it very straightforward for end users and that those could be just sent off to the swap data repository as I understand it.

I think these are very good. We do have in this proposal also something with regard to financial entities because Congress said we shall consider for those insured depository institutions, farm credit institutions and credit unions that are less than $10 billion exceptions
from the generalized rule that financials come in
and I know that some of my fellow Commissioners
had hoped that we would be very explicit and have
a proposal on that today, and if anybody is at
fault it's probably me where today I think we'll
be up to 36 rules. I suggested some time ago a
little bit more process to ask the public for some
help on this very important thing. I think
Congress was specific where they said we shall
consider it and we have a series of questions to
help us do that but it would be full anticipation
that sometime over the next I guess we have about
7 months to go here that we would be learning from
the public and taking that up as well. With that
I don't have any questions. Commissioner Dunn?
COMMISSIONER DUNN: Thank you, Mister Chairman. This has been probably one issue in
Dodd-Frank that we've heard more from folks lining
up to be exempted as an end user. We've had a lot
of them in our offices, we've received a lot of
information from them but not it really counts.
So for those folks who are concerned about the end
user exception, now is the time to get comments
in. What happens in the next 30 days on this is
extremely important.

I'd like to recognize George for the
important work that he did on the Hill in getting
this legislation out and I'm going to quote from
the Congressional Record of June 30, 2010, House
5246 page, and it's Mr. Holden from Pennsylvania
who engaged with a colloquy with Chairman Peterson
from the Agricultural Committee, and you'll
indulge me, Mister Chairman, I'd like to read that
colloquy and what led up to it. Mr. Holden says,
Over 20 years ago the Agricultural Committee put
in place a revised legislation and regulatory
regime for the Farm Credit System that has
successfully stood the test of time in ensuring
that these institutions operate safe and sound.
I'm very proud of that because I worked for
Chairman Leahy on that particular legislation, Bob
Cashdollar and my staff was my counterparty for
Mr. Jones over on the House side and it did work
well and I'm glad Mr. Holden recognized that. The
farm credit institutions are regulated and
examined by a fully empowered independent
regulatory agency, the Farm Credit Administration,
which has the authority to shut down and liquidate
a system or institution that is not financially
viable. In addition, the Farm Credit System is
the only GSE that has a self-funded insurance
program in place that was established to not only
protect investors and farm credit debt securities
against loss of principal and interest but also to
protect taxpayers. These are just a few of the
reasons why the Agricultural Committee insisted
that the institution of the Farm Credit System not
be subject to a number of provisions of this
legislation. They were not the cause of the
problem, did not utilize TARP funds and did not
engage in abusive subprime lending. We have
believed that this legislation should not do
anything to disrupt this record of success.
Mister Speaker, I would now like to enter into a
colloquy with the Chairman of the Agriculture
Committee. The conference report includes
comprise language that requires the Commodity Futures Trading Commission to consider exempting small banks, farm credit systems and credit unions from provisions requiring that all swaps be cleared. We understand that community banks, farm credit institutions and credit unions did not cause the financial crisis institution that precipitated this legislation. While the legislation places a special emphasis on institutions with less than $10 billion in assets, my reading of the language is that they should not in any way be viewed by the Commodity Futures Trading Commission as a limit on the size of the institution that should be considered for an exemption. Mister Chairman, would you concur with that? Mr. Peterson, yes, I full agree that the language says that institutions to be considered for exemption shall be included and include those with $10 billion or less in assets. It is not a firm standard. Some firms with larger assets could qualify while some with smaller assets may not. Regulators will have maximum flexibility
when looking at the risk portfolios of these institutions for consideration of an exemption.

We all know that legislative history and colloquy are not part of the statute per se, but we're driven by that because that's the intent of the Congress and that's what we ought to be looking at here. As I read that, that tells me that Congress thought that for small banks, for credit unions and farm credit institutions that $10 billion is not an absolute threshold and it confers upon us as regulators when making those decisions to talk to the NCUA for credit unions, to talk to the Farm Credit Administration for the farm credit systems, to find out exactly what is at stake and what risk these institutions have as we make these considerations. I would like to ask if that's the intent of what we have in this regulation and how we're going to be doing that.

MR. WILDER: Thank you, Commissioner.

Yes, it is. We have been in contact with the Farm Credit Administration, we've been in contact with the NCUA and other regulators around town so that
you're absolutely right that that's what Congress had in mind and we're hoping to hear what industry has to say and help us through this because there are some issues as you know among the different categories of financial institutions that are going to be challenging. That's why we've taken a cautious approach here and are looking forward to hearing more.

CHAIRMAN GENSLER: Thank you, Commissioner Dunn. I fully hope and even expect that we will hear from the public and I think it will help inform this Commission so that, yes, it may be a cautious view but I think it will be very helpful to hear from the public on this set of questions. Commissioner Sommers?

COMMISSIONER SOMMERS: Thank you, Mister Chairman. I want to follow-up with some specific questions on this same area and clarify that in the statute although there is this $10 billion or less, that the statute says including institutions that are $10 billion or less. In the colloquy Mr. Holden points out that he though that that gave us
the flexibility to include institutions that were above $10 billion. Where do you believe or what criteria should be in a risk profile that we look at to decide whether or not an institution that has more than $10 billion that would qualify and an institution that has less would not?

MR. WILDER: There is probably going to have to be some consideration of credit risk, risk to capital, a percentage of capital perhaps that is related to the exposure that the institution has to its swaps. Some of these institutions are large asset-wise but they're really not that big in terms of their swap activity so that it means that the asset test may not be the best way to go. We also have to be somewhat concerned I think about having some measure of parity amongst the four categories of institutions that are covered by this rule. Congress did say it not once, not twice but three times that they were suggesting the asset-based test for each category so that there may be a message there. But you're right on target that Congress recognized this problem and
they've directed us to solve it and there are
solutions there. We just need to be able to build
a record to support what we do.

COMMISSIONER SOMMERS: What do you think
are the challenges in us figuring out what the
solutions are?

MR. WILDER: I think that we need to
recognize that the four categories compete with
each other particularly say for ag lending so that
we need to be careful about not being perceived as
tipping a balance for those markets. We need to
take into consideration antitrust concerns here on
the Commodity Exchange Act. That's not an
insurmountable problem. I think that actually
there is probably a good solution to this but it's
going to require us to build a record, an
administrative record, that will support what we
do.

COMMISSIONER SOMMERS: Because all we do
in this proposal is ask questions and we don't set
up a proposed framework for how we would have a
solution to this, does that preclude us from being
able to include a framework for exemptions in a
final rule because this seems to be more like an
ANPR to me on this particular issue, so then are
we going to have to go out with another proposal
with regard to this?

MR. WILDER: That's a good observation
and you're right, there is a problem if the
Commission feels that it wants to go to a final
rule that it won't be able to do that at this
point. But there are options. The Commission has
options here. There is the possibility of issuing
an order and there are several ways the Commission
could issue an order here. The Commission may
very well issue an order without taking further
comments in the Federal Register. That's a
possibility. It's not like we're foreclosing.

You're not foreclosing yourself by just asking for
comments at this point. There's flexibility.

COMMISSIONER SOMMERS: I would say that
I think this is a good rule and I think you've
done a great job except for these provisions and I
fear that by delaying getting comment on a
particular solution for this delaying going final
with a process for exemption may have a lot of
untended consequences and may actually go against
congressional intent. Thanks, George.

MR. WILDER: Thank you.

CHAIRMAN GENSLER: Commissioner Chilton?

COMMISSIONER CHILTON: I just have a
quick comment. George, I think you and your team
have done a really good job and I thank you. I've
talked a little bit about this before generically
when I've said that a lot of people who have come
in and have met with us want the line for
regulation to begin right after them. In this
case if they want to be included the line is long
and in some cases it's sort of laughable who's
requested this. I don't want to make light of it
saying it's laughable, but we've had hedge funds
in here that have said their end users -- I even
had somebody suggest that in ETFs since they are
the natural counterparty to some of the end users
needed to be included in this. So some of these
requests while you want to take them seriously
quite frankly don't pass the smirk test. I think that you've done a really good job here to strike a reasonable balance. I'm not suggesting that it can't be improved, that we won't get some additional comments that will be helpful, but I thank you and your team for your good work.

MR. WILDER: Thank you.

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

COMMISSIONER O'MALIA: George, let me add to the chorus. This is a great rule except for one item.

MR. WILDER: One little thing.

COMMISSIONER O'MALIA: Yes.

Unfortunately with regard to the farm credit system I think we've missed it by a country mile.

MR. WILDER: You're right.

COMMISSIONER O'MALIA: I think every Commissioner has mentioned it, the $10 billion.

Commissioner Dunn obviously raised it and Commission Sommers as well. Last night at 7 o'clock which may be late for dinner when you sent
around a new question on this issue, it really
isn't late in terms of rulemaking. This is early
for a 7 o'clock change. But I think in the
question though you left out three important
words. It says in Section 2(h)(7)(ii), Congress
directed the Commission to consider exempting
depository institutions, farm credit institutions
and credit unions with total assets less than $10
billion. But when you go to the Act it says
including such entities. That makes a big
difference obviously in who we're considering in
this question or who should respond in the nature
of the question. Can we put in including such
entities back into the question so that it's more
consistent with the statute?

MR. WILDER: We are asking this question
whether there are measures other than $10 billion
in assets so that we're not only asking here in
terms of perhaps going above $10 billion, but
we're also asking are there different tests that
we could use so that I think this question is
consistent with what Congress intended.
COMMISSIONER O'MALIA: Why don't we put their words back in our question?

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

CHAIRMAN GENSLER: What are the words?

COMMISSIONER O'MALIA: Including such entities, straight from the statute.

CHAIRMAN GENSLER: Including such entities. Will we get closer to your country mile then, Commissioner O'Malia?

COMMISSIONER O'MALIA: We're within a country mile then.

CHAIRMAN GENSLER: What is the wording?

COMMISSIONER O'MALIA: Including such entities.

CHAIRMAN GENSLER: I'm asking for unanimous consent to include those three words in the question that came around at 7 o'clock last night. Was it three words?

COMMISSIONER O'MALIA: Yes.

CHAIRMAN GENSLER: Not hearing any objections, we've included those three words.

COMMISSIONER O'MALIA: Thank you.
Obviously my colleagues have covered the ground on this one and I appreciate the great rulemaking. I'm not proposing it, but what do you think about maybe a staff roundtable on this issue since we're starting from scratch would be a good idea?

MR. WILDER: You're asking me?

COMMISSIONER O'MALIA: I was just kind of putting it out there.

MR. WILDER: Sure. That's a possibility.

CHAIRMAN GENSLER: At the end of the day there are going to be rules that come out on this small bank, small farm credit, small credit union provision. I don't think we should necessarily delay. I think actually we are building a constructive administrative record. I think as the Commission we owe that to the rulemaking process. And as Commissioner Chilton has said, there has been a long list of people who have come in and said we're really not what Congress intended when they wrote that and then you can fill in swap execution facility, swap dealer,
major swap participant, almost anything in there. And you can look on our website because we publicly posted the 500 meetings, but it's a good assumption that a large percentage of those are coming in to say we're not what Congress intended so that this area where Congress actually said we shall consider exempting these financial institutions from an otherwise financial institution definition, and I will own up and I am proud of this decision to build an administrative record. This may be a bit more cautious than Commissioner Sommers would want, but I think it is something that's incumbent upon this Commission to do well and do something that's sustainable in the courts after we do it.

MR. BERKOVITZ: Mister Chairman, if I could add a clarification. The language in the proposal was a slight paraphrasing of the statutory language, but if you put in institutions including, we also had taken out the description of the banks as small banks and small institutions so that we may want to parallel the exact phrasing
in the statute.

CHAIRMAN GENSLER: Is that all right with you, Commissioner O'Malia? So that we'll consider that a technical cleanup.

MR. BER Kovitz: Correct.

CHAIRMAN GENSLER: Thanks. If there are no further questions, Dave Stawik, please call the roll.

MR. STAWIK: Commissioner O'Malia?

COMMISSIONER O'MALIA: No.

MR. STAWIK: Commissioner O'Malia, no.

Commissioner Chilton?

COMMISSIONER CHILTON: Aye.

MR. STAWIK: Commissioner Chilton, aye.

Commissioner Sommers?

COMMISSIONER SOMMERS: No.

MR. STAWIK: Commissioner Sommers, no.

Commissioner Dunn?

COMMISSIONER DUNN: Aye.

MR. STAWIK: Commissioner Dunn, aye.

Mister Chairman?

CHAIRMAN GENSLER: Aye.
MR. STAWIK: Mister Chairman, aye.
Mister Chairman, on this question the ayes are
three and the nays are two.

CHAIRMAN GENSLER: Thank you, George and
teach you, Dan. We'll see you back. Now we're
moving to the notice of proposed rule making and
staff's presentation on business conduct standards
for counterparties or what we have sometimes
called on our website and elsewhere external
business conduct standards which are very
important to protect the public. I'm filling a
little time here for the public as people are
coming in. The Congress clearly gave the SEC and
the CFTC authority to set business conduct
standards to protect against fraud, manipulation
and other potential abuses, to promote market
integrity and importantly promote a system of
sales practices to protect counterparties. We're
going to hear from Phyllis Cela who is the team
lead and is also our Deputy Director of the
Division of Enforcement, Vince McGonagle who is
our Acting Head of Enforcement, Peter Sanchez who
is ever present on the team and then Ananda Radhakrishnan who heads up our Division of Clearing and Intermediary Oversight is also back for yet another cameo. Phyllis?

MS. CELA: Thank you very much. Good morning, Mister Chairman and Commissioners.

Before presenting an overview of the proposed rules, I really would like to thank the Commission and its staff for your support and guidance during the rulemaking process, and in particular Tim Karpoff for his wise counsel. I also would like to thank my team.

CHAIRMAN GENSLER: Here's Tim. Do you want to tell him in person again?

MS. CELA: Your wise counsel. You missed it. I want to thank my team, Pete Sanchez, Katie Driscoll, Ted Neller, Barry McCardy, Michael Salinski, Russ Petalia, Vivette Jane, John Doland, Todd Pronost and Stephanie Horn. We have worked closely with our counterparts at the SEC and I would like to acknowledge Lordes Gonzalez, the team leader there and her team.
In the course of preparing the proposed rules we received very helpful advice from numerous stakeholders through letters and consultations and also from staff and fellow regulators at the OCC, Fed, the Department of Labor, the European Commission and the U.K. FSA. This has been truly a collaborative effort which has resulted in the recommendations that we are making today.

Section 731 of the Dodd-Frank Act adds Section 4(s)(H) to the Commodity Exchange Act and requires the Commission to promulgate rules to establish business conduct standards for swap dealers and major swap participants dealing with counterparties generally. In addition, Dodd-Frank empowers the Commission to promulgate rules to implement specific protections for special entities like state and municipal governments. The proposed rules will principally apply to swap dealers and major swap participants when they know their counterparty before entering into a swap. Often there will be uncleared bilateral swaps.
The disclosure and due diligence requirements will not apply to swaps initiated on a designated contract market or swap execution facility where the swap dealer or major swap participant does not know the identity of the counterparty prior to execution. In addition, where both counterparties or swap dealers, major swap participants, security-based swap dealers or major security-based swap participants, the disclosure and due diligence obligations will not apply.

Generally speaking there are three groups of proposed rules, the general provisions, the duties that relate to dealings with all types of counterparties, and conduct rules that apply to dealings with special entities. The general provisions include requirements to have policies and procedures, diligence supervision and record retention related to the business conduct standards. They also address acceptable means of complying with the new requirements. The general provisions contain prohibitions against fraud, manipulation and abusive practices. The antifraud
provision incorporates the statutory text from new Section 4(s)(H)(iv) which applies to swap dealers and major swap participants and prohibits fraudulent, deceptive and manipulative practices. These proposed rules also prohibit disclosure of material, confidential counterparty information and trading ahead and front running of counterparty swap transactions. Coupled with the proposed internal business conduct rules requiring codes of ethics and information barriers, these rules are intended to protect counterparties from abuse by swap dealers and major swap participants including undermining the interests of counterparties by misappropriating their trading opportunities.

The second group contains disclosure and due diligence requirements for dealings with counterparties generally. It begins with the duty to verify that the counterparty is an eligible contract participant and to determine whether a counterparty is a special entity. It continues with the duty to disclose the material risks and
characteristics of the swap and the material
incentives and conflicts of interest of the
participant dealer or major swap participant in
connection with the swap. As part of the duty to
disclose material risks, SDs and MSPs would be
required to provide a scenario analysis for all
high-risk, complex bilateral swaps. For bilateral
swaps that are not available for trading on a swap
execution facility or a designated contract
market, counterparties would be able to opt in to
require a scenario analysis from the SD or MSP.

For uncleared swaps, there is the duty
to disclose the daily mark which is defined as the
mid-market value of the swap, and the duty to
notify a counterparty of the right to clear, that
is, a swap that is exempt from mandatory clearing,
and to select the DCO. Under the proposed rules,
SDs and MSPs would also have a duty of fair
dealing and good faith and would be required to
communicate in a fair and balanced manner. In
this regard there is also an institutional
suitability obligation when swap dealers or major
swap participants make recommendations to counterparties.

The third group of rules applies to dealings with special entities. The statute requires that swap dealers that act as advisers to special entities must act in the best interests of the special entity and make reasonable efforts to obtain information necessary to ensure that their recommendations are in the special entity's best interests. The proposed rules adopt the statutory text and clarify that acts as an adviser to a special entity includes recommending a swap. The legislative history of Sections 4(s)(H)(iv) and (v) indicates that swap dealers should be able to continue to recommend a swap to a special entity and then enter into the same swap as a counterparty. For the statute and proposed rule to operate this way, the best interest duty would have to be interpreted to allow principal transactions between an adviser and its counterparty. Looking to case law, the best interest standard would require the adviser to put
the client's interests first by acting in good faith and making full and fair disclosure of all material facts and conflicts of interest and employing reasonable care that any recommendation is designed to further the purposes of the special entity. It would not bar principal transactions per se where the conflicts are properly disclosed and the counterparty consents.

When acting as a counterparty to a special entity, swap dealers and major swap participants will have the duty to ensure that the special entity has a representative either in-house or external who is independent of the swap dealer or major swap participant and who satisfied certain other criteria including that the representative acts in the best interests of the special entity. When dealing with ERISA plans there will be an additional duty to verify that the plan has a representative that is an ERISA fiduciary, and when dealing with a municipal entity that there will be an additional duty to verify that the municipality has a representative
that is subject to restrictions on certain political contributions or pay-to-play restrictions. Swap dealers and major participants also would be subject to pay-to-play restrictions when dealing with municipal entities. This rule is similar to existing rules for investment advisers and municipal securities dealers.

Finally, the proposed rules would require registered Commission intermediaries that handle customer orders for swaps that are available for trading on a swap execution facility or designated contract market to execute such orders on terms that are reasonably related to the best terms available. Thank you and I look forward to your comments and questions.

CHAIRMAN GENSLER: The Chair will entertain a motion on the staff recommendation on external business conduct standards.

COMMISSIONER DUNN: So moved.

COMMISSIONER SOMMERS: Second.

CHAIRMAN GENSLER: Thank you so much, Phyllis and everybody on the team. I know there
has been a lot of work that's gone in over the
last number of months and a lot of consultation
and I'm glad that you listed it. We shared as I
understand it drafts of this as it was coming
through with the SEC and the federal banking
regulators. Is that correct?

MS. CELA: All of them, yes.

CHAIRMAN GENSLER: You incorporated as
best you could their comments?

MS. CELA: We did. It was very helpful
and we did.

CHAIRMAN GENSLER: Also my thanks to
fellow regulators across this town, and you said
internationally, that you got comments from London
and Brussels.

MS. CELA: Absolutely. We sent term
sheets abroad and had very detailed exchanges.

CHAIRMAN GENSLER: I support the
proposed rulemaking to establish business conduct
standards for swap dealers and major swap
participants in their dealings with
counterparties. I think this is one of the
critical features of what Congress did in the statute, that there would be the promotion of the integrity of the markets in this way. Today's proposal implements those authorities that Congress asked us to do, to enforce robust sales practices in the swap markets and the rules will level the playing field and bring I think some needed transparency. There is even one transparency piece here, it's like the towel rack, but Congress did this one, which in the form of a question but I want to make sure I understand it, that if you're in a bilateral relationship because it's a customized swap or you're an end user that happens to decide not to use a clearinghouse, you can get a daily mid-market mark to market on valuation. Is that correct?

MS. CELA: That is correct.

CHAIRMAN GENSLER: That I think is a very positive thing to end users that Congress did and that we're incorporating in this rule that every day you get a chance to have that valuation directly and it's supposed to be mid-market. I
think it will strengthen the confidence in the markets. The proposed rules also prohibit fraud and certain other abusive practices. It would implement requirements for swap dealers to deal fairly with customers providing balanced communications and disclose conflicts of interest and material incentives before entering into the swaps. And the rule also would implement the Dodd-Frank heightened duties on the dealers when they deal with certain entities, what are called special entities. Am I correct that that's largely municipalities and pension plans?

MS. CELA: And endowments.

CHAIRMAN GENSLER: And endowments.

Thank you. With regard to these entities, the municipalities, pension plans and endowments, the proposed rules include higher standards than Congress wanted and as Phyllis said also it has a restriction on certain political contributions to municipal officers by the dealers, similar to the pay-to-play restrictions that the SEC has and you've tailored off of those restrictions. Is
that right?

MS. CELA: We did. We copied.

CHAIRMAN GENSLER: Plagiarism was allowed for now. It might not be plagiarized once the public comments and we may decide to change it.

MS. CELA: That's always possible.

CHAIRMAN GENSLER: The proposed rule is intended to ensure that swaps customers get fair treatment in the execution of their transactions and would require dealers to disclose what access they have to swap execution facilities so that as I understand it whether it's an end user like the commercial end users we talked about or financials, that the dealer would have to tell them there are these things called trading platforms and SEFs and so forth. Is that correct?

MS. CELA: That's correct. It's a two-piece disclosure so that you disclose where the swap is trading and which markets you have access to as a dealer.

CHAIRMAN GENSLER: So that if it's a
commercial end user that has a choice whether to
use a swap execution facility, they keep that
choice but they at least get some disclosure. Is
that correct?

MS. CELA: That is correct.

CHAIRMAN GENSLER: Then the rules
prohibit the dealers from defrauding a customer by
executing a transaction on terms that have no
reasonable relationship to the market. This may
be something that's very important to hear from
the public on, it may be something that doesn't
happen often, but at least as I understand it
includes that as well.

MR. CELA: It does. It's grounded in
concepts of fair dealing and antifraud and it
derives from the principal agent relationship in
the case law and has been articulated as a
reasonable relationship test.

CHAIRMAN GENSLER: I also think the
proposal asked a series of very important
questions. I commend Commissioner Dunn who worked
on a lot of these in terms of the counterparty
relationship and the adviser relationship and how
the two square in this bilateral world. Is that
right?

       MS. CELA: That is correct. It is a
complicated situation that Congress has addressed
in a way through a disclosure regime. That
disclosure regime actually derives from case law
beginning with the Supreme Court case in the
capital gains are in the mid-1960s which talks
about when you have an adviser relationship with a
client, disclosure and consent to disclosure is
very material and particular disclosures is the
way to put sunshine on the situation and try to
mitigate the situation.

       CHAIRMAN GENSLER: Can you, Phyllis,
tell us how this proposal defines adviser?

       MS. CELA: Adviser here would have its
meaning as adviser under the CTA definition, but
what we've done here is to particularly say that
when you make a recommendation as you would if you
were a commodity trading adviser, if you make a
particularized recommendation to a special entity
that would put you in the adviser box and obligate you to operate on a best interest standard of care.

CHAIRMAN GENSLER: So that if you make as you call it a particularized recommendation as opposed to a general the markets are going up. It's not like that.

MS. CELA: There is a carve-out. We thought it was important not to interfere where interference was unhelpful and not necessary. We were told that when there is general market information provided to a counterparty, that should certainly not be considered advising, or when a counterparty comes to receive terms on a request basis for a transaction from a swap dealer, whatever terms that the swap dealer would provide shouldn't be considered to be advice to that counterparty.

CHAIRMAN GENSLER: But where they're actually structuring a deal and so many of these dealers have structuring desks and they're working to structure something over days or maybe weeks,
then that would be particular advice?

MS. CELA: That would certainly seem to be particular advice. This isn't the first time that the law has considered what constitutes making a recommendation. Our own CTA case law, the CTS decision one and of course on the investment adviser side on for the SEC as well as under FINRA case law, there is a fairly substantial body of law to provide guidance on what does constitute a recommendation in the circumstance. The circumstance that you just described seems to me to be one that would fall cleanly within.

CHAIRMAN GENSLER: I thank you again and I very much look forward to the public's comments in this area. It's a very important area.

Commissioner Dunn?

COMMISSIONER DUNN: Thank you, Mister Chairman, and I thank staff for indulging me and I think this falls within a fiduciary responsibility
and at one point that was in the proposed statute. It wasn't in the final statute although in reading it I think Congress gives us the authority to require that if possible, but that may be just one of five opinions here.

Having said all that, I feel that there is an inherent conflict of interest from somebody who is both an adviser and a counterpartner and it goes against logic to say, no, there's not. Are you satisfied that what we're doing here will mitigate that conflicts of interest?

MS. CELA: Yes. I feel like what the proposed rule does and what Dodd-Frank does is acknowledge the conflict. It doesn't ignore the conflict or hide it or somehow put it under the rug. It says there is an issue here that needs to be addressed and the way the Congress addresses it is to impose this higher duty of care, this best interest standard for the adviser in dealing with certainly the special entity. What helps in this regard I believe is in order to enter into a transaction with a counterparty, that special
entity counterparty will have to have its own
independent representative and it too will have to
operate in the best interests of that special
entity. So I think it is certainly possible for
the special entity to be looking to its own
independent representative for reliance purposes
and to evaluate the recommendation that's coming
from the swap dealer who would be acting both as
the adviser and the counterparty. With that
additional protection in that circumstance,
Commissioner, I appreciate very much your concern.
We have it as well. Particularly as an
enforcement person I worry about things like that.
I think we've gone a fair distance to mitigating
as you say. You can't eliminate the conflict.
You can shed light on it and bring it to the open
and the parties can make judgments.

COMMISSIONER DUNN: You indicated and
the Chairman just elaborated on the fact that
we're looking at the current body of law as we go
through here and that suggests to me that this is
not static, that it's dynamic and that as case law
changes, this may change as well. My question to
you as an enforcer, how do we enforce this and how
do we push the boundaries of case law as we're
going through this to come down on the side of the
individuals?

       MS. CELA: I think we were given some
tools we didn't have before. We certainly have a
lot of tools. We had no tools before with respect
to this particular relationship between a swap
dealer and the counterparty. It was on the bus.
What Congress did was impose very particular due
diligence requirements around certification of the
appropriateness of counterparty in the first
instance and then a very robust disclosure regime.
What we've done here is really incorporating the
very robust language from the statute so that from
an enforcement standpoint it's the tripwire to
fraud. If you haven't made the disclosures the
risk is with respect to fraud, but making the
disclosures or failing to make the disclosures
themselves would be effective enforcement so that
in that context robust compliance and an audit
program would be very helpful in ensuring that the
business is going on in a way that would mitigate
those conflicts that you're concerned about and we
are too.

COMMISSIONER DUNN: Is the division
contemplating developing that type of audit group
to go out and look at this?

MS. CELA: That's why I invited Mr.
Radhakrishnan to the table today.

MR. RADHAKRISHNAN: In fact, depending
on how the Commission structures the agency, staff
is contemplating structuring an audit group to
look at swap dealers. Of course, everything is a
function of resources so if we get what we ask for
and we get it in time, then we can do it. Notice
I said get it in time as well because getting
money 2 to 3 years from now is going to help us.

COMMISSIONER DUNN: Is the entity that
the dealers register with going to have a duty
here as well?

MR. RADHAKRISHNAN: Commissioner, as the
Commission asked the question in the registration
rulemaking, the issue is always should we do it or should the NFA do it because I think in that rulemaking the Commission proposed that all swap dealers and MSPs have to register with the NFA. I don't know the answer to that. The answer would be a balance between us. I don't speak for the NFA, but I'm not sure that they will members and not look at them. But as to whether we do it I think is a function of resources and also of course what the Commission decides we should do.

COMMISSIONER DUNN: I would hate to think that the public thinks we're doing a regulation out here with no follow-up or with no police on the job.

MR. RADHAKRISHNAN: I agree with you. And I'm just guessing in that if the Commission doesn't get the resources I suspect that the NFA will do it, but I hope that we get the resources just so that the Commission's staff and the Commission itself gets a familiarity with how we implement these regulations.

COMMISSIONER DUNN: Phyllis, you had
indicated that you had talked with other agencies. How do our rules here compare with what the SEC does? Is there a difference and why?

MS. CELA: Let me say that my counterpart team at the SEC got a reprieve. They were supposed to be considered yesterday but won't be heard until next week.

CHAIRMAN GENSLER: A little like the SEF team. We're not the only ones who are human.

MS. CELA: I really can't tell you what will come of it. What I can say is that in the course of staff consultation and give and take, the rules are very close. There are some things that they are taking up in different work streams. There are some things that they already have in some ways that we don't have. An execution standard is something a little bit like that. Their antifraud rules may or may not be included for example in this rulemaking, more likely if at all in a subsequent rulemaking. But I would say that with respect to the disclosures, we are virtually the same and the due diligence
requirements and our treatment of special entities
is very, very close or at least to be recommended
to be very close. What makes it through on both
sides is of course up to you.

COMMISSIONER DUNN: To echo the
Chairman, I think this is one of the key
components of Dodd-Frank to ensure that we don't
have a financial meltdown in the future and that
people aren't taken advantage of. This is a point
in time where we need to have in my opinion very,
very strong conduct standards, we need to have
standards that are fair to everyone, but they also
have to be workable for the industry out there so
that I am really am looking forward to see the
types of comments that we get on this particular
concept of standards. I also note that some of
the things that you took in here are based on best
practices within the industry and that connotes to
me that that also is a dynamic thing that may
transpire in the future and so this is something
that I think staff and the Commission ought to
look at based on what happened in case law, what
happens in industry standards and best practices out there, that we on an ongoing basis review this so that we can be in front and not behind.

CHAIRMAN GENSLER: Thank you, Commissioner Dunn. Before I turn to Commissioner Sommers, on the resource question and this might be for Dan Berkovitz or Phyllis, I can't find the provision, is it not also the case that if a swap dealer is regulated as a bank or regulated by others, it could be a registered broker dealer, that the Federal Reserve and the bank regulators or the SEC also can examine this and the relationship as to show they can refer cases if there is an issue? Do I have that correct?

MS. CELA: The short answer is they are frontline regulators for the same entities and can look at practices by those entities.

CHAIRMAN GENSLER: If for some reason we don't get the resources as Ananda said, there are still the bank regulators or somebody else who can examine this and be as you call it the frontline regulators statutorily and they might have to
refer a case?

MR. BERKOVITZ: Correct. They could refer the case to us. We still be the primary enforcement authority, but they could refer it to us and provide us with information certainly.

CHAIRMAN GENSLER: It's another avenue. I'm thinking about this resource issue.

MS. CELA: What I wanted to say is keeping that in mind, we made the books and records that would be kept with respect to compliance with these rules available to appropriate prudential regulators so that there should be no artificial barrier to their access to the information.

CHAIRMAN GENSLER: Thank you. I'm sorry. Commissioner Sommers?

COMMISSIONER SOMMERS: Thank you, Mister Chairman. I want to commend Phyllis and Peter and your whole team. I think that this really has turned out to be a reasonable rule and based on a lot of what Commissioner Dunn said, best practices that are in the industry and I appreciate your
tolerance for numerous comments from myself and
from my office and the challenges that you had
because a lot of the rule was not very flexible so
you were working with what you had with words on
the paper. I want to make a comment on one of my
concerns in the rule that started as best
execution and has ended up as an execution
standard that ensures that the swap is executed on
terms that have a reasonable relationship to the
best terms available. I would suggest that there
seems to be or my fear is that there seems to be
this impression that counterparties have no idea
what the fair price in the market is. If there
are dealers out there who are executing swaps that
have no relationship to a reasonable price in the
market, that their customers are not going to be
their customers for very long so I think that this
provision may be a solution to a problem that
doesn't exist. I would ask like Commissioner Dunn
that I think this is one provision in this rule
that I would specifically ask for comment on
whether it's necessary and whether or not we are
overreaching in this area. Thank you.

CHAIRMAN GENSLER: Thank you,

Commissioner Sommers. Commissioner Chilton?

COMMISSIONER CHILTON: Thank you, Mister Chairman. I wanted to thank Phyllis for the proposal with regard to alerting the best execution rule to ensure that there are reasonable executions. I thank you for that. I see that Mark Young is here and he brought in a group of pension funds a while back probably not with all of us but I found it very helpful to listen to them. I know that they had some concerns and that you had subsequently had some conversations with the Department of Labor. Could you share a little bit of those conversations with us to sort of elucidate folks?

MS. CELA: I need to be careful. We had informal staff consultations so that the same way that if one of them had called me, nothing that I would say could bind Labor or you or anything else. We wanted to take up with them to get a better understanding of what the regulatory scheme
was. We were quite concerned based on what was being said to us that there was a concern about potential inconsistency with ERISA law or some duplication in Dodd-Frank with respect to what ERISA requires. Ultimately we had shared with Department of Labor staff the draft.

COMMISSIONER CHILTON: Phyllis quickly, the pension funds that ERISA requires this whole litany of things that they're already required to do, therefore maybe we didn't need to have a litany of things ourselves. Maybe it was duplicative perhaps so that was the issue.

MS. CELA: That was the issue, and so having gotten the very informal advice from the Department of Labor we felt that it was important that we go forward in the way that the Commission would interpret the provision to say that ERISA plans would be treated like other special entities but there were some changes to the specific statutory criteria to take account of concerns about particular compliance that they would have and we asked questions. We think it requires a
fuller record for us to make a judgment one way or another, and as I say on a very informal basis we were told that there were no concerns by staff about the approach that we were recommending to our Commission.

COMMISSIONER CHILTON: So that we are welcoming comments on this and we know Mr. Young is a prolific writer of letters and that others will write to us too.

MS. CELA: That's right. We expect to be pen pals.

COMMISSIONER CHILTON: Thank you.

CHAIRMAN GENSLER: Such a shout out.

Commissioner O'Malia?

COMMISSIONER O'MALIA: Who is Mark Young?

CHAIRMAN GENSLER: I don't know. Do you want him to stand up?

COMMISSIONER O'MALIA: No. Phyllis, my compliments, Peter and the whole team. For everybody watching, this is the rule for the little guy and maybe they haven't paid attention
and gone through end user priorities and there are
different provisions in the statute for the little
guy, but this is something they need to look at
and it's in Section 731(h), Business Conduct
Standards. It's a balancing act and Commissioner
Dunn's points are well taken that it has to be a
workable rule, but this does provide a new
authority protections for the little guy and it's
an important rule.

I have a couple of questions. Part
23.431 requires disclosure of material information
including material incentives and conflicts of
interest that a swap Dodd-Frank or an MSP may have
in connection with a particular swap including
incentives from any source other than a
counterparty. My question is what kinds of
incentives does staff think ought to be disclosed
under this provision and would that include
clearing incentives?

MS. CELA: I think as a general matter
it's understood that when swap dealers enter into
transactions they're earning a profit so that
that's not particularly helpful as a disclosure,
but what would be more interesting I think is if
the swap dealer is receiving some kind of
compensation from a third party unknown to the
counterparty. That might make a difference in the
nature of the transaction that will take place so
that we specifically indicate in there any
compensation that's received from a third party
would be the type we'd be thinking of in
particular.

COMMISSIONER O'MALIA: Do you think this
is a type of thing that will affect counterparty
decision making?

MS. CELA: I hope so. I hope it's
meaningful and I hope people where that would be
meaningful disclosure to them, for whatever reason
they would act on it.

COMMISSIONER O'MALIA: Will you
elaborate on the differences between the proposed
suitability requirements for swap dealers and MSPs
and the NFA's know-your-customer duties?

MS. CELA: That's a very good question,
Commissioner, and it's a very close issue. Know your customer is the standard and actually I saw Dan Roth before so that if I get it wrong I'm sure he'll speak up.

CHAIRMAN GENSLER: For the public, Dan Roth is not Mark Young.

MS. CELA: No.

CHAIRMAN GENSLER: He runs the NFA which is the self-regulatory organization in the futures area.

MS. CELA: Right. Know your customer is a concept that comes out of the SRO world and is intended to take a look at if I understand it correctly the qualifications of a customer to trade generally. The futures market has looked at risk disclosure and has looked at qualification of customers in a fairly generic way because of the nature of our products. Our products have been generic and they've been traded on exchange in a customized fashion and so that know your customer has worked in that environment and I know that NFA has worked very hard to make sure that it's a
robust screening or evaluation standard. But when you get into the kinds of products that are possible in the swaps world that do have differences in risk-reward profiles, then it feels like a more transaction-based rule that could have some application and may be effective in providing some additional due diligence so that what a suitability rule would do is look at recommendations to counterparties and on a transaction basis you're looking at a type of swap or a particular swap and you'd have to assess suitable in that way, a small difference but a difference nevertheless from know your customer.

COMMISSIONER O'MALIA: With regard to the execution standard there's been discussed how will this requirement affect futures trading in contracts that trade side-by-side on NYMEX and Globex and the floor? How might that impact a best execution or trying to achieve that?

MS. CELA: We are viewing this to come out a fair-dealing antifraud world of analysis so that it would seem to use that we would be looking
at conduct that is really over the course of a relationship. If a swap dealer were routinely sending orders for a customer to a market that had consistently worse execution standards than another, I think we would have to ask the question, we would be right to ask the question, about whether that was done in a reasonable relationship to the market and therefore whether or not it was fair and reasonable and was the swap dealer acting in good faith. The two markets that you identified, it is market neutral in the sense that wherever you can trade, you then have to evaluate the terms and then send the trades through or execute in a way that would be reasonable related to the best terms available.

COMMISSIONER O'MALIA: Bank of America recently paid more than $137 million in restitution to federal and state agencies for its participation in a conspiracy to rig bids in the muni bond market. Based on your knowledge of this matter, how would the proposal with regard to execution standards have protected the affected
federal and state agencies?

MS. CELA: I'm not at all qualified to comment on the particular case, but if I understand the kind of situation that was addressed there and I think it's really important as you consider these rules today to make sure that we've done our job that we have addressed the potential dangers in this area. There are a few things and Congress did most of them, frankly. There is this independent representative requirement. The independent representative has to be acting itself in the best interests of the special entity. If it's true that the representative firms were not acting in the best interests, that they didn't have the sophistication, that they were not independent of the swap dealer which his the bottom-line requirement for the independent representative provision that we have, if there is a relationship between that bid rigger and the dealer then that would it would seem me to be squarely within the prohibitions that we have. We also have added we
think very appropriately the pay-to-play
restrictions which would go a long way I think to
cleaning up the situation that has the potential,
not commenting on this case, for wrong.

COMMISSIONER O'MALIA: One final
question. Section 23.410 of the proposed rule
among other things prohibits the employment of
device, scheme or artifice to defraud any special
dentity. This language tracks with the language in
the CEA's new antimanipulation provisions of
Section 6(c). Would a violation of this
business-conduct rule result in $140,000 penalty
or a million-dollar penalty? And because you are
a swap dealer, would you have to be fined once
under the regulation and then again under the
statute for the same violation just by virtue of
our registration status?

MS. CELA: I want to answer the second
one and I'm going to give the first one to Vince.
Are you ready, Vince?

MR. MCGONAGLE: Sure.

MS. CELA: With respect to
double-counting, I think the Commission has given pretty good guidance in case law that it has and certainly federal court judges have so that we're not inclined to be receiving double-counting penalties on the basis of the same exact statutory language in connection with the same conduct so that I think we're good there. On the other, I think this was a topic of discussion and question at the earlier disruptive-practices meeting and that's why it's Vince's question.

MR. MCGONAGLE: I will give no clarity because in evaluating an enforcement action we're going to evaluate all potential violations of the Act so that to the extent that we're dealing with something that is disruptive, a disruptive trading practice that is also say manipulative that gets clearly into the larger calculus for a million dollars per penalty then that's going to be part of the discussion that we have as a recommendation to the Commission or as part of the settlement. The question about whether fraudulent activity itself or how the disruptive trading standards are
set up that they might be different because they're talking more about fraud I think is still a question that's a little left open for the comment period for that particular rule. But in practical experience I'll go back to the first sentence is which is we would be looking at all potential violations of the Act and so it's likely that there would be a range of sanctions that would be discussed so that it wouldn't be one clear claim versus another.

COMMISSIONER O'MALIA: Thanks for that clarity. I think I knew that going into the question.

MS. CELA: I'm sorry.

CHAIRMAN GENSLER: Did you get transparency too? I thank everyone. If there are no further questions, Mr. Stawik, if you can call the roll.

MR. STAWIK: Commissioner O'Malia?

COMMISSIONER O'MALIA: Aye.

MR. STAWIK: Commissioner O'Malia, aye.

Commissioner Chilton?
COMMISSIONER CHILTON: Aye.

MR. STAWIK: Commissioner Chilton, aye.

Commissioner Sommers?

COMMISSIONER SOMMERS: Aye.

MR. STAWIK: Commissioner Sommers, aye.

Commissioner Dunn?

COMMISSIONER DUNN: Aye.

MR. STAWIK: Commissioner Dunn, aye.

Mister Chairman?

CHAIRMAN GENSLER: Aye.

MR. STAWIK: Mister Chairman, aye.

CHAIRMAN GENSLER: Phyllis, aye. You heard it. Even Mark Young whoever he is heard it.

MR. STAWIK: On this question the ayes are five and nays are zero.

CHAIRMAN GENSLER: I thank the team for its excellent work. There is much more to do, but enjoy your holiday. We have now another group coming up. The final presentation is the Commission's consideration of the issuance of an interim final rule with regard to reporting of swaps. I would have done a break here but I think
this one is a little quicker. As they come in and
I fill some time, we have already issued an
interim final rule with regard to swaps that were
in existence when the President signed the bill
which is called the date of enactment. In essence
what that interim final rule said was save the
information. This consideration here is a
proposal on swaps entered into after the President
signed the bill or the date of enactment but prior
to the effect date that some of our data rules and
other things would be effective at the earliest in
the late summer of next year or maybe those
effective dates will be even into months later.
With that, Susan Nathan who is our lead of a
number of our data teams, the swap data repository
team you share, but a number of our data teams,
Rick Shilts who heads our Division of Market
Oversight and Dan Berkovitz who is our General
Counsel. I turn it over to the team to present
this interim final rule on in essence saving data.

MS. NATHAN: Good morning, Mister
Chairman, good morning Commissioners. There is no
team to thank on this particular rulemaking but I would like to express appreciation to Dan and his staff for their guidance in developing the rule. This morning staff is presenting for the Commission's consideration as the Chairman said an interim final rule under Part 44 of the Commission's regulations, it will be Part 44.03, to establish requirements related to the reporting of transition swaps to a registered SDR or to the Commission. Transition swaps are those swaps entered into on or before the date of enactment of the Dodd-Frank Act and prior to the effective date of permanent swap data reporting and rules that will shortly be promulgated by the Commission pursuant to new Section 2(h)(v) of the Act. That provision in turn was added by Section 723 of Dodd-Frank and requires that the Commission adopt rules for the reporting of data related to on the one hand preenactment swaps and on the other hand these transition swaps. As the Chairman mentioned, in September the Commission adopted an interim final rule, Rule
44.02, addressing the reporting timetable for pre-enactment swaps. The purpose of that rule was to clarify that reporting obligations would attach to those swaps and to ensure that counterparties would preserve relevant information pending the Commission's implementation of permanent data reporting rules under Section 2(h)(v). The interim final rule before the Commission today is similar in both substance and purpose. It directs that counterparties to transition swaps report data to a registered swap data repository or to the Commission within a specified time period or by the compliance date to be established by the permanent rules under 2(h)(v)(B). The rule further advises potential counterparties to preserve data related to transition swaps until reporting can be affected and specifically states that no counterparties will be required to create or otherwise adjust the data that they have in order to comply, it's whatever they have in the format that they have it.

An interim final rulemaking is an
expedited process that permits an agency to adopt for good cause a rule that has not been subject to the Administrative Procedure Act's requirement that the public be given notice and an opportunity to comment on a proposed rule. In an IFR the agency publishes the rule as final but concurrently encourages public comment. To the extent appropriate, that comment will be addressed in the permanent rulemaking. Staff believes that an interim final rule is warranted here in order to timely clarify for counterparties the reporting obligations that will be imposed under 2(h)(v)(B) and thus to ensure that counterparties retain relevant data until these permanent recordkeeping and reporting rules are adopted. I welcome your questions.

CHAIRMAN GENSLER: Do I hear a motion on the staff recommendation on this interim final rule?

COMMISSIONER DUNN: So moved.

COMMISSIONER SOMMERS: Second.

CHAIRMAN GENSLER: Thank you. Susan, if
I might ask, I understand that this came up in reaction to questions from market participants as to we did an interim final rule for preenactment swaps and they were asking what do we do until you finalize it, and you might want to say why we are addressing this and how did the question come up.

MS. NATHAN: That is the primary way in which the question came up and on the whole, once we realized that there might be some misunderstanding it seemed prudent to come out with this interim rule to clarify obligations and eliminate to the extent we can any confusion over who needs to report and what they need to do.

CHAIRMAN GENSLER: Am I correct in understand that the main thing we're clarifying is what you need to do before the effective dates which could be up to a year from now? Is that the main question?

MS. NATHAN: That is the main thrust of this rulemaking. Stripped of its title, what this is is a heads-up. If you believe that you are a counterparty to a transition swap, preserve
whatever data you currently keep in the course of
normal business practice so that it's available
for reporting as necessary under the permanent
rules when they're adopted.

CHAIRMAN GENSLER: I do support this.
Why I really like it, but I'd like to know if I'm
correct on this, is it's saying we're not going to
be retroactive and say you have to create a
different record than you currently have.

MS. NATHAN: Precisely.

CHAIRMAN GENSLER: So that until our
data rules go effective, again this could be next
fall or whenever, nobody needs to worry about
going back and recreating records.

MS. NATHAN: No, and the rule's text
itself is very clear. It's what the counterparty
has on the date of enactment.

CHAIRMAN GENSLER: Or even after the
date of enactment. Right?

MS. NATHAN: Or even after, yes.

CHAIRMAN GENSLER: So that if somebody
enters into something today, December 9 or after
this gets into the Federal Register, it's whatever
they are keeping now they keep and any regulatory
obligations to have more data fields happens
later.

MS. NATHAN: That's correct.

CHAIRMAN GENSLER: Thank you for
clarifying that. I do support this. Commissioner
Dunn?

COMMISSIONER DUNN: Thank you, Mister
Chairman, and I was going to note that in the
preamble it says it does not require any
counterparties to a transition swap transaction to
create new records and permits records to be
retained in their existing format. Are we
prepared to ask for these and if so where would
they go to and how would we store this data and
what would be doing with it?

MS. NATHAN: Are you asking whether
there is an immediate reporting obligation imposed
by this rule? No, there is not. The reporting
obligations will be imposed under the permanent
2(h)(v) rules.
COMMISSIONER DUNN: Thank you.

CHAIRMAN GENSLER: Commissioner Sommers?

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

CHAIRMAN GENSLER: Commissioner Chilton?

COMMISSIONER CHILTON: I wasn't going to ask anything because I think you've done a really good job on this, Susan. But this talk of timing, I wanted to get a little bit of clarification.

There were a couple of news articles recently. I think there was one yesterday and I don't want to ascribe exactly who it was because I'm not sure, but I believe there was somebody at Barclays who said it's going to take 3 years to implement this law. I don't see that happening. Congress gave us some discretion, Mr. Berkovitz, and the law, and I'm paraphrasing, says that the Commission once they promulgate a final rule shall implement it in not less than 60 days. What that means is that it could be more than 60 days but that it can't be less than 60 days unless otherwise prescribed in the Act. So unless there's a
different date, that minimum of 60 days before implementation, so theoretically it is open-ended. Theoretically at least you could wait 3 years. That's not wise and I don't think we'll end up there, but theoretically you could be there. I'm not going to get into a specific rule, but there are other places that have prescribed specific effective dates. There are just a handful. The Chairman said we've done 36 but there are going to be more than 40 of these and there's a handful of those the Commission doesn't have the sort of leeway that we have with regard to the section I tried to paraphrase there, the 60 days. Is that correct?

MR. BERKOVITZ: Generally, yes, Commissioner, I think that's generally a correct observation. The provision you referred to says unless otherwise specified in the Act, the provisions of this Act shall be effective on the later of 360 days or 60 days after the promulgation of the final rule that is required.
COMMISSIONER CHILTON: I thought it was not less than 60 days.

MR. BERKOVITZ: Right. Maybe I misspoke. Not less than 60 days after.

COMMISSIONER CHILTON: Meaning it could be more unless it's otherwise prescribed.

MR. BERKOVITZ: Correct.

COMMISSIONER CHILTON: Thank you very much. I appreciate it.

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

Nothing there? Mr. Stawik, do you want to call the roll?

MR. STAWIK: Commissioner O'Malia?

COMMISSIONER O'MALIA: Aye.

MR. STAWIK: Commissioner O'Malia, aye.

Commissioner Chilton?

COMMISSIONER CHILTON: Aye.

MR. STAWIK: Commissioner Chilton, aye.

Commissioner Sommers?

COMMISSIONER SOMMERS: Aye.

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

COMMISSIONER DUNN: Aye.

MR. STAWIK: Commissioner Dunn, aye.

Mister Chairman?

CHAIRMAN GENSLER: Aye.

MR. STAWIK: Mister Chairman, aye.

Mister Chairman, on this vote the ayes are five and nays are zero.

CHAIRMAN GENSLER: Thank you very much and thank you, Susan, Rick and Dan. At this point I'd like to ask for unanimous consent to allow staff to make technical corrections to the documents voted on today prior to send them to the Federal Register. Do I hear any objection? Not hearing objections, so moved. Our next meeting of this Commission is on December 16 where we will review the topics that I outlined earlier and I think we will also vote at that meeting on two more meetings in January. Of course we'll be posting the various topics 7 days in advance on each of those. I also want to remind the public and the press that we have a very important
roundtable tomorrow, December 10. I think the
venue is over at the Securities and Exchange
Commission if I'm not mistaken, but it's going to
be with the Federal Reserve and the other bank
regulators, the SEC and CFTC staff hearing from
important topics on capital margins and we no
doubt going to have more roundtables, Commissioner
O'Malia. I think it is a good think to have
roundtables. I don't know which topics we'll
have. If there is no further Commission business,
I'd like to hear a motion to adjourn the meeting.

COMMISSIONER DUNN: So moved.
COMMISSIONER SOMMERS: Second.
CHAIRMAN GENSLER: We don't have to call
the roll on this do we Mr. Stawik? All in favor?
Aye.

(Chorus of ayes.)

CHAIRMAN GENSLER: Are there any
opposed? No. Thank you.

(Whereupon, at 12:00 p.m., the
PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Christine Allen, notary public in and for the District of Columbia, do hereby certify that the forgoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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Notary Public, in and for the District of Columbia
My Commission Expires: January 14, 2013