

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

PUBLIC MEETING

Washington, D.C.

Wednesday, September 17, 2014

1 PARTICIPANTS:

2 Commission Members:

3 TIMOTHY G. MASSAD, Chairman

4 MARK P. WETJEN, Commissioner

5 SHARON Y. BOWEN, Commissioner

6 J. CHRISTOPHER GIANCARLO, Commissioner

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14 CHRISTOPHER W. CUMMINGS, Division of Swap
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17 JOHN C. LAWTON, Division of Clearing and Risk

18 THOMAS J. SMITH, Division of Swap Dealer and
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21 Intermediary Oversight

22 CHRISTOPHER KIRKPATRICK, Secretary

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P R O C E E D I N G S

(1:58 p.m.)

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3 CHAIRMAN MASSAD: This meeting will come
4 to order. This is a public meeting of the
5 Commodity Futures Trading Commission. It is the
6 first open meeting of the Commission since two of
7 my fellow commissioners, Commissioner Bowen and
8 Commissioner Giancarlo, and I took office. So I'm
9 very pleased that we're here today. I'm very
10 pleased to have the benefit of their experience
11 and insight as we move ahead. I also want to
12 acknowledge and thank Commissioner Wetjen, our
13 veteran, who has put in a tremendous effort,
14 particularly over the first several months of this
15 year when he served as Acting Chairman and who's
16 been very helpful to all of us as we have gotten
17 up to speed on various issues. Thank you, Mark.

18 I would also like to welcome members of
19 the public, market participants, and members of
20 the media as well as those listening to the
21 meeting on the phone or watching the Webcast.

22 As we take up any rule required by the

1 Dodd-Frank Wall Street Reform and Consumer
2 Protection Act, we must never forget why the act
3 was passed and the motivations behind Title VII.
4 The Dodd-Frank Act was a comprehensive response to
5 the worst financial crisis since the Great
6 Depression. While there are many causes of the
7 crisis, one was excessive risk from
8 over-the-counter swaps, a large global industry
9 essentially unregulated by any jurisdiction at
10 that time.

11 It was six years ago almost to the day
12 -- September 16, 2008 -- when our government was
13 required to step in and prevent the failure of
14 AIG, which was on the brink of collapse because of
15 excessive swap risk, a collapse that could have
16 thrown our nation into another Great Depression.

17 These rules, like many of the
18 Commission's, are highly technical and complex.
19 They may seem esoteric and far removed from the
20 lives of most Americans, but the costs of the
21 crisis were not. They were very real, very large,
22 and borne by the American people through millions

1 of lost homes and jobs, many businesses shuttered,
2 and many educations and retirements deferred.
3 That is why these reforms are so important and
4 that is what brings us here today.

5 Today we will consider a final rule that
6 will help make sure that many of the small utility
7 companies that serve communities across our nation
8 can reduce their risk of doing business when it
9 comes to cost of fuel. We will also consider a
10 proposed rule that will reduce the risk to our
11 financial system that can be created when swap
12 dealers enter into swaps that are not then cleared
13 on central clearinghouses. Both of these agenda
14 items are important steps in our effort to finish
15 the job of implementing the Dodd-Frank Act. They
16 help us achieve the full benefit of the new
17 regulatory framework, while at the same time
18 protecting the interests of commercial companies
19 that need to use these markets.

20 We will begin with consideration of the
21 final rule pertaining to the swap activities of
22 small utility companies, a small but important

1 part of the market, and that is what I like to
2 refer to as the fine tuning of rules that is
3 inevitably required when you have reforms as
4 significant as Dodd-Frank required.

5 Congress directed the Commission to
6 regulate swap dealers. Among other things, we
7 require swap dealers to treat customers fairly and
8 manage risk adequately. Congress directed the
9 Commission to impose heightened standards on swap
10 dealers in their swaps activity with federal,
11 state, and municipal government agencies and
12 certain other so-called special entities. This
13 was in response to the instances where swap
14 dealers may have failed to disclose material risks
15 of swap transactions to municipal entities or
16 otherwise acted improperly, which often resulted
17 in massive losses to the municipality.

18 Because Congress defines special entity
19 broadly, when the Commission implemented this
20 congressional directive, it applied to many
21 utility companies that are government owned.
22 These are the companies responsible for keeping

1 the lights on in communities across our country,
2 for heating and cooling our homes, and powering
3 the kitchen appliances we use every day to feed
4 our families.

5 To do their job, they must manage the
6 risk of their own fuel costs and to do that, they
7 must be able to access the energy commodity
8 markets. They engage in energy swaps. The
9 counterparties with whom they transact business
10 were often not registered swap dealers, nor were
11 they the dealers that engaged in the abusive
12 practices that led to Congress's concerns. The
13 imposition of these requirements through a
14 designation as a swap dealer could unduly burden
15 their business and thereby threaten the ability of
16 our local utility companies to manage their risks.

17 To avoid burdening local utility
18 companies, CFTC staff issued a series of no-action
19 letters so that such requirements weren't
20 effective while the Commission studied the issue
21 further and decided whether to take permanent
22 action -- and I commend Commissioner Wetjen, who

1 was then Acting Chairman, for doing that. The
2 rule we are considering today provides a permanent
3 solution to enable such utility companies to
4 continue to use these markets effectively.

5 We are also considering today a proposed
6 rule on margin requirements for uncleared swaps.
7 A key mandate of the Dodd-Frank Act was central
8 clearing of swaps. This is a significant tool to
9 monitor and mitigate risk, and we have already
10 succeeded in increasing the overall percentage of
11 the market that is cleared from an estimated 17
12 percent in 2007 to 60 percent last month when
13 measured by notional amount.

14 But cleared swaps are only part of the
15 market; uncleared bilateral swap transactions will
16 continue to be an important part of the
17 derivatives market. This is so for a variety of
18 reasons. Sometimes commercial risks cannot be
19 hedged sufficiently through clearable swap
20 contracts; therefore, market participants must
21 craft more tailored contracts that cannot be
22 cleared. In addition, certain products may lack

1 sufficient liquidity to be centrally risk managed
2 and cleared. This may be true even for products
3 that have been in existence for some time and
4 there will and always should be innovation in the
5 market, which will lead to new products. That is
6 why margin for uncleared swaps is important. It
7 is a means to mitigate the risk of default and,
8 therefore, the potential risk to the financial
9 system as a whole. We need only recall how
10 Treasury and the Federal Reserve had to commit
11 \$182 billion to AIG because their uncleared swaps
12 activity threatened to bring down our financial
13 system to appreciate the importance of the rule we
14 are considering today.

15 The proposed rule requires swap dealers
16 and major swap participants to post and collect
17 margin in their swaps with one another. They must
18 also do so in their swaps with financial entities
19 if the level of activity is above certain
20 thresholds. This focus on swap dealers and major
21 swap participants is appropriate. They are the
22 participants that much of our oversight is focused

1 on. The proposal does not require commercial
2 end-users to post or collect margin. This is a
3 very important point.

4 The two rules we are considering today
5 thus share an important characteristic, which
6 reflects one of my priorities and I believe a
7 priority of my fellow Commissioners, and that is
8 to make sure the overall regulatory scheme we are
9 putting in place recognizes the needs and concerns
10 of commercial end-users. While each rule is part
11 of our framework for regulating the potential
12 risks of this market, each proposal is designed to
13 minimize burdens on commercial end-users who
14 depend on the derivatives markets to hedge normal
15 business risks. Today's proposal on margin also
16 reflects the benefit of substantial collaboration
17 between our staff and our colleagues at the
18 Federal Reserve, the OCC, and the FDIC as well as
19 significant public comment.

20 The Dodd-Frank Act directs each of the
21 prudential regulators to propose rules on margin
22 for the entities for which it is the primary

1 regulator. The CFTC is directed to propose a rule
2 for other entities engaging in uncleared swaps
3 transactions. The Dodd-Frank Act also directs us
4 to harmonize our rules as much as possible.
5 Today's proposed rule is very similar to the
6 proposal of the prudential regulators that was
7 issued two weeks ago -- and I want to thank our
8 staff as well as the staffs of the prudential
9 regulators for working together so well to
10 accomplish that task.

11 We have also sought to harmonize our
12 proposal with rules being developed in Europe and
13 Asia. Our proposed rule is largely consistent
14 with the standards proposed by the Basel Committee
15 on Banking Supervision and the International
16 Organization of Securities Commissions, and we
17 have been in touch with overseas regulators as we
18 developed our proposal. There are some
19 differences that the staff will discuss.

20 The importance of international
21 harmonization cannot be understated. It is
22 particularly important to reach harmonization in

1 the area of margin for uncleared swaps because
2 this is a new requirement and we do not want to
3 create the potential for regulatory arbitrage in
4 the market by creating unnecessary differences.
5 Margin for uncleared swaps goes hand in hand with
6 the global mandates to clear swaps. Imposing
7 margin on uncleared swaps will level the playing
8 field between cleared and uncleared swaps and
9 remove any incentive not to clear swaps that can
10 be cleared.

11 Now, with regard to clearing there's
12 been attention lately on the issue of cross-border
13 recognition of clearinghouses, so let me if I may
14 say a few words about that. I am firmly committed
15 to working with the European Commission on this
16 issue. In particular it is very important that
17 they recognize our exchanges and clearinghouses to
18 prevent any potential for market disruption and so
19 that European market participants can continue to
20 trade and clear transactions in the United States.
21 I believe we can and we'll achieve this soon.

22 Now, a little history may be helpful.

1 The path forward statement issued in July 2013 by
2 my predecessor as Chairman, Gary Gensler, and EC
3 Vice President, Michel Barnier, recognized the
4 important role played by clearing organizations
5 that are "registered in both the U.S. and the EU."
6 The path forward stated that the goal of avoiding
7 significant market fragmentation and uncertainty
8 around clearing obligations was to be achieved
9 through the EC's equivalence decisions and ESMA's
10 recognition of foreign CCPs along with the CFTC's
11 issuance of targeted no-action relief to certain
12 CCPs located in the European Union. The CFTC
13 provided such relief to two European CCPs at the
14 time the path forward was issued, and we are
15 working now to finalize the remaining steps
16 necessary to "provide an effective equivalent
17 system for the recognition of swap clearinghouses
18 in Europe." This is the final remaining legal
19 requirement for their recognition of our
20 clearinghouses under our dual registration
21 structure.

22 Now, I believe our laws already permit

1 the recognition of clearinghouses on both sides of
2 the Atlantic. It is important to understand how
3 our clearinghouse recognition law works and how it
4 is different than theirs. Our laws for the
5 clearing of swaps were built on the laws and
6 successful practices that have developed
7 concerning the clearing of futures. We do not
8 require that clearing of swaps take place in the
9 U.S., just as we do not require that for futures
10 traded on U.S. exchanges. But Dodd-Frank does
11 require that clearing of swaps for customers take
12 place through a registered futures commission
13 merchant, or FCM, who in turn clears on a
14 registered clearinghouse. The law contains that
15 requirement because clearing through an FCM and on
16 a registered clearinghouse is very important for
17 protecting U.S. customers. These requirements are
18 closely tied to how U.S. bankruptcy law applies to
19 an FCM. The standards ensure not only that
20 customer funds are protected, but also that in the
21 event of a defaulting FCM, customer accounts can
22 be moved quickly to another FCM. This is very

1 important for stability, and we have seen its
2 value most recently in the crisis as well as in
3 the failure of MF Global.

4 This legal framework has worked to
5 promote the global market. There have been
6 clearinghouses located outside the U.S. that have
7 been registered with the U.S. and with their home
8 authorities for many years. We work with the home
9 authority to ensure cooperative supervision and
10 oversight. The dually registered clearinghouses
11 in Europe have grown to be globally important
12 clearinghouses. One, for example, has been dually
13 registered since 2001 and it handles most of the
14 market for swap clearing and a majority of that
15 clearing is for U.S. persons.

16 I also believe this is a good approach
17 because central clearinghouses are even more
18 important in the global financial system today as
19 a result of our reforms to the OTC swap market
20 and, therefore, regulators must work together to
21 make sure clearinghouses operate transparently and
22 do not pose risks to financial stability. We have

1 cooperated well with other regulators on this to
2 date, and I envision that cooperation and
3 interaction increasing, not decreasing. Here at
4 home, for example, we are now working with the
5 Federal Reserve on clearinghouse examinations, and
6 we are increasingly working with foreign
7 regulators on the supervision of our
8 clearinghouses.

9 In short, I believe the system of dual
10 registration is not a source of potential market
11 fragmentation; it is just the opposite. The
12 foundation that allowed us not to insist that
13 clearing take place on our shores and which has in
14 turn led to a global market, and cooperative
15 oversight is a key part of that.

16 We must make sure that dual
17 registration, however, does not create conflicts
18 and inconsistencies and that is what we are
19 discussing currently. That is, the issue today is
20 not primarily about the standards that apply to
21 our clearinghouses. Our clearinghouses have long
22 met the standards agreed to by international

1 regulators, known as the principles for financial
2 market infrastructures. And shortly after I took
3 office, I traveled to Europe to meet with European
4 regulators. They informed me that they were
5 satisfied with our standards and did not have
6 further issues.

7 Our discussion today is focused on the
8 EMIR requirement for "effective recognition"
9 within this context of dual registration. So we
10 are looking at whether particular regulatory
11 objectives that we have can be met through the
12 regulation and oversight of the home country
13 regulator. We are also exploring ways to enhance
14 cooperation in the joint supervision of dually
15 registered clearinghouses. I am hopeful we can
16 reach agreement soon.

17 I am also encouraged by the recent
18 statements from European Vice President Barnier
19 and reports in the press that the European
20 Commission can postpone the December 15 deadline
21 for the imposition of capital charges on European
22 firms for transactions on our exchanges and

1 clearinghouses if recognition has not occurred by
2 this time. While I believe we and they are still
3 committed to resolving this issue well before such
4 date, I think this is a very important gesture of
5 good faith on their part and so there is not a
6 risk of market disruption.

7 Now, I apologize to my fellow
8 Commissioners for taking so much time on this
9 point, but I felt it was important to share our
10 progress with the Europeans on these issues.

11 So before we hear from the staff on the
12 rulemakings that we will consider today, I would
13 like to thank my fellow Commissioners for their
14 contributions to these rules and especially to the
15 CFTC's hardworking and dedicated staff. And I
16 would now also like to recognize my fellow
17 Commissioners for their opening statements. I
18 will start with Commissioner Wetjen.

19 COMMISSIONER WETJEN: Thank you,
20 Chairman Massad. Let me start by saying it's a
21 pleasure to be here today on the dais with you and
22 Commissioners Giancarlo and Bowen. Welcome. It's

1 been a real honor these last few months to work
2 with all three of you, and even in this short
3 amount of time I've learned a great deal from each
4 of you and have really enjoyed the work and
5 experience, so thank you. It's great to have you
6 here.

7 I want to commend Chairman Massad for
8 his focus on the unfinished work of Title VII as
9 well as his focus on appropriate fine-tuning of
10 recent rulemakings, which is reflected in today's
11 agenda. Staff has been coordinating with
12 international and domestic regulators for many
13 months on the new margin proposal as well, and
14 they should be commended for completing their work
15 in a way that positions us along with the
16 prudential regulators to seek comment on a new
17 approach.

18 As for the special entities release,
19 finalizing this rule today shows the Commission's
20 continuing commitment to course correction when
21 necessary. End-users have been disadvantaged in
22 their ability to find counterparties to hedge the

1 risks due to complications under the Commission's
2 swap dealer definition rule and today's release
3 addresses that.

4 Today's proposal, on margin for
5 uncleared swaps, establishes initial and variation
6 margin requirements for uncleared swaps between
7 swap dealers and certain financial entities with
8 material swap exposures. It also contains
9 important risk management and documentation
10 provisions for swap dealers and major swap
11 participants. I am supportive of today's release
12 in order to facilitate an ongoing dialogue on the
13 appropriate means for ensuring the safety and
14 soundness of these critical intermediaries. I do,
15 however, have a number of questions and indeed
16 some concerns with the proposal that I will
17 identify in my following remarks.

18 Today's release has been largely
19 harmonized with those proposed by the prudential
20 regulators two weeks ago as well as with the 2013
21 global margin framework developed through IOSCO
22 and CPMI, but there remains some important

1 differences. Public comments will be especially
2 critical in addressing these differences.

3 Along these lines, I am most eager to
4 review public comments relating to the
5 cross-border impact of today's release. Unlike
6 previous drafts and as a result of many
7 discussions among Commissioners in recent days,
8 the ANPR now proposes several ways of applying the
9 margin rule in a cross-border context. Again, I
10 commend Chairman Massad for his openness to these
11 multiple approaches. One option proposed would be
12 to allow the cross-border approach taken by the
13 prudential regulators. Another option would be
14 for the margin rule to apply pursuant to the
15 Commission's cross-border guidance finalized last
16 year, which at the moment I believe is the best
17 option. And the third option proposed would be a
18 hybrid of the aforementioned approaches, in my
19 view, and would treat the margin rule as an
20 entity-level requirement of the Commission.

21 The prudential regulators' approach
22 essentially and not surprisingly would treat the

1 margin rule as an entity-type rule. Through this
2 approach, non-U.S. dealers registered with the
3 Commission would need to comply with the rule in
4 many instances, again with substituted compliance
5 available under appropriate foreign regimes.
6 Under this option the Commission would take the
7 step of codifying a U.S. person definition that is
8 applicable solely to the margin requirements and
9 not to other transaction-level requirements in its
10 guidance from last summer.

11 This prudential-like approach is founded
12 on the policy rationale that entities having
13 sufficient U.S. contacts or counterparties pose
14 sufficient safety and soundness concerns for U.S.
15 Regulators. The Commission, however, should
16 carefully consider whether the transaction-level
17 approach under the guidance struck at least an
18 equally agreeable balance and perhaps better
19 ensured an equal playing field for swap dealers
20 operating in global markets. The Commission's
21 cross-border guidance treated margin as a
22 transaction-level requirement that would apply

1 differently depending on an analysis of whether
2 the entity qualifies as a U.S. person and
3 depending on whether the entity faces a non-U.S.
4 Counterparty.

5 The cross-border guidance also
6 recognized that capital rules interact with the
7 margin rules to the extent additional capital is
8 required when trades are not fully margined. It
9 is worth noting, therefore, that the credit risks
10 addressed by the present proposal may be addressed
11 in part by indirect capital requirements at the
12 holding company level and direct capital
13 requirements at the registrant level. To the
14 extent any foreign swap dealer were to fail and
15 expose U.S. financial entities to unmargined
16 losses, the Commission's cross-border guidance
17 requires those trades to be fully collateralized
18 consistent with the CFTC margin rules. Losses
19 would be mitigated, therefore, by provisions such
20 as custodial protections, which are intended to
21 safeguard U.S. collateral posted in connection
22 with such trades.

1 Consequently, the Commission should be
2 careful when applying its margin rule abroad
3 knowing that a covered swap entity is complying
4 with capital rules here or in a foreign
5 jurisdiction that is equally comprehensive and
6 comparable. By following the Commission's
7 guidance in applying the margin rule, the
8 Commission could still fulfill its regulatory
9 objectives and avoid disadvantaging U.S. firms
10 competing overseas. Stated differently, there are
11 far fewer complications related to
12 operationalizing substituted compliance for the
13 Commission's capital rule than for today's margin
14 proposal given the latter's requirement that
15 initial margin be passed in both directions
16 between counterparties.

17 To be clear, I do not intend to suggest
18 that the cross-border guidance is the perfect
19 answer to all cross-border considerations. But it
20 is important to remember that many operational and
21 compliance decisions with significant costs have
22 been made by firms under the Commission's

1 jurisdiction pursuant to that guidance, and we
2 should not depart from the policy driving those
3 decisions without sufficient cause. Additionally,
4 following the guidance instead of one of the other
5 cross-border approaches proposed today would avoid
6 adding yet another cross-border analysis to a
7 Commission rule, but with narrow application. The
8 Commission should not knowingly make the
9 cross-border application of our rules
10 unnecessarily complex, even in the face of a
11 statutory mandate that the Commission follow the
12 prudential regulators' approach as closely as
13 possible.

14 And, finally, the Commission should
15 propose its capital rules in the near future and
16 reopen the comment period for its margin proposal
17 at that time. Only by fully considering the
18 margin rule alongside the capital rule can the
19 Commission make the very best policy judgment
20 about how best to protect against the risk posed
21 by covered swap entities.

22 I have a number of other issues that I

1 mention in a written statement, Mr. Chairman, so I
2 point that written statement out to the public if
3 they're interested. But I'll close my oral
4 remarks at this time and take up some of those
5 issues addressed in the written statement through
6 my questions.

7 And just real quickly on the special
8 entity rule, again, I applaud you, Chairman
9 Massad, for focusing on this matter and putting us
10 in a position to finalize this rule today.
11 Today's rule would amend the Commission's swap
12 dealer definition and permit the exclusion of
13 utility operations-related swaps when determining
14 whether that person has exceeded the de minimis
15 threshold specific to dealing with special
16 entities. The final rule includes beneficial
17 modifications to the original proposal, including
18 striking the notice requirement for market
19 participants who rely on the exclusion provided by
20 the rule. And, likewise, I support removing
21 redundant recordkeeping requirements for swaps
22 with utility special entities and instead relying

1 on current Part 45 requirements and
2 representations that the swap qualifies for the
3 exclusion. I look forward to staff
4 recommendations regarding how our Part 45 rules
5 might be amended to further account for swaps with
6 utility special entities.

7 And with that, thank you again. I look
8 forward to the other opening statements.

9 CHAIRMAN MASSAD: Thank you,
10 Commissioner Wetjen. Let me turn now to
11 Commissioner Bowen.

12 COMMISSIONER BOWEN: Thank you, Chairman
13 Massad. Before we proceed with the rules today
14 before this Commission, I want to thank Chairman
15 Massad and Commissioner Wetjen for your assistance
16 during my first weeks here at the Commission.
17 You've both been extremely helpful during my
18 transition. I would also like to acknowledge
19 Commissioner Giancarlo who joined nearly at the
20 same time as I did and who has been very
21 supportive as we each moved into our new roles. I
22 have sincerely enjoyed working with all of you so

1 far. I'm very optimistic about how we as a
2 Commission will be able to move forward on the
3 many issues before us.

4 And, indeed, there are a wide variety of
5 issues before us. Over these last three months, I
6 have been meeting with the staff from all of the
7 divisions and offices. I am very impressed with
8 their expertise, professionalism, and commitment.
9 They are handling a broad range of activities and
10 responsibilities with very limited resources. I
11 want to express my appreciation for their efforts.

12 The broad range of issues we are working
13 on is exemplified by the two rules before us
14 today. First, the proposed margin rules would
15 affect swap dealers, MSPs, and the largest
16 financial end-users of swaps. Second, the
17 adjustment to the de minimis rule will affect
18 municipal electric and natural gas utilities -- a
19 few large and many very small -- when they are in
20 the market to hedge their commodity risk. From
21 the largest financial conglomerate to a municipal
22 utility serving a small locality, the range of

1 market participants before us is as broad as it
2 could be.

3 Although these two rules affect
4 different types of companies, they both serve in
5 different ways the same purpose of maintaining our
6 well-functioning, stable markets. As we continue
7 on this path, we must be mindful of our need to
8 coordinate with our fellow domestic and
9 international regulators. In fact, our
10 consideration of today's re-proposed rule on
11 margin for uncleared swaps is a result of a
12 domestic and international cooperative effort to
13 reduce global systemic risk. It focused
14 particularly on the risk arising at the largest
15 global financial institutions from the use of
16 uncleared swaps.

17 There is a place for uncleared bespoke
18 swaps, but we don't want the risk from these swaps
19 to accumulate unchecked. Collection of margin
20 helps to manage risk and to attenuate risk. Our
21 goal is to reduce systemic leverage and discourage
22 the excessive growth of risky, uncleared

1 derivatives. I'm interested to hear from
2 commenters today and later on as to whether the
3 proposed rules will achieve our goal.

4 As for the de minimis rule, I understand
5 that in many instances electricity and natural gas
6 service is provided to consumers and businesses
7 from municipal utilities, also known as special
8 entities. Provision of electricity and natural
9 gas is different from other services provided by
10 local governments, in that it involves a
11 continuous supply of gas and electricity to homes
12 and businesses around the clock. The electricity
13 and natural gas markets are particularly complex,
14 in part because there are interlocking swap
15 arrangements between the various participants and
16 demand and supply fluctuates in real time.

17 So this is a crucial corner of a special
18 entity world where I think it makes sense to take
19 a different approach and depart from the \$25
20 million threshold in the rule that applies to
21 other special entities.

22 Last, I'd like to take a moment to

1 acknowledge the point we have reached today. This
2 is the first meeting of the CFTC where all of the
3 commissioners have arrived after passage of the
4 Dodd-Frank Act. We have the responsibility to
5 preserve and continue the good work that's already
6 been done by our predecessors. Although I
7 understand that tweaks must be made and details
8 added, I wouldn't want to give up the market
9 improvements that we have already received from
10 these new rules.

11 As a commissioner, my door will always
12 be open to hear the viewpoints of the many
13 stakeholders who are affected by our rulemaking.
14 As I stated during my confirmation hearing, I feel
15 a special obligation to be the voice of those who
16 have not had a seat at the table as do I. I saw
17 the devastating effects from our financial crisis
18 and the burdens placed on many individuals who
19 lost their jobs, lifesavings, retirement accounts,
20 and homes. My vision is to get it right. As we
21 build upon the incredible progress the Commission
22 has achieved to date, I look forward to improving

1 upon our well-functioning market in a way that's
2 transparent and fair without barriers and undue
3 burdens.

4 Thank you and I look forward to hearing
5 the staff's presentation.

6 CHAIRMAN MASSAD: Thank you,
7 Commissioner Bowen. Let me now turn to
8 Commissioner Giancarlo.

9 COMMISSIONER GIANCARLO: Mr. Chairman,
10 it's a great pleasure to participate today with my
11 fellow Commissioners in this first open meeting
12 under your chairmanship. I thank the CFTC staff
13 for their very warm welcome and their ready
14 support to me and my team and to get us up and
15 running. I thank Commissioner Bowen for her
16 kindness and fellowship throughout the Senate
17 confirmation process and our first few months at
18 the Commission. And I thank Commissioner Wetjen
19 for his steady leadership as Acting Chair and his
20 policy insights as a Commissioner, especially on
21 the challenging subject of cross-border rule
22 implementation. And I thank you, Chairman Massad,

1 for the tone of professionalism and collegiality
2 that you're setting at the Commission. It bodes
3 well for a very productive agenda of oversight of
4 U.S. financial and commodity derivative markets.
5 I look forward to participating in the important
6 work of this Commission in service to the American
7 people, starting with today's open meeting.

8 And I'll turn to the special entity
9 utility final rule. As you know, the Dodd-Frank
10 Act requires that American towns and
11 municipalities be labeled as special entities for
12 swaps transactions. The purpose was to provide
13 protections for complex financial swaps of the
14 type that ensnared Jefferson County, Alabama, and
15 led it to file what was at the time the largest
16 municipal bankruptcy in U.S. history. But
17 Congress never intended to limit the ability of
18 public-owned utilities to manage ordinary risks
19 associated with generating electricity or
20 producing natural gas.

21 Unfortunately, the CFTC's first shot at
22 this special entity rule contained some onerous

1 restrictions on ordinary risk management
2 activities by America's taxpayer-owned utilities.
3 It generated an enormous amount of public comments
4 and many of them asserted that the rule would
5 cause trading counterparties to avoid dealing with
6 these special entity utilities due to increased
7 regulatory compliance and registration burdens.
8 That meant that these utilities would have had far
9 fewer tools to control fluctuations in operational
10 costs and supply and demand and that would have
11 caused electricity and other energy costs to rise
12 for American consumers.

13 The initial CFTC proposal also led to
14 two identical pieces of legislation in Congress,
15 one that passed the House unanimously and the
16 other introduced in the Senate with 14 co-sponsors
17 from both political parties. Both bills would
18 have reversed the impact of the CFTC's initial
19 proposed rule -- and I should note that few bills
20 pending in Congress seeking to amend Dodd-Frank
21 have had such broad support.

22 So, in fact, the final rule we are

1 considering today recognizes Congress's concern
2 and revises the earlier proposal. It provides the
3 relief these utilities need to manage risks in the
4 production of gas and electricity. The more
5 options our rules give utilities to manage these
6 risks, the less Americans pay in utility bills.
7 So, in short, today's rule is a good rule, and I'm
8 going to be glad to vote for it.

9 I would like everyone listening to know
10 that the work that went into today's special
11 entity utility rule exemplifies how this agency
12 should conduct rulemaking -- reasoned,
13 collaborative, and supportive of U.S. financial
14 markets while at the same time providing proper
15 protections for the American public. I commend
16 Commissioner Wetjen for proposing this commonsense
17 rule when he was Acting Chairman, and I applaud
18 Chairman Massad and his team for making the
19 special entity rule a priority and for his
20 thoughtfulness and pragmatic approach throughout.
21 I thank the CFTC staff for working with
22 Commissioner staffs to improve the rule by making

1 it less burdensome on market participants. And I
2 look forward to helping develop a straightforward
3 reporting regime that works for the marketplace.

4 I now turn to the uncleared margin rule
5 proposal. Uncleared over-the-counter swaps and
6 derivatives are vital to the U.S. economy. Used
7 properly, they enable American companies and the
8 banks they borrow from to manage challenging
9 commodity and energy prices and fluctuating
10 currency and interest rates. They allow our state
11 and local governments to manage their obligations
12 and our pension funds to support healthy
13 retirements. Uncleared swaps serve a key role in
14 American business planning and risk management
15 that cannot be filled by cleared derivatives.
16 They do so by allowing businesses to avoid basis
17 risk and obtain hedge accounting treatment for
18 more complex, nonstandardized exposures. While
19 much of the swaps and over-the-counter derivatives
20 markets will eventually be cleared -- a transition
21 I have long supported -- uncleared swaps will
22 remain an important tool for customized risk

1 management by businesses, governments, asset
2 managers, and other institutions whose operations
3 are essential to American economic growth.

4 Turning to the aspect of the rule
5 concerning end-users, I take positive note that
6 the prudential regulators have moved in the CFTC's
7 direction in regard to nonfinancial end-users.
8 They will no longer be required to pay margin
9 except in certain circumstances. This accords
10 with congressional intent. Nonfinancial end-users
11 do not cause and create systematic risk and should
12 not bear the increased cost of uncleared swaps
13 margin. This is one rule set that the CFTC got
14 right the first time. I commend the CFTC's
15 commonsense leadership on the issue.

16 Now I want to address the 10-day margin
17 requirement. Somewhat less positively, I note
18 that today's proposal requires collateral coverage
19 on uncleared swaps equal to a 10-day liquidation
20 period. This 10-day calculation comports with
21 rules adopted recently by the U.S. prudential bank
22 regulators. But the question must be asked, is 10

1 days the right calculation? Why not 9 days? Why
2 not 11 days? Should it be the same 10 days for
3 uncleared credit default swaps as it is for
4 uncleared interest rate swaps and all other swaps?
5 Surely all noncleared swap products do not have
6 the same liquidity characteristics and risk
7 profile.

8 I'm mindful of a recent statement by SEC
9 Chair, Mary Jo White. She said, "Our regulatory
10 changes must be informed by clear-eyed, unbiased,
11 and fact-based assessments of the likely impacts
12 -- positive and negative -- on market quality for
13 investors and issuers." Chair White's standard of
14 assessment certainly must be applied to the
15 proposed rule on uncleared swaps. Where is the
16 clear-eyed assessment of the 10-day margin
17 requirement? Where is the cost benefit analysis?
18 What are the intended consequences, and what are
19 the unintended ones? How much of the increased
20 margin cost will be passed on to America's
21 farmers, ranchers, and manufacturers, and
22 ultimately to ordinary Americans who consume their

1 goods and services?

2 I'm very concerned by recent press
3 reports of remarks by unnamed Fed officials that
4 the 10-day coverage period was meant to be
5 intentionally "punitive" in order to move the
6 majority of trades into a cleared environment.
7 Any punitive or arbitrary squeeze on noncleared
8 swaps will surely have consequences, likely
9 unintended, for American consumers and the U.S.
10 Economy. With tens of millions of Americans
11 falling back on part-time work, it is not in our
12 national interest to deter U.S. employers from
13 safely hedging commercial risk to free capital for
14 new ventures offering full-time jobs. It's time
15 we moved away from punishing U.S. capital markets
16 toward rules designed to revive American
17 prosperity.

18 In a related concern I note that the
19 CFTC and the prudential regulators have set the
20 threshold for material swaps exposure for
21 financial end-users at \$3 billion while the 2013
22 international framework sets the threshold closer

1 to \$11 billion. It appears that the middle tier
2 of American financial end-users could be subject
3 to margin requirements that will not be borne by
4 similar firms overseas. This may well limit the
5 number of American counterparties willing to enter
6 into swaps with these American lenders.

7 In this time of dismal economic growth,
8 it's hard to justify placing higher burdens on
9 America's medium-sized financial firms than is
10 being asked of foreign firms. Again, why are we
11 punishing America's lenders? Where is the
12 "clear-eyed" analysis of the impact of this rule
13 on the American economy? It's time our rules were
14 designed less to punish and more to promote U.S.
15 Capital markets. Punishment as a singular
16 regulatory policy is getting old and is
17 counterproductive. We must refocus our rules on
18 returning Americans to work and prosperity.

19 In short, on the cross-border, I do want
20 to make the point that I support the decision to
21 issue an Advance Notice of Proposed Rulemaking to
22 solicit comments on how the uncleared margin rules

1 should apply in light of last summer's
2 cross-border interpretive guidance. It's
3 undeniable that the lack of such certainty is
4 fragmenting what were once global swaps markets
5 and increasing systemic risk rather than reducing
6 it.

7 I do want to note in a positive fashion
8 that the Advance Notice of Proposed Rulemaking on
9 the treatment of cross-border reach of the
10 uncleared margin rule shows a pragmatism and a
11 flexibility that belies the notion of CFTC
12 rulemaking that widely and woodenly overreaches in
13 the assertion of extraterritorial jurisdiction. I
14 commend it to our fellow regulators abroad as a
15 portent of greater accord in global regulatory
16 reform.

17 I will be issuing a written statement
18 with the publication of the uncleared margin
19 proposal that will amplify these concerns and
20 several additional ones. It will include
21 commentary about the cross-border components of
22 the proposal where I have several concerns and

1 seek well-informed public comment.

2 I do, despite my concerns, want to
3 commend my fellow commissioners, especially
4 Commissioner Wetjen, for leadership on the
5 cross-border issues both in this proposal and
6 generally. And I also want to thank Chairman
7 Massad and the rule-writing staff for their deep
8 thoughtfulness and flexibility in responding to
9 the cross-border issues raised by me and my staff
10 and those of my fellow Commissioners. Thank you.

11 CHAIRMAN MASSAD: Thank you,
12 Commissioner Giancarlo. The staff will now make
13 presentations to the Commission concerning two
14 recommendations: First, the final rule on utility
15 special entities and then the proposed rule on
16 margin. After each presentation, the floor will
17 be open for questions and comments from each of
18 the Commissioners. Following these discussions,
19 the Commission may take votes on the
20 recommendations as presented. All final votes
21 conducted in this public meeting shall be recorded
22 votes, and the results of those votes will be

1 included in their relevant Federal Register
2 releases.

3 At this point, I ask unanimous consent
4 to allow staff to make technical corrections to
5 the documents voted on today prior to sending them
6 to the Federal Register. Is there any objection?
7 Without objection, so ordered.

8 So at this time I would like to welcome
9 Erik Remmler, Barbara Gold, Israel Goodman, and
10 Chris Cummings from the Division of Swap Dealer
11 and Intermediary Oversight, and Stephen Kane from
12 the Office of the Chief Economist, to present the
13 staff recommendation concerning the final rule.
14 And let me again thank all of you, and I know
15 there are many more members of your teams and our
16 staff who have been involved in this. So thanks
17 again. Please go ahead.

18 MR. REMMLER: Good afternoon,
19 Commissioners. Before summarizing the particulars
20 of this rule, I would like to recognize the hard
21 work of the staff sitting with me today, in
22 particular Israel Goodman, Barbara Gold, and Chris

1 Cummings. They were the staff who did much of the
2 writing and analysis in preparing the proposed
3 rule as well as the final rule before you today.
4 They also undertook the review and analysis of
5 comments received from the public. Also with us
6 today is Steve Kane from the Office of the Chief
7 Economist who provided good insights on the cost
8 benefit analysis. And I would also like to thank
9 in particular the Office of General Counsel who
10 helped with preparing the rule.

11 This rule is a final rule. The proposed
12 version was published in the Federal Register on
13 June 2 of this year, and the Commission received
14 ten comment letters on the proposed rule. If
15 adopted, the final rule we are recommending today
16 would amend the Commission's regulation 1.3(ggg)
17 that identifies which entities must register as
18 swap dealers. Under the swap dealer rule, an
19 entity dealing in swaps only needs to register if
20 the aggregate notional amount of swaps entered
21 into by that entity on a dealing basis over a
22 12-month period exceeds a specified de minimis

1 amount. The general de minimis amount is \$8
2 billion.

3 The swap dealer rule also establishes a
4 separate de minimis amount of \$25 million for
5 dealing swaps entered into with special entities.
6 As the Commissioners noted, special entities are
7 defined in the Dodd-Frank Act as certain federal
8 agencies, states, political subdivisions of
9 states, and certain of their agencies,
10 instrumentalities, and pension systems.

11 The Commission proposed this rule in
12 response to a petition for rulemaking. The
13 petition indicated that utilities that are special
14 entities often rely on customized swaps to hedge
15 and mitigate the risks of their electric and
16 natural gas businesses. They rely on these swaps
17 to meet their obligations to provide continuous
18 service to their customers.

19 The petition indicated that the low de
20 minimis threshold for special entities was having
21 a chilling effect on the willingness of
22 counterparties with specialized expertise in these

1 operational swaps to enter into those swaps with
2 utility special entities. The basic effect of the
3 amendments to rule 1.3(ggg) in the final rule
4 before you would permit a person that deals in
5 utility operations-related swaps with utility
6 special entities to exclude those swaps in
7 calculating whether the person's dealing
8 activities exceeds the \$25 million de minimis. As
9 noted above, if they exceed that de minimis, they
10 would need to register as swap dealers.

11 To give effect to this provision, the
12 proposed rule defines certain terms. The term
13 "utility special entity" is defined to mean a
14 special entity that owns or operates electric or
15 natural gas facilities or operations or
16 anticipated electric or natural gas facilities or
17 operations, supplies natural gas or electric
18 energy to other utility special entities, has
19 public service obligations or anticipated public
20 service obligations under law or regulation to
21 deliver electric energy or natural gas to utility
22 customers, or that is a federal power marketing

1 agency as defined in Section 3 of the Federal
2 Power Act. This definition is unchanged from the
3 proposed rule.

4 The final rule would also define the
5 term "utility operations-related swap" to mean a
6 swap with the following characteristics: One of
7 the counterparties to the swap must be a utility
8 special entity; the utility special entity must be
9 using the swap to hedge or mitigate its commercial
10 risks; a swap must be related to an exempt
11 commodity, as defined in the Commodity Exchange
12 Act, or to an agricultural commodity used for fuel
13 for generation of electricity or otherwise used in
14 the normal operations of the utility special
15 entity; and the swap must be an electric energy or
16 natural gas swap or be associated with any one of
17 a number of listed purposes related to the normal
18 operations of utility special entities. I note
19 that this definition has been modified in a couple
20 of ways, most prominently we added at the request
21 of commenters agricultural swaps as a permitted
22 form of swap.

1 Other changes in the final rule from the
2 proposed rule based on comments received from the
3 public: After consideration of those comments, a
4 requirement that a person that relies on the rule
5 must file a notice with the NFA has been removed
6 from the final rule.

7 Also in response to comments, the final
8 rule text includes a provision permitting a person
9 relying on the rule to rely on written
10 representations from the utility special entity
11 counterparty that the entity is a utility special
12 entity and that the swap is a utility
13 operations-related swap as required by the rule.

14 And, finally, the final rule no longer
15 includes a requirement that persons relying on the
16 rule must maintain certain books and records in
17 accordance with the Commission's regulations in
18 order to be eligible to use the rule.

19 With that I'll take any questions you
20 may have.

21 CHAIRMAN MASSAD: Thank you, Mr.
22 Remmler. Just on the notice provision, can you

1 talk about the alternative that the staff is
2 contemplating and why we're contemplating that
3 alternative?

4 MR. REMMLER: Yes, sure. The notice
5 provision that was proposed would have required
6 the counterparties to the utility special entities
7 to identify themselves in a notice to NFA.
8 Commenters indicated that that requirement could
9 have a chilling effect on counterparties using the
10 rule. And also staff after consideration of
11 comments was also concerned that that notice
12 provision may not in effect provide fully the
13 information that would be useful in administering
14 this rule. So after consideration, we have
15 included in the preamble of the rule an indication
16 that staff will consider possible alternatives.
17 In particular, one alternative that we would look
18 at is whether a reporting requirement can be added
19 to Part 45, in which an additional data field
20 would be required whenever one of these swaps is
21 reported to an SDR, or swap data repository,
22 indicating that the swap is a utility

1 operations-related swap.

2 CHAIRMAN MASSAD: Thank you. I realize
3 that in my desire to get to the questions, and I
4 know my fellow Commissioners want to get to the
5 questions, I overlooked the proper process here.
6 I'm supposed to first, to open the Commission's
7 consideration of this rulemaking, I think we need
8 a motion to adopt the final rule as presented by
9 the staff, and then we can have the discussion.
10 So I will wait for that motion.

11 COMMISSIONER WETJEN: So moved.

12 CHAIRMAN MASSAD: Is there a second?

13 COMMISSIONER BOWEN: Second.

14 CHAIRMAN MASSAD: Okay, now we can begin
15 the discussion. I take it I don't need to repeat
16 that question, but I appreciate the staff's
17 answers. As I understand it, that would give us
18 actually -- if we went the Part 45 route, that
19 would actually give us more granular data that
20 would be swap by swap, which is in my mind more
21 useful. Is that correct?

22 MR. REMMLER: Yes, I would agree.

1 CHAIRMAN MASSAD: Okay. And on this
2 point I just want to thank Commissioner Giancarlo
3 for raising this idea and for his support for
4 looking at that as an alternative. I thought it
5 was a very good suggestion.

6 I want to allow the other Commissioners
7 to ask questions. Let me just make a couple of
8 comments because I don't have any other questions.
9 But just to reiterate, I support the staff's
10 recommendation. As I noted in my opening
11 statement, this final rule addresses an issue for
12 a limited, but important, group of end-users.
13 These public power companies, such as municipal
14 gas and electric companies, provide vital services
15 to communities across our country. And to do
16 their job, they must be able to access the energy
17 commodity markets and hedge fuel price risk. The
18 rule we are voting on today will help them
19 continue to do so. The rule addresses an
20 unintended consequence of the actions taken by the
21 Commission to implement a very important directive
22 of Congress, to provide certain municipal

1 government entities and other special entities
2 heightened protection when they transact business
3 in the derivatives markets so that we prevent some
4 of the abuses of the past.

5 In order to implement that directive,
6 the Commission set a lower de minimis threshold
7 for being a swap dealer when it comes to swap
8 activity with special entities. This was because
9 the Commission wanted to make sure the special
10 entities would receive heightened protections for
11 more companies than just large swap dealers, but
12 the Commission's prior rule adversely impacted the
13 ability of these utility companies to hedge or
14 mitigate their commercial risks. And due to the
15 unique nature of the energy markets in which these
16 utility companies operate, segments of the markets
17 they use are not nearly as liquid or large as say
18 the interest rate swap market.

19 Consequently, the number of potential
20 counterparties for utility operations swaps is
21 limited, and the regulatory requirements
22 associated with swap dealer registration could

1 discourage potential counterparties from
2 transacting with these utility companies. That
3 could, in turn, impose costs that would ultimately
4 be passed on to consumers. The final rule fixes
5 that problem and, as you have noted, I think it
6 has benefited from public comment.

7 In sum I believe the final rule advances
8 the core goals of financial reform as set forth in
9 the Dodd-Frank Act while responding to an
10 important need and that is why I support the final
11 rule.

12 With that I will now open the floor to
13 allow the Commissioners to make any statements or
14 ask any questions they may have, and I will start
15 with Commissioner Wetjen.

16 COMMISSIONER WETJEN: Thank you, Mr.
17 Chairman. I also intend to support the final rule
18 before us today. I'm delighted to do so and,
19 again, applaud your efforts, Mr. Chairman, in
20 bringing this before the Commission so quickly
21 after the comment period ended. And I do not have
22 any further questions.

1 CHAIRMAN MASSAD: Thank you.
2 Commissioner Bowen?

3 COMMISSIONER BOWEN: Yes, thank you,
4 just a couple of questions. Can you confirm
5 whether this rule will have any effect on how the
6 utility special entities would otherwise transact
7 in interest rate swaps or other swaps not related
8 to energy?

9 MR. REMMLER: Sure. The definition of
10 the term "utility operations-related swap"
11 excludes interest rate swaps and other types of
12 financial swaps. Accordingly, the rule would not
13 affect how utility special entities would enter
14 into these types of swaps. They can do so in the
15 same way that any other type of special entity
16 could enter into these swaps. And to the extent
17 their counterparty is entering into the swap with
18 a utility special entity, they would have to count
19 that swap -- interest rate swaps -- in the same
20 way that they would if they were entering into a
21 swap with any other type of special entity.

22 COMMISSIONER BOWEN: Thank you. And

1 then could you also elaborate a little bit on why
2 the utility special entity -- why they should be
3 different from other special entities? For
4 example, why doesn't this rule apply to a local
5 government using swaps to hedge financial risk?

6 MR. REMMLER: Sure, sure. As the
7 Chairman noted, the Dodd-Frank Act had created
8 heightened protections for special entities in
9 connection with the swaps they enter into. Many
10 of those swaps were interest rate swaps and other
11 financial swaps that in some cases led to some
12 significant losses for these governmental
13 entities. Some of those swaps may have been
14 entered into without a clear understanding of some
15 of the risks involved in those swaps.

16 Unlike other special entities, utility
17 special entities are engaged in a very focused
18 business activity of providing electric energy and
19 natural gas services to their clients. In doing
20 so, they buy and sell physical commodities
21 routinely and regularly have historically entered
22 into specialized swaps for hedging their

1 businesses. Because of this experience, the
2 utility special entities are more likely to have
3 developed a greater expertise with the underlying
4 commodities and the swaps themselves. And so the
5 needs for those heightened protections is lessened
6 because of that experience.

7 I think I would also add that registered
8 swap dealers will make markets and interest rate
9 swaps and other financial swaps readily with
10 special entities and utility special entities.
11 However, because of the customized nature of the
12 utility operations-related swaps that this rule
13 addresses, these swaps are often very customized
14 based on the location and the specific needs of
15 each utility special entity. And because of that
16 there's a greater need for relief in connection
17 with utility special entities and with these
18 particular types of swaps.

19 COMMISSIONER BOWEN: Thank you. I think
20 we've struck the right and appropriate balance in
21 this rule, but I will be vigilant in making sure
22 that we don't have any loopholes that may arise.

1 Thank you.

2 CHAIRMAN MASSAD: Thank you,
3 Commissioner Bowen. Let me now turn to
4 Commissioner Giancarlo.

5 COMMISSIONER GIANCARLO: Thank you,
6 Chairman. Just briefly, I think this is indeed a
7 good rule made better through thoughtfulness,
8 through flexibility and collaboration amongst the
9 agency staff and the Commissioners. So I'm very
10 pleased to support it and thank you very much for
11 your hard work on it, over the last few days
12 especially.

13 CHAIRMAN MASSAD: Are the Commissioners
14 prepared to vote? If so, I will ask Mr.
15 Kirkpatrick, can you call the roll?

16 MR. KIRKPATRICK: Mr. Chairman, the
17 motion now before the Commission is on the
18 adoption of the final rule on exclusion of utility
19 operations-related swaps with utility special
20 entities from de minimis threshold for swaps with
21 special entities. Commissioner Giancarlo?

22 COMMISSIONER GIANCARLO: Aye.

1 MR. KIRKPATRICK: Commissioner
2 Giancarlo, aye. Commissioner Bowen?

3 COMMISSIONER BOWEN: Aye.

4 MR. KIRKPATRICK: Commissioner Bowen,
5 aye. Commissioner Wetjen?

6 COMMISSIONER WETJEN: Aye.

7 MR. KIRKPATRICK: Commissioner Wetjen,
8 aye. Chairman Massad?

9 CHAIRMAN MASSAD: Aye.

10 MR. KIRKPATRICK: Chairman Massad, aye.
11 Mr. Chairman, on this matter the aye's have four,
12 the no's have zero.

13 CHAIRMAN MASSAD: Thank you, Mr.
14 Kirkpatrick. Let us now move to the presentation
15 on proposal two, so we'll ask our staff to change
16 seats.

17 First, let me also once again make a
18 slight backtrack, having not memorized all my
19 lines. I was supposed to say "the aye's have it"
20 on that prior recommendation and "the motion to
21 adopt the final rule is approved."

22 So let's now go on to proposal two on

1 margin requirements. At this time I would like to
2 welcome John Lawton from the Division of Clearing
3 and Risk, Tom Smith and Rafael Martinez from the
4 Division of Swap Dealer and Intermediary
5 Oversight, and Stephen Kane once again from the
6 Office of the Chief Economist, to present the
7 margin rule proposal. Again, thank you all, and
8 let me extend my thanks again to the many members
9 of your teams that have worked on this. Please go
10 ahead.

11 MR. LAWTON: Good afternoon,
12 Commissioners. The proposed rules before the
13 Commission would implement Section 4s(e) of the
14 Commodity Exchange Act. They would address margin
15 requirements for uncleared swaps entered into by
16 swap dealers, SDs, or major swap participants,
17 MSPs. The rules would apply to SD/MSPs that are
18 not subject to regulation by either the Federal
19 Reserve Board, the Office of the Comptroller of
20 the Currency, the Federal Deposit Insurance
21 Corporation, the Farm Credit Administration, or
22 the Federal Housing Finance Agency. Collectively,

1 these agencies are known as the prudential
2 regulators.

3 In developing the proposed rules,
4 Commission staff worked closely with the
5 prudential regulators. Commission staff also
6 consulted with staff of the Securities and
7 Exchange Commission. The proposed rules are very
8 similar to the rules recently proposed by the
9 prudential regulators. The proposed rules are
10 also very similar to the international standards
11 that were issued in 2013 by the Basel Committee on
12 Banking Supervision and the International
13 Organization of Securities Commissions.

14 In this presentation I will briefly
15 touch on the following topics: The products that
16 are subject to the rules, the market participants
17 that are subject to the rules, the nature and
18 timing of margin requirements, how initial margin
19 would be calculated, acceptable collateral,
20 custodial arrangements, the implementation
21 schedule, and finally cross-border issues.

22 Moving first to products, the rule would

1 apply to uncleared swaps entered into after the
2 effective dates of the regulation. As I will
3 describe in a few moments, the rules will be
4 phased in so they will apply to different parties
5 at different times. The requirements would not
6 apply retroactively to swaps entered into before
7 the applicable effective date.

8 The market participants that are covered
9 would be those SDs and MSPs that are not subject
10 to oversight by prudential regulators. We refer
11 to these SDs and MSPs as covered swap entities, or
12 CSEs. The rules would impose margin requirements
13 on trades between a CSE and any other SD/MSP and
14 on trades between a CSE and a financial end-user.
15 The rules would not impose margin requirements on
16 commercial end-users.

17 Turning to the nature and timing of
18 margin requirements: With regard to initial
19 margin, the rules would require two-way initial
20 margin; that is to say posting and collecting for
21 all trades between a CSE and any SD/MSP. The
22 rules would also require two-way margin for all

1 trades between a CSE and a financial end-user that
2 had over \$3 billion in gross notional exposure in
3 uncleared swaps. This provision recognizes that
4 certain financial end-users with relatively
5 smaller positions do not pose the same risk as
6 those with larger positions. By reducing the
7 number of market participants subject to initial
8 margin requirements, it also would address
9 concerns that have been mentioned about the
10 availability of sufficient collateral to meet
11 these requirements. This concept is consistent
12 with international standards, but the proposed
13 threshold is lower. The proposed threshold is the
14 same as that recently proposed by prudential
15 regulators. Based on analysis of additional data
16 that became available after the initial standards
17 were issued, Commission staff and prudential
18 regulator staff concluded that the lower threshold
19 would more closely align with the expressed intent
20 of the international standards, which was to
21 exclude market participants who would have margin
22 requirements below \$65 million.

1 Turning to variation margin, the rules
2 would require daily payment of variation margin
3 for all trades between a CSE and another SD/MSP.
4 The rules would also require daily payment of
5 variation margin for all trades between the CSE
6 and a financial end-user. In contrast to initial
7 margin, there isn't a threshold for variation
8 margin.

9 Turning to the calculation of initial
10 margin, the rules would permit the calculation of
11 initial margin to be based on models or a
12 standardized table. Models would be required to
13 use a 99 percent confidence level or a 10-day
14 liquidation time. The rules would permit the
15 parties to establish a \$65 million threshold below
16 which margin would not need to be collected. This
17 threshold is designed to mitigate the cost of
18 these rules while continuing to protect the
19 overall financial integrity of the swap dealers
20 and the financial system. Smaller exposures would
21 be permitted to go uncollateralized, but a
22 significant percentage of all larger exposures

1 would, in fact, be subject to collateral. To
2 illustrate the operation of this provision, if the
3 initial margin for a particular trade was \$55
4 million, no margin would be required to be
5 collected. If it was \$75 million, \$10 million
6 would be required to be collected. That is the
7 difference between the margin required and the \$65
8 million threshold.

9 Moving to forms of margin: For initial
10 margin, the rules would permit cash; sovereign
11 debt; certain government-sponsored debt;
12 investment-grade debt, including certain corporate
13 and municipal bonds; certain equities that meet
14 certain standards; and gold. This list is the
15 same as the list that the prudential regulators
16 proposed a couple of weeks ago. It's a
17 substantial expansion of the list that was
18 proposed by the Commission and by the prudential
19 regulators in 2011. This was in response to
20 concerns that there might be a potential scarcity
21 of collateral if we had a very narrow list of
22 eligible collateral. The rules would require the

1 variation margin to be paid in cash. This is the
2 same as the prudential regulators' proposal.

3 Turning to custodial arrangements: The
4 rules would require initial margin to be held at
5 an independent custodian. The rules would not
6 permit the re-hypothecation of initial margin.
7 Again, both of these provisions are the same as
8 the prudential regulators' proposal. The
9 prohibition of re-hypothecation is stricter than
10 what is in the international standards, which did
11 allow re-hypothecation under certain
12 circumstances. The concern that has been
13 expressed is that if collateral is being allowed
14 to be re-hypothecated, it could be used to margin
15 more than one position or it could be lost in a
16 financial stress situation and someone wouldn't
17 actually be able to recover collateral that they
18 thought was rightfully theirs.

19 The implementation schedule is
20 consistent -- again, it's identical to the
21 implementation schedule proposed by the prudential
22 regulators and in the international standards. It

1 would require that variation margin requirements
2 be effective December 1, 2015. Initial margin
3 requirements would be phased in starting December
4 1, 2015, with a different group coming in December
5 1 of each year through 2019 based on their gross
6 notional exposure. So only the largest
7 participants would be effective December 1, 2015,
8 and then intermediate groups in '16, '17, and '18,
9 and then the last group on December 1, 2019.

10 The final topic I want to address is the
11 cross-border application of these rules. Here the
12 Federal Register release does not propose rule
13 text, but instead takes the approach of an Advance
14 Notice of Proposed Rulemaking. The release
15 describes three alternative ways in which these
16 issues could be addressed and requests public
17 comment. The three alternatives are first, the
18 approach taken on the cross-border guidance issued
19 by the Commission last year, which is broadly and
20 generally a transaction-based approach. The
21 second alternative, the approach taken by the
22 prudential regulators two weeks ago, which is

1 generally an entity-based approach with some
2 modification. Or a third approach, which is also
3 an entity-based approach, which would differ from
4 the prudential regulators' approach in a couple of
5 particulars. The release asks a number of
6 questions about each of the approaches intended to
7 elicit comment on the pluses and the minuses of
8 each of these approaches or any other approach
9 that members of the public might think were
10 preferable or some combination.

11 In closing I'd like to thank the other
12 members of the staff who worked on this project --
13 Tom Smith, Rafael Martinez, Francis Kuo, Steve
14 Kane, David Reiffen, Carlene Kim, Paul
15 Schlichting, and Laura Badian. Thank you.

16 CHAIRMAN MASSAD: Thank you. To begin
17 the Commission's consideration of this rulemaking,
18 I will now entertain a motion to adopt the
19 proposed rule as presented by the staff.

20 COMMISSIONER WETJEN: So moved.

21 CHAIRMAN MASSAD: Is there a second?

22 COMMISSIONER BOWEN: Second.

1 CHAIRMAN MASSAD: Thank you. Let me
2 begin. I would like to ask a few questions. Mr.
3 Lawton, can you just explain further on the
4 threshold? You said that our threshold for
5 collection of margin is higher than -- it's the
6 same as the prudential regulators. It is higher
7 than the IOSCO standard, but you said it
8 nevertheless really -- it's consistent with the
9 intent of the IOSCO standards as to the \$65
10 million threshold. Can you talk a little bit more
11 about that and the data or analysis that you made?

12 MR. LAWTON: Right. The international
13 standards and this rule and the prudential
14 regulators' rule all stated that if you have a
15 margin requirement below \$65 million, you need not
16 post margin. The threshold of gross notional
17 exposure was effectively an attempt to
18 reverse-engineer what amount of gross notional
19 would tend to generate \$65 million in margin to
20 allow people sort of a safe harbor. If you have
21 below this gross notional, you don't even have to
22 do the computation. So the international group

1 based on data that it got essentially from the
2 largest of the dealers came up with a standard,
3 which was 8 billion euros, which is roughly \$11
4 billion.

5 Subsequent to the issuance of that, we
6 started looking at data with regard to cleared
7 swaps. We looked at over 4,000 accounts and
8 calculated what was the ratio of margin to gross
9 notional and found that the ratio was frequently a
10 much higher number than had been found based on
11 the data that the international group had used to
12 set the threshold. We provided this data to the
13 prudential regulators. They also analyzed it.
14 They reached the same conclusion that CFTC staff
15 had reached; that, in fact, the -- and one further
16 point I should make and this was cleared data. If
17 one is calculating a ratio of margin to gross
18 notional for a cleared position, you're doing that
19 based on a 5-day liquidation horizon. The
20 proposed rules for uncleared would require a
21 10-day liquidation horizon. Roughly speaking, one
22 would expect a 10-day liquidation horizon to have

1 about a 40 percent higher number.

2 So, again, the data from the cleared
3 world indicated that the safe harbor in the
4 international standard would probably exclude a
5 lot of people whose margin requirements would, in
6 fact, turn out to be greater than \$65 million. So
7 we presented this data to the prudential
8 regulators. They analyzed it. They reached the
9 same conclusion. We've also provided this data to
10 the monitoring group of the international group.
11 It's going to be an active topic for this
12 monitoring group after these rules are proposed so
13 that the foreign regulators can analyze it and see
14 if they reach the same conclusion and perhaps
15 there will be discussions. Perhaps the
16 international standard might be adjusted based on
17 this data.

18 CHAIRMAN MASSAD: So we are in
19 discussions with our international counterparts on
20 trying to harmonize these standards?

21 MR. LAWTON: Yes, definitely.

22 CHAIRMAN MASSAD: Okay, thank you.

1 Secondly, can you talk a little bit more about the
2 types of acceptable collateral? You included in
3 your list municipal securities. I know that when
4 the prudential regulators adopted their proposal,
5 the Fed also adopted its liquidity coverage ratio
6 and there was some discussion in the press that
7 municipal securities were not included. Now, the
8 rules are different. Our margin proposal today as
9 well as the prudential regulators' includes
10 corporate debt and corporate equities, so I do
11 think it's important that we include municipal
12 bonds. Obviously, they can be subject to some
13 liquidity and quality standards, but can you talk
14 a little bit more about that?

15 MR. LAWTON: Yes. Again, on acceptable
16 collateral, our rule is identical to the
17 prudential regulators' except in one place where
18 we effectively -- they cross referenced some of
19 their own rules and we simply cross referenced
20 anything that's been approved by the prudential
21 regulators. And that would be particularly
22 relevant on this particular point because, for

1 example, one of the cross references is to -- one
2 of their regulations, which defines investment
3 grade securities, and basically that means "a
4 security where the issuer has adequate capacity to
5 meet financial commitments under the security for
6 the projected life of the asset or exposure."
7 Staff of the prudential regulators has indicated
8 that there is corporate debt that meets that
9 standard. There are municipal bonds that meet
10 that standard. And, therefore, those particular
11 assets would be acceptable collateral under their
12 proposed rules; therefore, by extension under
13 ours, our thinking being that it would make sense
14 for swap dealers to have the same standards of
15 collateral whether it's a CFTC regulated swap
16 dealer or a prudentially regulated swap dealer.

17 CHAIRMAN MASSAD: Thank you. Let me
18 also ask you about the process for approving the
19 models used to calculate margin. Obviously, we
20 need a very robust review process. It also needs
21 to be an efficient review process. This is
22 especially a concern given our limited resources.

1 What would be the interaction between us and other
2 regulators in that regard?

3 MR. LAWTON: We anticipate working very
4 closely both with the prudential regulators, the
5 SEC, and we hope many international regulators. I
6 think we'll find that there's a lot of swap
7 dealers, there's multiple swap dealers in the same
8 corporate family. We would anticipate that
9 largely they would use the same model. So,
10 therefore, if the Comptroller of the Currency
11 approved a model that was being used by the bank,
12 we would expect it to be essentially the same
13 model approved by the bank's affiliates that were
14 under CFTC jurisdiction. So we think there can be
15 a very close cooperative relationship, which will
16 expedite that given the CFTC's limited staff. And
17 we think that could probably work internationally
18 as well if there are affiliates of foreign banks
19 that might be subject to our jurisdiction.

20 We also anticipate that there'll be some
21 instances where there might be third-party models
22 out there, which, again, might be approved by one

1 of the other regulators. And that also might be
2 used by a standalone swap dealer, and we would be
3 able to expedite approval of that.

4 We're also contemplating the concept of
5 provisional approval so that people can be using
6 models pending review.

7 MR. CHAIRMAN: Yes, Tom?

8 MR. SMITH: I'd just like to add just
9 one more comment to that point that John was
10 making. This was a significant issue when the
11 Commission proposed its capital regulations and
12 the question came up there. Same thing, who would
13 be able to perform model reviews? And in looking
14 at it today on who is provisionally registered
15 with CFTC as a swap dealer, there are a number of
16 entities that are not part of a prudential
17 regulator family. They're not a nonbank
18 subsidiary of a bank holding company. They don't
19 have a foreign regulator; that is, a prudential
20 regulator. So we're looking at that.

21 And in the capital rule, a lot of the
22 comments that came in on the capital model review

1 were what would be the role of the National
2 Futures Association and should they have a role?
3 We have put in questions regarding that in this
4 proposal as well for those swap dealers that are
5 not part of a prudential regulator family or have
6 foreign regulators.

7 MR. CHAIRMAN: Thank you. Well, thank
8 you very much for the presentation. I support the
9 proposal as I think we've all noted. I think this
10 is a key part of our Dodd-Frank mandate. Margin
11 requirements for uncleared swaps are vital to
12 improving the safety and soundness of our swaps
13 marketplace. I think it's very important that our
14 rule does not unnecessarily burden commercial
15 end-users and, therefore, I'm pleased that our
16 rule, as well as the prudential regulators'
17 proposals, does not require commercial end-users
18 to post or collect margin.

19 I'm also pleased that our proposal is
20 very similar to the proposed rules approved by the
21 prudential regulators and that it is very similar
22 to the international standards. It's extremely

1 important that we try to harmonize these rules as
2 much as possible in order to promote fair
3 competition by entities regulated in different
4 jurisdictions and by different regulators.

5 I think we all recognize that more
6 stringent margin requirements impose costs on
7 market participants and, therefore, the proposal
8 includes a detailed cost-benefit analysis. I
9 believe the proposal before us balances the
10 inherent tradeoff between mitigating systemic risk
11 and minimizing costs on individual participants.
12 But I'm very interested in having public feedback
13 on that analysis as well as on the proposal as a
14 whole. And I would be particularly interested in
15 commenters' views on some of the issues I've
16 noted, such as the threshold, the types of
17 acceptable collateral, the process for approving
18 margin models. I think also the requirement that
19 collateral be held by a third-party custodian and
20 the prohibition on re-hypothecation. These are
21 important measures, as you've noted, to protect a
22 posting party's collateral and minimize the

1 buildup of overall risk in the system. However,
2 they do create costs of compliance, and we invite
3 comments on the benefits as well as the costs.

4 Finally, on the cross-border application
5 of the rule, I think it is a good approach that
6 we've outlined a few options. And I think the
7 reason for that is pretty apparent, but I'm happy
8 to explain it. On the one hand, there is clearly
9 value in being consistent with our prior guidance,
10 which did look at margin as a transaction-based
11 requirement. At the same time, the law requires
12 us to harmonize as much as possible with the
13 prudential regulators. They have taken an
14 approach which is slightly different in some cases
15 to what the guidance would imply. And, finally,
16 there are those who have suggested that we should
17 really think of margin and capital not as
18 transaction requirements, but as entity
19 requirements, particularly when you think about
20 the fact that if you are a swap dealer who's
21 applying a margin model to some participants, why
22 not just apply it to all participants. So that's

1 the reason for inviting public comment, and we
2 look forward to those comments.

3 The thing I would like to note is really
4 when you step back the key here again is to
5 achieve as much harmonization as we can between
6 the rules of different regulators not only
7 domestically, but abroad. If the rules are
8 essentially the same, then whether we say our rule
9 applies in this particular case or we say our rule
10 applies, but with substituted compliance, or we
11 say we have total difference, you end up in the
12 same place if the rules with that other
13 jurisdiction are essentially the same. So, again,
14 that is I think a key objective here.

15 Again, I want to thank the staff for
16 their hard work on this proposal, which as I say I
17 support. I would now like to open the floor to
18 allow the Commissioners to make any statements and
19 ask any questions they may have, and I will begin
20 with Commissioner Wetjen.

21 COMMISSIONER WETJEN: Thank you, Mr.
22 Chairman. I think I'll go in the order reverse of

1 how it reads in my notes and start with a question
2 on approving margin methodologies since it's
3 something that we were just talking about.

4 I share some of the concerns of the
5 Chairman with respect to the agency's already
6 greatly burdened staff and agree very much that it
7 would make a lot sense where we can to borrow from
8 or benefit from the work of some of the other
9 regulators who are also making similar reviews and
10 approvals or disapprovals of margin methodologies.
11 And I would just note that there are a couple of
12 different ways we could do this and ways that
13 would be similar to what Mr. Smith alluded to.
14 Tom, you mentioned the involvement of the NFA in
15 how methodologies can be used pending approval or
16 disapproval by the Commission.

17 There's a number of other ways we can do
18 it along those lines. We have precedent through
19 Part 40 of our rules where a dealer could perhaps
20 basically follow methodology that's self-executing
21 and deemed approved pending review; that might be
22 one efficient way of doing it. We've done

1 something similar even in the context of
2 registering SEFs in the last year where we have
3 provisional registration. SEFs are up and
4 operating under a provisional registration while
5 the staff continues to review the actual
6 compliance with the core principles; that could be
7 another precedent we could use here.

8 But it sounds like the staff agrees
9 based on comments I've heard here today. We want
10 to make sure that people can continue doing
11 business and the market can continue operating as
12 it should while the agency does its work in making
13 sure the methodologies are sound and fair. So I
14 look forward to the comments and seeing whether
15 there might even be additional ways we could
16 approach this, balancing the needs of the
17 Commission, but also recognizing some of the
18 constraints that we have. So I look forward,
19 again, to additional insights into that topic.

20 Turning to a different topic, I wanted
21 to ask the staff -- there's a decision made, at
22 least in the proposal here, about what constitutes

1 a cleared swap and what does not constitute a
2 cleared swap. And we say in the proposal that "a
3 cleared swap is only one that's cleared by a
4 registered DCO or cleared by a clearinghouse that
5 is subject to relief from the Commission." Can
6 you explain what the rationale for that decision,
7 or proposal rather, what that rationale is?

8 MR. LAWTON: Actually, the statute
9 refers to a cleared swap as being one that's
10 cleared by a DCO, so what we proposed actually
11 goes beyond what's in the statute. The prudential
12 regulators actually just followed the statute, so
13 we actually proposed something a little bit beyond
14 that because we did identify the concern that
15 there are trades, which are executed by people who
16 might be subject to this rule, that are submitted
17 to CCPs, central counterparties, but CCPs that are
18 not actually registered with the Commission. And
19 we didn't think that it was the intent of the
20 statute to apply these rules to that circumstance.

21 It's hard to figure out how that would
22 practically work because these rules are two-way

1 margin. Typically if you do a trade and you
2 submit it to clearing, the counterparties no
3 longer have a relationship with one another. They
4 have a relationship with the clearinghouse. And
5 if you tried to apply these rules, then you would
6 be saying that the clearinghouse has to post
7 margin with the clearing member; whereas typically
8 in the clearing world, margin just goes one way
9 from the clearing member to the clearinghouse.

10 So we just flagged this as an issue,
11 hoping to get comment from the public as to how to
12 address this. On the other hand we didn't want to
13 say that any clearinghouse anywhere would
14 necessarily qualify, so we tried to come up with
15 standards. We asked, for example, whether the
16 PFMI might be an appropriate standard for
17 determining what's an acceptable clearinghouse to
18 take you out from under the coverage of this rule.

19 COMMISSIONER WETJEN: Thank you, John.
20 I think it's excellent that we posed that question
21 in today's release, and I'm thinking about a
22 comment made by Commissioner Giancarlo earlier.

1 Obviously -- and I'm sure this is a concern the
2 other Commissioners share as well -- we need to be
3 pragmatic with our rules, too. It might make some
4 sense to go beyond what's in the proposal and
5 consider swaps to be cleared for purposes of the
6 margin rule, even in the case of a swap cleared by
7 an unregistered CCP so long as the CCP abides by
8 the PFMI standards adopted by IOSCO.

9 To give some context to the practical
10 implications here, there's a recent story in one
11 of the newspapers that described how some dealers
12 are members of literally dozens and dozens of
13 clearinghouses. I'm quite certain we don't have
14 registered as DCOs dozens and dozens of
15 clearinghouses, and I know that we only have a
16 handful of clearinghouses that are subject to
17 relief by the staff. But, nonetheless, I would
18 imagine most of those remaining clearinghouses are
19 probably following rules in jurisdictions that
20 were informed by IOSCO PFMI standards. We've seen
21 some of the difficulties of not fully embracing
22 where we can and should these PFMI standards. I

1 presume that Chairman Massad knows that better
2 than anyone in recent months. And so I think it's
3 something we need to think about carefully. So,
4 again, I look forward to the comments as they come
5 in that speak to this issue.

6 I have just a couple of points of
7 clarification on the issue of the material swap
8 threshold. The way the proposal works, it says
9 that "the threshold is exceeded if the average
10 daily aggregate notional amount of uncleared swap
11 activity of a corporate group with all
12 counterparties over a three-month period in the
13 previous year exceeds \$3 billion." And so the
14 proposal goes on to identify three specific months
15 as those three months through which to make the
16 calculation. I want to ask for the benefit of the
17 public, why were those months chosen? The months,
18 by the way, are June, July, and August, as you
19 know.

20 MR. LAWTON: That was working backwards
21 from the implementation schedule, which the
22 implementation schedule starts December 1 of each

1 year. So these months were chosen by the
2 International Committee and then the prudential
3 regulators and this proposal conformed to that.
4 But the idea was that those months are fairly
5 close in time to the December 1 implementation
6 date, but give a little bit of room for people to
7 do the calculation, determine whether, in fact,
8 they've now gone over the threshold and might be
9 subject to having to post and collect margin on
10 December 1.

11 COMMISSIONER WETJEN: And how's the
12 notional amount of basis swaps considered? How is
13 that supposed to be calculated in this notional
14 calculation?

15 MR. LAWTON: That actually isn't
16 specified in the proposal. That's an interesting
17 question. I'm not sure exactly how that would be
18 calculated.

19 COMMISSIONER WETJEN: So another issue
20 to flag for the commenters. It sounds like we
21 could probably use some direction on that.

22 Just one other area to point out where

1 there is a bit of a departure, although I don't
2 think a serious one in any way, but a bit of a
3 departure from the global margin framework. And
4 that is in regard to the requirement under today's
5 release that variation margin be passed as cash
6 rather than some other liquid asset. So just help
7 us understand why the proposal went the direction
8 it did.

9 MR. LAWTON: Basically variation margin
10 serves a different purpose than initial margin. I
11 mean initial margin is a performance bond to cover
12 potential future exposure. Variation margin is
13 intended to remove current exposure from the
14 market. In the cleared world, variation margin is
15 always paid in cash, at least at DCOs. This was
16 an attempt to move in the same direction. I mean
17 there were practical difficulties with the idea of
18 if you could post variation margin say with some
19 sort of bond and let's say that the bond declined
20 in value the next day, how would you address that?
21 Did you, in fact, now create some exposure that
22 you thought you had taken out of the market?

1 There were issues that were discussed with regard
2 to how would you haircut variation margin if it
3 wasn't cash? There were issues discussed about
4 where would you hold variation margin if it
5 weren't cash? So our understanding is that,
6 generally speaking, now most variation margin is,
7 in fact, paid in cash. So staff here and staff at
8 the prudential regulators thought it would be
9 worthwhile to propose cash for these rules. But
10 we, of course, are very interested in comment if
11 people think there are practical difficulties with
12 doing that and if there are ways to address any
13 practical difficulties with accepting non-cash
14 variation margin.

15 COMMISSIONER WETJEN: And, finally, just
16 one last issue to cover. John, you and I spoke
17 about the approach taken in this proposal as it
18 relates to the requirement that there be
19 segregation of collateral collected by a dealer
20 from a customer. And there's an interesting
21 discussion behind all that as you and I went
22 through. But jumping over that point for the

1 moment, in the proposal do we specify as to
2 whether customer collateral can be kept in an
3 omnibus account or does it have to be kept in
4 individual accounts for the customer?

5 MR. LAWTON: We don't actually specify
6 in this proposal. There is an existing Commission
7 rule on the books that was done pursuant to
8 Section 4s(1) of the Act, which is the voluntary
9 segregation. And that rule would require that the
10 seg be held in an individual account. I think
11 that our anticipation -- again, we welcome
12 comments -- I think our anticipation would be that
13 mandatory seg would be subject to the same
14 requirement as voluntary seg; that is to say,
15 individual seg rather than omnibus seg. There's a
16 concern that omnibus seg may not provide
17 bankruptcy protection in the same way that
18 individual seg would.

19 COMMISSIONER WETJEN: And, again,
20 referring back to the global margin framework, I
21 believe that framework would permit the dealer to
22 keep the collateral in an omnibus account, though.

1 Isn't that correct?

2 MR. LAWTON: It's actually -- it's
3 ambiguous there as well. We've asked -- at least
4 at the staff level -- people at the prudential
5 regulators their anticipation as they would
6 require individual seg. But, again, I think the
7 actual rule text may be somewhat ambiguous at this
8 point.

9 COMMISSIONER WETJEN: Thank you, John.
10 Thank you to the rest of the team as well. A lot
11 of hard work over recent days and apologies for
12 the scurry over the last two or three days in
13 particular as we sorted out some of the
14 cross-border matters, but really appreciate the
15 efforts there.

16 And thanks again to you, Mr. Chairman.
17 The flexibility you showed here and also leading
18 these creative discussions about how to solve for
19 this cross-border issue result in something that
20 we haven't done in a while with this ANPR, and I
21 think it's a very appropriate approach in this
22 circumstance. So thank you.

1 MR. CHAIRMAN: Thank you, Commissioner
2 Wetjen. Commissioner Bowen?

3 COMMISSIONER BOWEN: Yes, just a couple
4 of questions. I know we've talked quite a bit
5 about the threshold, and I just want to make sure
6 that, generally speaking, the largest global
7 institutions would be over this threshold and
8 subject to initial margin.

9 MR. LAWTON: Yes. They'd be quite a bit
10 over. The implementation schedule, which was
11 based on data provided to the International
12 Committee, starts at \$3 trillion. So there are
13 global market participants who actually would be
14 over that threshold, which, of course, are many
15 multiples of the 2019 threshold.

16 COMMISSIONER BOWEN: That's good to
17 hear, particularly given the importance of initial
18 margin as a risk management tool. I'd be very
19 interested in hearing from our commenters,
20 especially about how we would address this in the
21 cross-border context, if there's a way we can get
22 the rule right in that respect and capture the

1 largest global firms as well.

2 I'd like to ask a little bit about swap
3 dealers. As you know, many of the largest firms
4 try as best they can to be one single global firm
5 and to service their clients around the world. At
6 the same time they're subject to different rules
7 in those jurisdictions. Given the three options
8 that have been proposed for the cross-border
9 rules, what factors can we look at when we're
10 considering these global firms?

11 MR. LAWTON: Well, I think there are a
12 couple of factors that would be looked at.
13 Certainly you would want to look at the extent to
14 which you think the risk of these trades would
15 come back to the United States, to United
16 States-based entities, or to the United States
17 somehow. But you also would want to balance that
18 against competitive effects; that you wouldn't
19 want to create a system which unfairly advantaged
20 some participants in the markets over others. So
21 I think there's some sort of balancing that would
22 be involved there.

1 COMMISSIONER BOWEN: Thank you. This is
2 another topic that obviously we're looking forward
3 to getting comments on.

4 And I also want to just thank the
5 Chairman and the other Commissioners, in terms of
6 their approach the last several days, especially
7 your willingness to hear all of our viewpoints and
8 really to take that into consideration. The time
9 that the staff took to meet with us on several
10 occasions, I really appreciate it.

11 CHAIRMAN MASSAD: Thank you,
12 Commissioner Bowen. Commissioner Giancarlo?

13 COMMISSIONER GIANCARLO: John, thank you
14 for your explanation of the lowering of the
15 threshold for financial end-users to \$3 billion.
16 In the event the Europeans and other regulators do
17 not lower their \$11 billion threshold to our more
18 restrictive \$3 billion level, what cost-benefit
19 analysis is presented on the impact of the
20 differential on the U.S. economy?

21 MR. KANE: We didn't make an estimate.
22 We said that we're at the proposal stage. We're

1 still negotiating. So we anticipate that we will
2 meet. So we didn't analyze it, but we did ask for
3 questions. It's very hard to quantify at this
4 point.

5 COMMISSIONER GIANCARLO: Thank you. I'm
6 hopeful that interested members of the public,
7 especially those with significant econometric
8 capabilities, will weigh in on this topic. I
9 think it's a very important one to take into
10 account. And I do want to say, despite the
11 concerns I've raised about cost-benefit, I do want
12 to compliment actually the good work of the Office
13 of the Chief Economist of the CFTC. My concerns
14 here are not directed to them. I think this is a
15 system-wide prudential regulator or regulatory-
16 wide concern about the impact of some of these
17 rules. So I hope the public will weigh in. We'll
18 look forward to seeing those comments.

19 I also want to, again, thank the agency
20 staff and my fellow Commissioners for their
21 collaborative approach to this very important rule
22 proposal. It reflects a good amount of

1 thoughtfulfulness and hard work, and I think it's a
2 very good product that's been put forth. I look
3 forward to the comments from the public.

4 CHAIRMAN MASSAD: Okay, if there are no
5 other comments or questions, are the Commissioners
6 prepared to vote? If so, I will ask Mr.
7 Kirkpatrick, will you call the roll?

8 MR. KIRKPATRICK: Mr. Chairman, the
9 motion now before the Commission is on the
10 adoption of a proposed rule and Advance Notice of
11 Proposed Rulemaking on margin requirements for
12 uncleared swaps for swap dealers and major swap
13 participants. Commissioner Giancarlo?

14 COMMISSIONER GIANCARLO: Aye.

15 MR. KIRKPATRICK: Commissioner
16 Giancarlo, aye. Commissioner Bowen?

17 COMMISSIONER BOWEN: Aye.

18 MR. KIRKPATRICK: Commissioner Bowen,
19 aye. Commissioner Wetjen?

20 COMMISSIONER WETJEN: Aye.

21 MR. KIRKPATRICK: Commissioner Wetjen,
22 aye. Chairman Massad?

1 CHAIRMAN MASSAD: Aye.

2 MR. KIRKPATRICK: Chairman Massad, aye.
3 Mr. Chairman, on this matter the aye's have four,
4 the no's have zero.

5 CHAIRMAN MASSAD: Thank you, Mr.
6 Kirkpatrick. Well, I would just like to say again
7 my thanks to the staff. There has been a lot of
8 hard work, frankly, not just in the last week, but
9 over many, many months on some of these issues.

10 I want to thank again my fellow
11 Commissioners for the collegiality and very good
12 discussion we have had. I think it just reflects
13 a willingness to consider one another's point of
14 view that's very good.

15 And I also want to say that I am very
16 pleased that with respect to these two very
17 important rules -- a proposed rule in one case and
18 final rule in another -- that we are unanimous in
19 our actions today. I think that's a great start.

20 Is there any other Commission business?
21 There being no further business, I would entertain
22 a motion to adjourn the meeting.

1 COMMISSIONER GIANCARLO: So moved.

2 CHAIRMAN MASSAD: Is there a second?

3 COMMISSIONER BOWEN: Second.

4 CHAIRMAN MASSAD: All in favor? Any
5 opposed? The ayes have it. The meeting is
6 adjourned. Thank you all very much.

7 (Whereupon, at 3:41 p.m., the
8 PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Carleton J. Anderson, III, 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.

(Signature and Seal on File)

Notary Public, in and for the District of Columbia

My Commission Expires: March 31, 2017

