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COMMODITY FUTURES TRADING COMMISSION

GLOBAL MARKETS ADVISORY COMMITTEE MEETING

Washington, D.C.

Tuesday, October 2, 2007

ANDERSON COURT REPORTING  
706 Duke Street, Suite 100  
Alexandria, VA 22314  
Phone (703) 519-7180 Fax (703) 519-7190

1 PARTICIPANTS:

2 CTFC Commissioners:

3 WALTER L. LUKKEN, Acting Chairman

4 JILL SOMMERS

5 MICHAEL V. DUNN

6 BART CHILTON

7 Panel Members:

8 DAVID WRIGHT  
9 Director for Financial Markets in the  
10 International Market Directorate European  
Commission

11 MARIO NAVA  
12 Director of the Office of Financial Markets  
Infrastructure European Commission

13 JACQUELINE MESA  
14 Director of the Office of International  
Affairs, CFTC

15 ANTHONY BELCHAMBERS  
16 Executive Director, Futures and Options  
Association

17 RICHARD BERLIAND  
18 Chairman, Futures Industry Association  
Managing Director, Global Head of Futures and  
Options, J.P. Morgan Securities Limited

19 ADAM COOPER  
20 General Counsel, Citadel Investment Group, LLC

21 GEORGE CRAPPLE  
22 Co-Chairman, Millburn Ridgefield Corporation

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## 1 PARTICIPANTS (CONT'D):

2 MICHAEL DAWLEY  
3 Managing Director, Futures Product Head  
4 Goldman, Sachs and Company

5 CRAIG DONOHUE  
6 Chief Executive Officer and Director, CME  
7 Group

8 DE'ANA DOW  
9 Vice President and Counsel, Regulatory Affairs  
10 New York Mercantile Exchange

11 ARUTHUR HAHN  
12 Partner, Katten Muchin Zavis Rosenman

13 ROBERT KLEIN  
14 Director and Associate General Counsel  
15 Citigroup Global Markets, Inc.

16 ROGER LIDDELL  
17 Chief Executive Officer, LCH.Clearnet Group  
18 Limited

19 BONNIE LITT  
20 Managing Director, Associate General Counsel  
21 Goldman, Sachs and Company

22 BARBARA MATTHEWS  
23 Financial Attaché to the European Union  
24 United States Treasury Department

25 BOB PICKEL  
26 Executive Director and Chief Executive Officer  
27 International Swaps and Derivatives  
28 Association

29 DAN ROTH  
30 President and Chief Executive Officer,  
31 National Futures Association

32 JOHNATHAN SHORT  
33 General Counsel, Intercontinental Exchange

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Alexandria, VA 22314  
Phone (703) 519-7180 Fax (703) 519-7190

1 P R O C E E D I N G S

2 (1:06 p.m.)

3 CHAIRMAN LUKKEN: (in progress)

4 traveling from abroad and nearby actually to come  
5 to our meeting at GMAC. As those participants  
6 know, we try to have these meetings once or twice  
7 a year if we can. But we're very fortunate today  
8 to have the presenters that have come before us  
9 this afternoon.

10 As you know, I'm acting chairman of the  
11 CFTC as well as chairman of the Global Market  
12 Advisory Committee. And this committee was formed  
13 for the express purpose of seeking industry input  
14 on matters that impact the global derivatives  
15 marketplace, and today's discussion certainly  
16 falls within that category.

17 Our meeting will focus on two  
18 significant developments coming out of Europe:  
19 The Markets in Financial Instruments Directive or  
20 MiFID and the European Clearing Code of Conduct.  
21 These are both timely and important developments  
22 in the global marketplace that not only affect our

1 European colleagues but also impact our  
2 interrelated U.S. markets.

3 Today you will hear such familiar  
4 concepts as regulatory recognition and  
5 passporting, tiered regulation for trading venues  
6 and participants, and clearing competition. I  
7 anticipate we'll enjoy a lively discussion on  
8 these matters and marvel at the similarities of  
9 these policies with our own developments here on  
10 this side of the Atlantic.

11 Two weeks ago, as many of you know, the  
12 CFTC held a public hearing on the U.S. regulation  
13 of exempt commercial markets. Today we will learn  
14 what the Europeans are doing in this area for  
15 similar markets.

16 In this time of globalization, it is  
17 particularly important that we understand and,  
18 when possible, coordinate regulatory approaches in  
19 major market jurisdictions, such as the EU and  
20 U.S. This meeting is a wonderful opportunity for  
21 our industry both to learn and to share our  
22 thoughts on these important matters.

1           Before we get started, though, I would  
2 like to begin by welcoming our two new  
3 commissioners to their first advisory committee  
4 meeting. Commissioners Jill Sommers and Bart  
5 Chilton, welcome.

6           Both Jill and Bart are no strangers to  
7 our industry or international affairs, and I'm  
8 sure you'll find that they bring a fresh and  
9 unique viewpoint to the commission, and I'm  
10 delighted by their presence today.

11           Turning to our agenda, we are very  
12 fortunate to have David Wright, the European  
13 Commission's Director of Financial Markets in  
14 their International Market Directorate. David and  
15 Mario are both on a whirlwind tour of Washington,  
16 D.C. From meeting to meeting; we're very, very  
17 fortunate to squeeze them in today to give us  
18 their viewpoints.

19           David comes with 30 years of public  
20 service experience at the European Commission, and  
21 he's one of the key individuals at the epicenter  
22 of MiFID's development. He will share with us his

1 views on (off mike) which is becoming a model of  
2 global regulatory regime for all of our markets.  
3 It's certainly a Herculean effort, and I'm pleased  
4 David is here with us today to provide his  
5 insights, especially as it pertains to their  
6 derivatives and commodities regulation.

7           Next on the agenda is Mario Nava,  
8 Director of the Office of Financial Markets  
9 Infrastructure for the European Commission.  
10 Professor Nava heads up the commission's efforts  
11 to implement the European Code of Conduct and  
12 Settlements, and we are fortunate to have him  
13 present for us an overview of the code as well as  
14 the next step and possibly extending it from  
15 securities to derivatives.

16           Given the interconnection of the U.S.  
17 and European markets as well as the likelihood of  
18 cross-Atlantic clearing linkages, it's important  
19 to understand how the Code of Conduct will impact  
20 U.S. markets and their participants and whether  
21 similar concepts could benefit the U.S.  
22 marketplace.

1                   However, first on the agenda today is  
2                   our own Jackie Mesa, Director of the Commission's  
3                   Office of International Affairs, with an update on  
4                   the Commission's efforts in this area. The past  
5                   year has been an exciting time in the  
6                   international arena, given the greater acceptance  
7                   among the global regulatory community of the  
8                   mutual recognition concept that the CFTC pioneered  
9                   20 years ago, as well as the commission's recent  
10                  technical assistance to emerging markets in India,  
11                  Egypt, and China.

12                  I would now like to turn to my fellow  
13                  commissioners and ask whether they have additional  
14                  comments or remarks.

15                  Commissioner Dunn?

16                  COMMISSIONER DUNN: Thank you, Mr.  
17                  Chairman. I commend you for having this meeting  
18                  today on such a timely matter and having such  
19                  great panelists on here. This is absolutely a  
20                  treat for us all.

21                  In my tenure here at the CFTC, between  
22                  electronic trading and globalization, I think



1       there's been as much of a change in the  
2       derivatives markets as there as been in all the  
3       time preceding that.  And so, I really do look  
4       forward to hearing from our counterparts in what's  
5       going on in their arenas.

6                   CHAIRMAN LUKKEN:  Thank you very much.  
7       Commissioner Sommers?

8                   COMMISSIONER SOMMERS:  Thank you all.  
9       Although this is not my first GMAC hearing, this  
10      is the first time I've ever been at the table.  
11      So, I appreciate the opportunity to listen and  
12      learn today about these very important subjects.

13                   And it's a pleasure to be here with my  
14      fellow commissioners and Chairman Lukken and  
15      welcome Mr. Wright and Professor Nava and Mr.  
16      Belchambers.  Thanks for being here.

17                   CHAIRMAN LUKKEN:  Mr. Chilton?

18                   COMMISSIONER CHILTON:  Thanks, Mr.  
19      Chairman.  And thank you all for being here  
20      really, for coming from so far away and spending  
21      the time with us.  It's a great education process  
22      for us.  And this is a real time, all-the-time

1 industry as we all know and a truly global  
2 industry. And we've got so many similarities that  
3 outweigh the differences, you know, keeping  
4 markets competitive and free from fraud, abuse,  
5 and manipulation and making sure that they are  
6 viable, efficient, and effective tools, not just  
7 for market participants but for consumers as well.

8 And at the hearing that the chairman  
9 talked about two weeks ago in this room, I said  
10 that I thought it was really a matter not of if  
11 something should be done with regard to energy  
12 markets, electronic energy markets that aren't  
13 regulated, but how and when.

14 And the EU has already answered part of  
15 the question. The "when" is coming up in what, a  
16 month or so, and so, I'd like to delve deeper into  
17 the depth and dimension and the texture of the  
18 "how." And I think that depth, dimension, and  
19 texture is something that in the give and take we  
20 can all learn from as we go forward in this  
21 important global market.

22 Thank you.

1           CHAIRMAN LUKKEN: I would like to  
2 recognize before we begin Anthony Belchambers, who  
3 is going to provide a European financial services  
4 viewpoint, on MiFID and how it's being implemented  
5 as well as the clearing code.

6           And I know you've been very involved in  
7 both those efforts, and we welcome you here today,  
8 and we're glad you could participate.

9           Before we begin, though, I would like to  
10 go around the room and have everybody introduce  
11 themselves, your name as well as what industry,  
12 association or firm you're with.

13           And also for logistical purposes, the  
14 mikes we're using today are wireless. You need to  
15 push the button in order to talk, but only three  
16 mikes work at a time, so remember to turn them off  
17 after you speak. Always having issues with  
18 microphones here at the CFTC, so if you could  
19 remember that, that would help our discussion.

20           So, we'll start with Bonnie.

21           MS. LITT: Bonnie Litt. I am an  
22 attorney at Goldman Sachs.

1           MR. SHORT: Johnathan Short -- oh,  
2 Johnathan Short. I'm the general counsel of  
3 Intercontinental Exchange.

4           MR. KLEIN: Bob Klein and I'm an  
5 attorney at Citigroup.

6           MR. LIDDELL: Roger Liddell, London  
7 Clearing House.

8           MR. DONOHUE: Craig Donohue, CEO CME  
9 Group.

10          MR. COOPER: Adam Cooper, general  
11 counsel, Citadel Investment Group.

12          MS. MESA: Jackie Mesa, Director of the  
13 Office of International Affairs.

14          MR. WRIGHT: David Wright. I'm the  
15 Director of Financial Services, Financial Policy  
16 in the European Commission in Brussels.

17          MR. NAVA: Mario Nava. I'm the head of  
18 Division of Financial Market Infrastructures.

19          MR. BELCHAMBERS: Anthony Belchambers,  
20 Chief Executive, Futures and Options Association.

21          MR. CRAPPLE: George Crapple, Co-CEO of  
22 Millburn Ridgefield, CTA and CPO.

1 MR. ROTH: Dan Roth, National Futures  
2 Association.

3 MR. FILLER: Ron Filler, Managing  
4 Director, Lingham Brothers.

5 MR. HAHN: Arthur Hahn with Katten.  
6 Sorry. Arthur Hahn with Katten Muchin on behalf  
7 of the Life Exchange.

8 MR. PICKEL: Bob Pickel with HSDA.

9 MR. BERLIAND: Richard Berliand. I run  
10 the cash equities and futures business at J.P.  
11 Morgan and chairman of the FOA.

12 MS. DOW: I'm De'Ana Dow. I'm vice  
13 president and counsel for the New York Mercantile  
14 Exchange.

15 CHAIRMAN LUKKEN: Great. With no  
16 further ado, I'll turn this over to David. Thank  
17 you, David.

18 Oh, I apologize for getting out of order  
19 here. We'll start with Jackie.

20 MS. MESA: He hears from me all the  
21 time, so. Well, thank you, Chairman Lukken and  
22 Commissioners, for giving me this opportunity to

1 highlight what's going on in the Office of  
2 International Affairs at the CFTC.

3           Before I kind of give you a brief  
4 summary of what's happened in the last year in our  
5 office, I wanted to ask for your help actually.  
6 We chair a number of technical assistance programs  
7 in various countries, which I'll highlight a  
8 little bit later, and we also participate in  
9 Treasury-led dialogues with other financial  
10 regulators.

11           These happen about once or twice a year,  
12 but before they happen, we're always calling  
13 around to our industry asking what do you see are  
14 the major issues happening in these countries.  
15 And we have sort of the normal people we go to,  
16 but we'd like to expand that group to get a  
17 broader base of people.

18           So, I'm passing around sign up sheets  
19 and begging for your participation. I have them  
20 by country. If you're interested in us contacting  
21 you by email, we won't bug you too much, then  
22 we'll just send out an email or you want to assign

1 somebody in your organization, better yet, this is  
2 your opportunity.

3 So, I'll start here with Adam. Thanks,  
4 Adam. So, just to give you a brief overview of  
5 what our office does, we assist the commission and  
6 the CFTC staff in international policy matters,  
7 coordinate with foreign regulatory authorities,  
8 provide technical assistance when requested, and  
9 participate in international regulatory  
10 organizations. I want to take each of these in  
11 turn and briefly talk about what we've done.

12 One matter that I'll start with is  
13 something that's coming out of our division of  
14 clearing and intermediary oversight. They've been  
15 reviewing an application by the CME. And Craig,  
16 if you want to jump in here and describe it in any  
17 more detail, please do. But CME and the China  
18 Foreign Exchange Trade System, which I'll call for  
19 short CFETS, for certain exemptive relief under  
20 the act, specifically, the CME and CFETS requested  
21 that CFETS and/or its members clear foreign  
22 currency and interest rate futures transactions at

1 the CME for customers domiciled in China.

2 CFETS is an affiliate of the People's  
3 Bank of China and operates an electronic trading  
4 system in the inner bank foreign exchange market  
5 in China. If the request is granted -- which I  
6 want to make clear it's not granted yet. There is  
7 a release that we've put out of the federal  
8 register. CFETS and its members would be exempted  
9 from registration as an FCM but would be required  
10 to meet certain financial requirements, large  
11 trader reporting, and monthly reporting and  
12 recording keeping.

13 But, because CFETS will not be  
14 registered as an FCM, it will need to meet  
15 alternative minimum capital requirements that are  
16 intended to parallel what we would require from  
17 one of our registrants. So, there is a federal  
18 register release. We are requesting comment. The  
19 comments were due by August 23rd, but we have  
20 given a two-week extension period, and we would  
21 just request that members, such as yourselves,  
22 perhaps write a comment if you're interested in



1 this.

2 Now, I want to get into our technical  
3 assistance and dialogues we've been carrying out  
4 on a country-by-country basis. First is China.  
5 Last year we sent a team over to the CSRC to  
6 conduct training for over 100 individuals that  
7 included the exchanges in China and regulators.  
8 It was a great training. They're going to  
9 continue this ongoing bilateral training and send  
10 people over to the CFTC next month.

11 And we also plan to host for the first  
12 time a secondment from the CSRC starting in  
13 January 2008. We already do host people from  
14 Korea and Japan and we have for a number of years.

15 Also, with China, we participate in a  
16 Treasury-led dialogue. And I think I can just say  
17 that China has made remarkable progress. And I  
18 won't credit the dialogue for all of that, but I  
19 will say that I think it has helped. China has  
20 announced that they'll no longer prohibit  
21 qualified foreign institutional investors to  
22 purchase stock index futures, which I think is a

1 good step.

2 But now let me give you the reverse,  
3 which is the bad side of this. They don't  
4 currently allow stock index futures trading in  
5 China, but that will happen on the Shanghai  
6 Financial Futures Exchange, which we keep hearing  
7 will open. And I know you've been reading about  
8 this as well, that last year they announced it was  
9 going to open, and then it's been delayed and  
10 delayed and delayed.

11 And our understanding is that this is  
12 due to the fact that they want certain laws in  
13 place before they open the exchange, and due to  
14 recent volatility, they don't want actually added  
15 volatility in their markets. But, be watching for  
16 this because I think this is a good progress.

17 Also, CSRC has expanded their outbound  
18 trading that they allow Chinese to participate in,  
19 their institutional investors. It used to be you  
20 could only participate in our markets or other  
21 international markets for your own business  
22 purpose, for commercial purpose only, for hedging

1 purposes. And now, that's been expanded to  
2 include banks, and asset management companies can  
3 participate for hedging purposes in foreign  
4 markets.

5 One thing that we keep hearing from our  
6 own exchange is, and we're going to keep pressing  
7 them on it, is that there has been a ban on  
8 futures exchanges opening representative offices  
9 in China. This same ban does not exist for  
10 equity. So, for instance, New York Stock Exchange  
11 and NASD have authority to open up representative  
12 offices. So, we will keep pressing this, and you  
13 can keep pressing this at your levels as well.

14 In India -- in June we provided trading  
15 in India for over 50 people, exchanges, Central  
16 Bank of India, exchanges, et cetera. They are  
17 particularly concerned about physical delivery in  
18 the ad markets. And we talked about that and  
19 consumer fraud. And I know that you know this,  
20 but there's a general misunderstanding there, I  
21 think, about the speculation and how that raises  
22 prices on essential commodities in India. And

1 they've actually banned certain trading in  
2 essential commodities in India saying that the  
3 futures trading has increased these prices. We're  
4 working with the government to explain how these  
5 markets function.

6 Also, foreign firms have been forbidden  
7 membership in exchanges is our understanding and  
8 we're working on that. They still prohibit  
9 omnibus accounts in India. And finally, there is  
10 limited hedge fund participation in India. I  
11 think there's a requirement that they know who the  
12 ultimate customer is, for one thing. And also,  
13 they can't qualify as an institutional investor  
14 for trading.

15 So, I won't go on too much about what we  
16 do with the European Union because they're sitting  
17 right here and you can ask them yourselves. But I  
18 will tell you that most of our work takes place  
19 through the Committee of European Security  
20 Commission and that's -- or regulators, rather,  
21 CESR. And we plan to coordinate, and Anthony can  
22 talk about this a little bit, our efforts with FIA

1 and FOA on their Transatlantic report within the  
2 context of our dialogue with CESR and try to pick  
3 out a few things that would be useful to this  
4 industry to take forward on a bilateral basis.

5 We've discussed a couple of things with  
6 CESR including a common portal for registration.  
7 If you want to see who is registered in Europe,  
8 maybe you can go to one stop shop -- stop  
9 shopping, plug in the name or the firm, and then  
10 be directed to different European countries to see  
11 if they're registered and their registration  
12 status. I think that would help people around the  
13 table. You can tell me if that's true. And also  
14 develop a common risk disclosure that you can use  
15 in Europe and in the U.S.

16 And yesterday, we participated in a  
17 Treasury-led EU dialogue, but again, you're going  
18 to hear from the people themselves, so I won't go  
19 into detail.

20 Ethiopia is starting a cash market, and  
21 they have established -- they're in the works of  
22 establishing the law. And actually, it has passed

1 very quickly. I think we provided technical  
2 assistance over the phone and then the next week,  
3 it was passed. They're also going to try to  
4 upstart a futures exchange at the same time. Just  
5 this morning, we found out, just appointed  
6 commissioners. And they will send their  
7 commissioners here in two weeks to talk to the  
8 CFTC, and they will appoint staff. And we'll do  
9 an intensive training in Ethiopia in January 2008.

10 Indonesia, we've sent some of our market  
11 folks to Indonesia. They have a problem with  
12 their law in that the law has to specify which  
13 products they trade. So, of course, innovation is  
14 slightly slowed down there in Indonesia.

15 Egypt, we've provided some great  
16 technical assistance to Egypt this summer. Egypt  
17 is working on draft legislation, which should be  
18 done by the end of the year. And they are also  
19 going to start a market.

20 So, there are some exciting things  
21 happening in the developing markets, and we'll  
22 keep tabs on that let you know as things develop.

1           I also want to just highlight -- and I  
2 think almost everyone around this table knows that  
3 we provide training to large delegation I Chicago  
4 every year. And the reason I think you all know  
5 is that everyone around this table has probably  
6 participated or had their staff participate at one  
7 time. And I appreciate your help with training  
8 these people. We usually get 60 to 70 people from  
9 all around the world and emerging and more  
10 developed markets.

11           And finally, I'm going to highlight a  
12 few projects happening in the International  
13 Organization of Security Commissions, our -- the  
14 international body that deals with securities  
15 because I think these -- this is a time for you to  
16 comment. These papers always go out for comment  
17 from the industry and it's time to see your input.

18           If you don't like the way IOSCO is going  
19 on a certain principle that's going to govern  
20 security regulators across the board, we should  
21 know before it goes out and becomes final. So,  
22 let me highlight these in a big picture way.

1           There's a mandate taking place right now  
2           on direct electronic access to the markets  
3           committee of IOSCO. There was enough concerns,  
4           you know, participants are in a rush to get to the  
5           market. Of course, milliseconds count. And  
6           there's not maybe enough filters on what's going  
7           through directly to the market. So, there's a  
8           survey going out that the committee is putting out  
9           and has put out actually to exchanges to talk  
10          about what exchanges are doing with rules and  
11          policies that govern direct electronic access to  
12          exchanges. And we're going to look at what's  
13          happening all over the world, take those, and see  
14          what we can do to streamline or approach.

15                 But we also understand and recognize, at  
16          least from the CFTC, that is not only an exchange  
17          issue but an intermediary issue. So, what are  
18          intermediaries doing for risk management of direct  
19          electronic access? And this is going to be taken,  
20          I think, either by IOSCO and definitely by this  
21          commission.

22                 Another group within IOSCO is examining



1       what regulators should now be doing with  
2       electronic record keeping. I think if you look at  
3       our act, you'll see that our act was developed  
4       around the notion that everything was -- would be  
5       kept by paper, and that's how it was written. And  
6       now that everything is kept electronically, should  
7       regulators around the world be changing what we  
8       request and what we require to be kept?

9               So, I'm going to ask you to volunteer  
10       one more time. You see a theme here. The IOSCO  
11       is holding panels around the world. They've  
12       already had one public panel in Asia. They had  
13       one in Europe. And now we're going to have one in  
14       the Americas, in Miami. And we're looking for one  
15       from our FCM community to participate on the panel  
16       to talk about how you're keeping your records,  
17       what form -- how you deal with and communicate  
18       with electronic service providers. So, see me  
19       after the meeting if you have a particular  
20       interest in this.

21               And finally, in another interesting  
22       report -- there's a lot more going on, but I'm

1       trying to just highlight the big points --  
2       evaluation of hedge funds. A final report will  
3       come out in November by IOSCO. It has already  
4       been out for industry comment. Industry comment  
5       was taken and to tell you the truth, we didn't get  
6       a ton of industry comment. So either you thought  
7       everything was great or you didn't -- it wasn't  
8       brought to your attention, so I'm trying to bring  
9       these things to your attention. But it will come  
10      out final in November.

11               And then finally, I just want to talk  
12      about two big things that are going on in IOSCO  
13      that are continuing to happen and have been  
14      happening for a long time. One is the IOSCO  
15      multilateral MOU. It raises standards across the  
16      board for information sharing among foreign  
17      regulators. IOSCO has made a statement that by  
18      2010, they want all IOSCO members to have applied  
19      to be an IOSCO multilateral MOU.

20               And if you don't meet the standards --  
21      it's a very tough review process. If you're not  
22      meeting the standard for information sharing as a

1 regulator, you at least have to pride your  
2 intention to change your laws to be able to get  
3 there. So, jurisdictions such as Bermuda, Dubai,  
4 China, Sri Lanka have all signed on, and this  
5 helps the CFTC greatly.

6           And then, the last thing that's an  
7 ongoing project of IOSCO is the principles. There  
8 are 30 principles for key -- for regulators that  
9 they must meet. And we're encouraging  
10 jurisdictions to go through a self assessment. In  
11 other words, look at these principles and see if  
12 they're meeting them. I gave a speech last week  
13 for regulators from the Americas trying to  
14 encourage them to look at their laws and see if  
15 they're meeting the standards that IOSCO has put  
16 out.

17           So, in a nutshell, that's what's been  
18 happening the last year. And I just have to end  
19 with saying I really thank my own staff. We're  
20 mean and lean and at least lean and not so mean  
21 here at the CFTC.

22           And I can talk and showcase what we're

1 doing here in the Office of International Affairs,  
2 but it's really -- the work is done by my staff.  
3 So, I appreciate this opportunity.

4 CHAIRMAN LUKKEN: Well, we're very  
5 fortunate to have Jackie heading up our  
6 international effort here at the CFTC and her  
7 staff who do an excellent job. And you get a feel  
8 for how important international issues are. It  
9 used to be, I think, two separate worlds, but now  
10 all these things are so important to the daily  
11 functioning of our business. And that's what  
12 we're here to talk about today.

13 So, with that, I will introduce our  
14 guest, Mr. David Wright. Thank you, David.

15 MR. WRIGHT: Acting Chairman Lukken,  
16 Commissioners from the CFTC, distinguished guests,  
17 I'm very honored to be here, and we feel extremely  
18 privileged, Mario and myself, to have the  
19 opportunity to talk to you today about two major  
20 securities industry projects underway, one of them  
21 near completion in the European Union.

22 We greatly welcome this openness and

1 your friendliness to us. We're here to share  
2 views and listen to your perceptions. And I think  
3 we have a lot in common, a lot of issues in  
4 common. And I think we'll discover that over the  
5 next few hours or so.

6 I think this is a good example of the  
7 sort of cooperation that we value in the European  
8 Union between ourselves and the United States. We  
9 encompass that through what we call a financial  
10 markets regulatory dialogue where we talk with our  
11 counterparts in the Treasury, the CFTC, the FED,  
12 NAIC, and so forth to try and understand where we  
13 have problems and to try and resolve issues.

14 So, the more we understand each other it  
15 seems to me, the more capital markets will grow  
16 and be stronger and the more we will influence the  
17 emerging markets that Jackie has just been talking  
18 about. And I'd like to thank her for her very  
19 efficient help in bringing us here today.

20 I'd like to over the next 20 minutes or  
21 so outline what is known as MiFID, the Markets in  
22 Financial Instruments Directive, a little bit

1 clumsy the terminology. I want to outline the key  
2 political issues here, the choices we have to  
3 make, and I'd like to certainly concentrate on  
4 some of the commodity and energy derivative issues  
5 that are obviously of major interest to the CFTC.

6 If you look at this extraordinary  
7 diagram, and I start with a quotation because my  
8 commissioner, who is Commissioner McCreevy from  
9 Ireland, has described MiFID as not, I repeat,  
10 "Not some fearsome man-eating plant. It is simply  
11 shorthand for the Markets in Financial Instruments  
12 Directive."

13 Now, this diagram, I can't make it out  
14 myself. My staff produced it for me. I don't  
15 know whether that's a skull or -- at the top. I  
16 don't know whether this is sort of modern art,  
17 some sort of Tracey Urman thing that's worth a  
18 fortune, but MiFID is actually quite a good  
19 acronym when you compare it to some of our other  
20 directives, one of which is known as MAD, m-a-d,  
21 the Market Abuse Directive, which has come into  
22 the news recently because the governor of the Bank

1 of England claimed erroneously that it prevented  
2 him from providing assistance to Northern Iraq.  
3 So, MiFID is actually much more simple than I hope  
4 the title implies.

5 Now, where are we in terms of procedure  
6 before we get to some of the substance. But it's  
7 taken us in Europe and the European Commission and  
8 among the member states, it's taken us about four  
9 years to get to the main directive, which was  
10 eventually agreed after some -- a lot of political  
11 turbulence at one stage. Eventually, we got  
12 everybody to agree, all our 27 member states and  
13 the European Parliament. We have a co-decision  
14 process. And I'll come back to that.

15 So, the basic rules were agreed in 2004.  
16 We then had to flesh out the detail. And that  
17 took us another two years or so and further  
18 complex negotiations with all our constituents,  
19 market participants, member states, the European  
20 Parliament, and also we've got a lot of important  
21 advice from our regulators, which we call CESR,  
22 the Committee of the European Securities

1 Regulators.

2 And now our method enters into force  
3 very shortly on the first of November, 2007, so  
4 your meeting today, Chairman, is extremely timely.

5 MiFID is the centerpiece of our  
6 financial integration process in Europe and the  
7 key issue for us now in political terms is to get  
8 this thing implemented across all our member  
9 states and across all markets.

10 Now, in spite of what is sometimes  
11 referred to in the press as a poor record so far,  
12 we believe that some 23 of our member states will  
13 be on time by the first of November. That's not  
14 so bad out of 27. Of course, those who are late  
15 will be subject to what we have as our  
16 disciplinary procedures. We can take the member  
17 states to the Court of Justice. And what is worse  
18 for those late comers is that their firms will not  
19 be able to benefit from the passport regime, but  
20 they will not be able to stop new inward flows of  
21 business, so actually it doesn't make the  
22 slightest bit of sense to be late, and we



1 constantly remind member states of that.

2 Now, as I said, MiFID is a comprehensive  
3 regulatory regime governing financial trading and  
4 intermediation in Europe. It's the centerpiece of  
5 our regulatory effort to integrate the capital  
6 markets in Europe. We believe that the evidence  
7 is suggesting that the capital markets in Europe,  
8 all things considered, are getting stronger.  
9 Markets are growing well. And we believe MiFID  
10 will encourage those forces further. And I will  
11 certainly give you some evidence on those grounds.

12 Why do we bother in the first place?  
13 Well, we had some problems with the old rule. And  
14 the problems with the old rule were that there was  
15 a lack of harmonization of some aspects. There  
16 were public good clauses or let-outs, which  
17 allowed certain member states in certain  
18 conditions to block types of cross-border  
19 business, and basically, financial markets between  
20 1993 and 2004 had undergone a profound revolution  
21 in terms of both trading and in terms of service  
22 provision. So, the 1993 directive was simply not

1 fit for purpose.

2 The second area that we felt really  
3 needed changing was an old rule which was called  
4 the Concentration Rule, which basically allowed  
5 member states to channel all trading to regulated  
6 markets. And some member states indeed did that,  
7 France for one, Italy for another and so forth.

8 Now, we felt that that was not  
9 competitive. We needed to open up trading, more  
10 competitive trading, drive down the cost of  
11 capital. And we did a lot of economic work to  
12 show that if we could do that, if we could capture  
13 those basic points in reducing the cost of  
14 capital, European GDP would strengthen. And we  
15 believe we're seeing the signs of that now. And  
16 those numbers are important, extremely important,  
17 and I believe that the numbers will increase in  
18 intensity, positive benefits as we go forward.

19 One of -- another type of weakness we  
20 had before was that there was inconsistent  
21 reporting of trading, and some member states, for  
22 example, there was no trading whatsoever reporting

1 of OTC trades, which meant you never really --  
2 investors never really got a full picture of the  
3 market.

4 So, as I said, MiFID is at the center of  
5 this integration process. It's part of a suite of  
6 directives, a suite of proposals, all of which  
7 have now been agreed, including a Simplified and  
8 Harmonized Prospectus Regime, the Market Abuse  
9 Regime, which I've referred to that's called MAD,  
10 as you'll recall, transparency obligations,  
11 company law reform, auditing, and accounting. And  
12 accounting, the International Accounting Standards  
13 System, you're aware Europe took, I think, a very  
14 bold move to introduce that throughout the  
15 European Union. And now we're at this challenging  
16 moment where we want to converge U.S. gap with IAS  
17 and make it even easier for companies to do  
18 transatlantic business without reconciling and  
19 spending a lot of money on reconciling accounts.

20 The philosophy of MiFID I think is very  
21 important to understand. It is a principles-based  
22 approach. And a principles-based approach is

1 something we think is absolutely critical in  
2 Europe to any regulatory problem. We do not think  
3 that we can regulate every nook and cranny of  
4 financial markets, because by the time you have  
5 done that, markets have moved on. We think it's  
6 much more important to concentrate on basic  
7 principles.

8 Now, the judgment of what is a principle  
9 and what is a rule is never easy. And of course,  
10 principles require a very important coordination  
11 of regulators to ensure that those principles are  
12 broadly implemented on the ground in a consistent  
13 way. So, we've had a lot of discussion about  
14 whether are rules are not principles-based enough,  
15 too principles-based, and so forth. So, there's  
16 always a fine level of judgment here.

17 The second issue of great importance in  
18 MiFID is the level and high level of investor  
19 protection. In Europe, we have basically two  
20 schools of regulatory philosophy. I simplify to  
21 make the point. We have one school which I would  
22 describe as the caveat impetor let. Consumers,

1 investors have -- should get proper information  
2 and then take their responsibility.

3 But we have another school which is --  
4 fears that that is not enough, that fears that  
5 this will lead perhaps to scandals in the market  
6 and have some evidence to back that up. And so  
7 here, you have a school of philosophy and perhaps  
8 one could say led by France, Italy, and others  
9 which wants very deep levels of investor  
10 protection, very strong levels of harmonized  
11 rules. So, that again has been an area where  
12 compromises have to be found.

13 We don't rely on massive levels of  
14 disclosure in MiFID, but we do rely on strong  
15 rules for inducements, conflicts of interest, and  
16 best execution. And best execution was an area  
17 where we spent a long time deciding what is best  
18 execution, what are the variables that should be  
19 included in the best execution basket, does it  
20 include, for example, the commissioned charges of  
21 firms. In the end, we decided it would.

22 And the fourth principle that we've

1       tried to apply and I think successfully is we  
2       tried to calibrate MiFID according to the  
3       different types of business. So, if you're a  
4       professional firm, the rules are lighter. If you  
5       are a retail investor, the applied rules are much  
6       more developed.

7                So, we have in effect three levels. We  
8       have the retail, we have professional, and we have  
9       eligible counter-party. And if it's an eligible  
10      counter-party -- eligible counter-party  
11      transaction, much of the conduct of business  
12      rules, for example, are waived. Light touch, a  
13      light touch approach to professional markets, and  
14      we believe that's the right approach with  
15      professional markets taking their responsibility.

16              We've also tried, and I don't know  
17      whether you have this problem in the United  
18      States, to limit what we call add-ons or gold  
19      plating. Gold plating is when a member state  
20      takes the agreed rules of the European Union level  
21      and just tweaks them a bit or adds a bit or puts  
22      some more detail in.

1           There's one famous example of a ten page  
2 insurance mediation directive which ended up with  
3 900 pages of guidance. Well, we don't like that.  
4 We think that's inefficient. We think it creates  
5 fragmentation. So, what we have tried to do very  
6 hard with MiFID is to limit gold plating to the  
7 absolute minimum. And here, for example, and my  
8 good friends in the UK, of which one is on the  
9 left here, the UK does have a tendency to slightly  
10 add in new rules on top of European rules. So,  
11 we've tried to narrow down the possibility to do  
12 that.

13           We've also tried to use what we call a  
14 regulation, a rule which is directly applicable in  
15 member states wherever possible, as opposed to a  
16 directive, where there is latitude for our member  
17 states to add additional explanation.

18           How have we -- I beg your pardon. How  
19 have we decided all of this? We've decided this  
20 through what we call the Lamfalussy Process. And  
21 I won't go into great detail here, but this is a  
22 quite evolutionary approach to the decision making

1 in Europe on financial services. And it's called  
2 Lamfalussy after a report which was drafted under  
3 his chairmanship in the year 2000, which I  
4 participated in. And it has helped dynamize and  
5 unblock blockages in the political process which  
6 have allowed us to move forward.

7 It's based on four levels. And the  
8 first level is classic decision making in the  
9 European Union whereby my institution, the  
10 commission, proposes to the council and the  
11 European Parliament a proposal and it is agreed in  
12 co-decision between those two parties, the Council  
13 of Ministers, if you like, of the member states  
14 and the European Parliament, the director --  
15 directly elected members of Parliament from each  
16 of the member states. So, that is the first  
17 level.

18 After the -- after the first level, we  
19 have level two. And level two is all about the  
20 implementing rules. Those are the rules that the  
21 commission, my institution, can adopt having got  
22 the agreement of our member states through what is



1 called the European Securities Committee.

2 And what we've done here is because  
3 these rules are very technical, we've asked our  
4 regulators, which is CESR, you remember the name  
5 CESR, to provide us with all the technical details  
6 that we've needed. And that is the real novelty  
7 of the Lamfalussy process because this has allowed  
8 us to network our regulators together, to force  
9 them to work together, to advise the commission,  
10 and to come out with what we believe to be good  
11 rules.

12 The third level of Lamfalussy is about  
13 strengthening the cooperation between the  
14 regulators themselves. Having got our rules  
15 through level one and level two, we've got to make  
16 sure that they're adopted on the ground in a  
17 consistent way. That's what level three is about,  
18 the day to day regulatory cooperation between the  
19 FSA in London, the AMF in France, or Levarthian in  
20 Germany.

21 And the final part of Lamfalussy is  
22 strengthened enforcement of the law. And that

1 means by the commission. It means by member  
2 states. It means being extremely active in  
3 pursuing any breach of community law. And again,  
4 there are a lot of technical measures we've done  
5 to try to accelerate and deepen our efforts here.

6           What are the key deals? What are the  
7 political deals of MiFID that have been so  
8 important? I think the first that we have to  
9 mention here is that the strengthening of the  
10 strengthened single passport for investment firms  
11 on the basis of home country control. In other  
12 words, a firm goes to its home regulator, says I  
13 want to deliver investment services, whether  
14 they're commodity business or whatever, throughout  
15 the European Union and gets a single passport from  
16 the member state. And that is absolutely critical  
17 for the freed provision of services and for  
18 efficient markets. That is at the heart of MiFID  
19 and it's extremely critical.

20           But in order to do that, the quid pro  
21 quo has been extremely high standards of investor  
22 protection to compensate this, if you like,

1 delegation of power from one member state to  
2 another. So, that has been a critical, if you  
3 like, political deal at the heart of MiFID.

4           And the second of them is one I've  
5 mentioned already, has been the abolition of the  
6 concentration rule. We've got rid of this rule  
7 which required all trading to be done on regulated  
8 markets. What we've now done is to allow  
9 competition, competition between stock exchanges,  
10 multilateral trading platforms, systematic  
11 internalizers, in other words, firms like Goldman,  
12 Sachs or Morgan Stanley who want to run their own  
13 electronic systems. So, we're now opening up into  
14 a much more pro competitive way for trading  
15 financial instruments and shares.

16           What is the quid pro quo for that?  
17 Well, the deal for that was more pre and post  
18 trade transparency for regulated markets, for  
19 multilateral trading platforms, and particularly  
20 for systematic internalizers, you have to pose  
21 under certain conditions their pre-trade numbers  
22 on the screens for everybody to see and trade.

1                   Transaction reporting too has been a  
2 major innovation, and I'm going to come to that in  
3 a minute.

4                   The requirements for firms are  
5 important. I don't think they're over onerous.  
6 They're organizational. They require requirements  
7 related to risk management, audit, compliance,  
8 personnel dealing, limitations on personal dealing  
9 by employees. We've got rules that say that you  
10 can outsource portfolio management to third  
11 countries, for example, but you've got to take  
12 great care. And the outsource company has to be  
13 regulated in the third country.

14                   There are very strong provisions in  
15 MiFID about conflicts of interest. We do not want  
16 to have a system which is riddled with conflicts  
17 of interest throughout the whole system. Likewise  
18 in MiFID, there are extremely important conduct of  
19 business rules. For example, information to  
20 clients must be fair, clear, and not misleading,  
21 but we don't go into endless detail about what  
22 that should be. That is a principle.

1                   Investment advice and portfolio  
2 management must be suitable, suitable for the  
3 investor's level of experience, risk appetite, and  
4 investment objectives. Suitability then  
5 absolutely at the heart of the relationship  
6 between an investment firm and a client. And  
7 other services, other services outside that scope  
8 must be appropriate, key issue here  
9 appropriateness to the investor's knowledge and  
10 again, as a knocked out here, there is an  
11 exception which allows execution only to be  
12 outside the scope of those disciplines.

13                   Firms must provide best execution when  
14 executing orders on behalf of clients. And as I  
15 said earlier, we spent a long time regulating and  
16 trying to find the right balance here.

17                   There is strong regulation of  
18 inducements. The payments from firms -- from --  
19 to and from firms in relation to investment  
20 services must be justified and fully disclosed and  
21 must be in the interest of clients. And as usual  
22 and quite predictably, there are important record

1 keeping obligations and requirements for client  
2 agreements for retail clients.

3 We avoided what I think would have been  
4 a big mistake, which is something our regulators,  
5 for example, were in favor of, which was to draw  
6 up a standard contract. We in the commission  
7 looked carefully at that advice and said no. We  
8 thought that was too much, and the results, I  
9 think, would have saved firms a great deal of  
10 money because they would have had to redo every  
11 single client contract. So, we avoided  
12 harmonizing in every single area.

13 Let me move on now to an important area  
14 which was transaction reporting. And I'm moving  
15 closer perhaps to your areas of major interest.  
16 Now here we have a serious of disciplines, which  
17 are extremely important and at the top -- at the  
18 heart of our MiFID regime.

19 Transaction reporting to local competent  
20 authorities of all -- for buy and sell  
21 transactions must be carried out in all financial  
22 instruments admitted to trading on a regulated

1 market. We want -- we then had provisions which  
2 requires the sharing of data between competent  
3 authorities to ensure that the competent authority  
4 of the home firm knows exactly what the position  
5 is on such and such a stock, but we do have  
6 carve-outs from those obligations for primary  
7 market transactions, securities financing, and for  
8 certain options. So, transactions reporting here  
9 absolutely critical, post-trade transaction  
10 reporting.

11 For commodity derivatives, regulators  
12 have adopted an exchange centric approach since  
13 there is no OTC trading of exchange admitted  
14 instruments. So here, for example, the exchange  
15 provides the feed to local regulators. We have a  
16 system -- we've introduced a flexible system in  
17 order to code those various products. And the  
18 home competent authorities of remote members can  
19 request data from exchanges -- from the exchange's  
20 local regulators in order to make sure we  
21 overburden the system here with too much  
22 automaticity and too much cost.

1           Now, the transparency -- the detailed  
2 transparency provisions apply to shares only.  
3 They apply to all trading venues. They apply to  
4 firms subject to post-trade obligations for OTC  
5 trades. You remember earlier, that was not the  
6 case in certain markets. We've now made that  
7 obligatory in order to get the full picture of  
8 trading of all instruments covered by MiFID.

9           There are exemptions for crossing  
10 networks, and there are importantly, and this was  
11 another long discussion, delayed publication for  
12 post-trade information for large trades on under a  
13 sliding scale. Some of the big United States  
14 investment firms were very concerned that for big  
15 block trades, sufficient time was needed in order  
16 to divest big trades and not to prejudice market  
17 trading.

18           We've had carve outs here for primary  
19 market transactions, stock lending and repos,  
20 options and warrants. The reporting is required  
21 within three minutes except for portfolio trades  
22 and out of hours trades. And there's a



1 requirement of course for organization and conduct  
2 of regulated markets. So, you can see here a very  
3 extensive and complete reporting set of  
4 requirements under MiFID.

5 Now, concerning the issue of  
6 commodities, what commodities and what products  
7 are covered? And this is an important slide which  
8 I think we should concentrate briefly on.  
9 Basically, what you have in this matrix in the  
10 second row down is that MiFID covers options and  
11 futures only if it's cash settled or on the  
12 standardized basis and for which types of firms,  
13 banks and primarily investment firms. Not all  
14 investment firms, investment firms -- not all  
15 investment firms are covered if there are -- there  
16 are exceptions as you can see here where firms are  
17 dealing on own account, otherwise then as a market  
18 maker or off market liquidity provider.

19 So, we are talking here in MiFID at the  
20 moment, the scope is covering options and futures,  
21 covering the types of firms, banks and investment  
22 firms for cash settled or standardized options and

1 futures trading. We do not cover either  
2 non-financial groups. That is, for example, BP.  
3 Trading energy products, that is outside the scope  
4 or indeed their subsidiaries. One of the issues  
5 now is this the right picture. And we've been  
6 required under the rules to start out with a major  
7 -- a review of whether the current scope and the  
8 current application of MiFID is appropriate.

9           And what we're doing here is to carryout  
10 a very detailed consultation process on the basis  
11 of three legal requirements. The first of them  
12 requires us to look at the scope. Under Article  
13 65 of MiFID, there are questions of scope as to --  
14 as well as of conduct -- as well as of content of  
15 financial regulation in relation to persons active  
16 in commodity derivatives and exotic derivatives.  
17 So, the question is here what is the right scope  
18 for MiFID, and we are required now to carry that  
19 review and we were doing that.

20           The second is to look and this is a  
21 requirement under Article 40 of MiFID. We are  
22 required to reexamine the provisions relating to

1 the criteria for determining which OTC derivative  
2 contracts relating to commodities and exotic  
3 derivatives are to be treated as financial  
4 instruments for the purposes of MiFID. So, that  
5 is the second hook on which we have to work.

6 And the third hook requires us to look  
7 at whether the capital requirements under the CRD,  
8 the Capital Requirements Directive are  
9 appropriate. Because in certain cases, firms do  
10 not have capital requirements for carrying out  
11 commodities derivatives business and in certain  
12 cases, they do. So, the question is here what is  
13 the right balance. Well, how do we get to a level  
14 playing field? So, we are now looking at those  
15 issues as well.

16 Now, another issue that has just come up  
17 very, very recently, and some of you here I know  
18 are aware of it, is the commission wants to open  
19 up and create much more dynamic energy markets in  
20 the European Union. And that means looking at the  
21 structure of energy, looking at unbundling of  
22 supply from the -- ownership of the

1 infrastructures and so forth.

2           And just the last week or so big  
3 proposals have emerged. And part of that proposal  
4 has been a request to carryout some further work  
5 whereby the regulators, CESR, will be requested  
6 alongside our energy regulators to investigate  
7 whether transactions in gas and electricity supply  
8 contracts and derivatives should be a subject of  
9 pre and post trade transparency requirements. So  
10 again, the question is here what should be covered  
11 by MiFID, what should not be covered by MiFID, and  
12 what should be covered by the Capital Requirements  
13 Directive.

14           Now, I don't want to anticipate in  
15 anyway the outcomes of this work. We're very much  
16 in the early stages of it. On the slide, you will  
17 see that we intend to bring forward our final  
18 report at the end of next year. We are certainly  
19 seeking more evidence and more advice from people  
20 like Anthony Belchambers but also from our  
21 regulators on a number of complex issues.

22           And I think it would be foolish on

1       behalf of the commission to try to do this work in  
2       a hurry. I have a general principle, by the way,  
3       that fast regulation and fast decisions are not  
4       usually the right approach in financial markets.  
5       You need to think very, very carefully about all  
6       the impacts of different positions.

7                    Another area that I should draw your  
8       attention to where we're underway is whether there  
9       should be more forced transparency, obligatory  
10      transparency in the post trading area, notably for  
11      the bond markets. And here the commission has  
12      been carrying out a great deal of work again.  
13      We've been getting an awful lot of advice.

14                   The general view around is that there is  
15      no market failure with respect to transparency and  
16      wholesale markets. The general view around is  
17      that nevertheless there are issues concerning  
18      access to bond markets. We just had a big hearing  
19      on all this in Brussels. We've exhaustively  
20      discussed the issues. We're going to come forward  
21      with our final report at the beginning of next  
22      year. And I think we're encouraged by the fact

1 that the industry itself is taking initiatives not  
2 so bold as your trace system in the United States  
3 but I think a first move to start making a much  
4 more open retail size type transaction reporting  
5 for all the most liquid bonds in Europe, and we  
6 hope to see that start early next year.

7 So, looking and summarizing here, what  
8 do we think MiFID is going to do? Well, we do  
9 think it's going to capitalize significant market  
10 change. We do certainly think it's going to  
11 increase competition between trading venues and  
12 investment firms. We think that will drive down  
13 the cost of capital and the cost of trading. And  
14 we believe that many market users will benefit.  
15 We believe the competition across the border is  
16 going to hot up.

17 You're all aware of enormous amounts of  
18 trading -- changes in the structures of stock  
19 exchanges, for example, in the European Union.  
20 And that in our view, to some extent, has been  
21 driven by MiFID. We believe that trading volumes  
22 and financial information flows will improve.

1 We're seeing a lot of innovation going on here.  
2 We think over time and we think we have evidence  
3 that our markets in Europe will be more  
4 interconnected, deeper, and more liquid. And in  
5 the end, the final investors will benefit.

6           And for example, here, we've seen a very  
7 interesting project led by some of the world's  
8 major investment banks called Project Turquoise.  
9 This is a direct challenge to stock exchange.  
10 It's going to try to capture all the flow and  
11 trade extremely fast. We've seen other projects  
12 such as Project Boat in the area of the provision  
13 of financial information, Equiduct looking at  
14 providing Pan European trading of stocks and  
15 shares for the smaller banking community.

16           So, overall is it an export of the  
17 European Union? I don't like to think too much in  
18 terms of exporting, but I believe that here we  
19 have a project, a model, which I think has a lot  
20 of good policy in it. It has been absolutely  
21 exhaustively discussed. It's a principles-based  
22 approach. It gives passports to firms from their

1 home base to do their business right across the  
2 European Union. It harmonizes where we have to  
3 harmonize, and it provides a much more open and  
4 transparent system. And I don't think we would  
5 have got there, Chairman, if we hadn't had our  
6 renovated decision making structure called MiFID.

7 So, the jury is out, of course. As I  
8 said earlier, we began on the first of November, a  
9 few more days to countdown. But I hope if I'm  
10 ever asked back, I hope I'll be able to report a  
11 really exciting and developing and innovative  
12 capital market in Europe, where at the end, all  
13 our investors and our economies benefit.

14 Thank you very much.

15 CHAIRMAN LUKKEN: Thank you very much,  
16 David. That was a very interesting overview of  
17 MiFID to do in that amount of time. I know  
18 there's a lot to chew on there for us. And many  
19 of these folks, I think, are going to have  
20 interest in the commodities section in particular.

21 So, I figured it might be appropriate  
22 just to ask Anthony, somebody who has been very



1 involved from the industry point of view on MiFID,  
2 to give an industry prospective from Europe and --  
3 well, you can kick it off, but others, feel free  
4 with your name cards to put them on their side  
5 when you have a question or have a comment,  
6 including commissioners. And we will get to those  
7 in order.

8 But let's start out with Anthony. I  
9 think that would be appropriate.

10 MR. BELCHAMBERS: Just a few  
11 observations, if I may, first on what David is  
12 saying. He's absolutely right, and I would  
13 commend the commission for trying to get 27 member  
14 states with very different structures, trading  
15 structures, very different regulatory authorities,  
16 very different regulatory functions to actually  
17 agree a common directive is, I think, a remarkable  
18 achievement, even if we didn't always like some of  
19 the results. It's nevertheless a huge  
20 achievement.

21 Having said that, I think one of the big  
22 lessons that we need to learn and I think we have

1 not yet learned is the credibility of these big  
2 projects turns on the ability of firms to deliver  
3 on the ground. And it turns on the ability of the  
4 firms to implement efficiently and effectively.

5           And I still think sometimes they are the  
6 Taylor and Charlies in the process. The  
7 legislators have a bite. The regulators have a  
8 bite. And very often it's left to the firms to  
9 pick up the pieces in quite a short time table.  
10 So, there's usually a scramble and a mad rush by  
11 compliance to try to get in on time. I think  
12 sometimes we just don't reflect enough sympathy  
13 for that position.

14           All of that said, I think it's also  
15 inevitable that we will have some member states  
16 who are stragglers in the process. They have  
17 different legislative procedures. This directive  
18 will impact very differently on some member states  
19 to others, and so you're bound to get a staggered  
20 approach towards getting in on time. But again, I  
21 think it's going to turn out to be a very good  
22 achievement at the end of the day.

1           I think it principles great supervision,  
2           which is what David touched on. I think it's  
3           interesting. It isn't the time to go through it  
4           now, but basically, as I read it, what it means is  
5           the regulator will set the rules, will set the  
6           targets, will enforce those rules, but the firms  
7           will have freedom to implement as they see fit.

8           And what is critically important is that  
9           if this is -- if this is to genuinely move from a  
10          supervisory approach that says comply or explain,  
11          it's important that the supervisors understand  
12          what that means as well as the compliance  
13          departments and officers within the firms  
14          themselves and the senior managers. They all have  
15          to grow into this new, dare I say it, mature way  
16          of regulating.

17          And I'm a great buyer of the idea, but I  
18          think the regulatory authorities as well as the  
19          compliance have to deliver on this new way of  
20          regulating. And I think that's critically  
21          important. Otherwise, we'll probably end up in  
22          tears. There will be a misunderstanding about

1 what the process means by one side or the other.

2           If I just touch on one other thing and  
3 that is -- and I think personally when David  
4 mentioned key deals, I think principles-based  
5 supervision is a key deal. I think it's the third  
6 key deal out of this. But there's something else  
7 we mustn't lose sight of. And this that for the  
8 very small firms or domestically oriented firms  
9 who have no real aspirations to do cross border  
10 business, this is regulatory cost -- this is huge  
11 cost to them without a lot of direct benefits,  
12 strategic benefits. And I think sometimes we --  
13 there's a risk that we might just lose sight of  
14 that.

15           General observations, in terms of  
16 commodities, I think we all know who we mean.  
17 It's essentially non-bank, non-investment  
18 corporates whose main underlying business  
19 essentially is trading in commodities. And the  
20 breeding space that they have got which we  
21 particularly want to make sure the regulatory  
22 structure is proportionate, is it not -- the

1 industry is not making a case of no regulation  
2 here. It's a plea to say what we would like to  
3 make sure is we've got proportionate regulation  
4 that actually takes account of a number of  
5 fundamental differences that exist between banks  
6 and investment firms on the one hand and these  
7 corporates on the other, so that in effect, we end  
8 up with tailored regulation, if I can use that  
9 description.

10 I won't go through all the differences,  
11 what I would say is if I may just finish on a  
12 quick summary of what the industry position is and  
13 in this context, we're working very closely with  
14 ISDA and an organization called EPHEd, which  
15 really represents the sort of physical, more  
16 physical side of the industry. And essentially  
17 our position is quite straightforward.

18 The first thing we're saying is we like  
19 the definitions as they are at the moment. We  
20 thoroughly approve of those and don't want to see  
21 any change in them. The second thing is that we  
22 think prudential regulation is best built around

1 these types of firms, where it's founded on for  
2 example, systems and controls, more pillar two  
3 than pillar one.

4 We also think that because of the nature  
5 of the business, retail protection doesn't sit in  
6 the market. It sits in the high street. There  
7 are physical regulations, price regulators who  
8 will be looking after the interests of consumers  
9 in the high street, rather than the concept of  
10 investors. So, I think there again, there is a  
11 fundamental difference that sits over these  
12 markets.

13 And it's worthwhile remembering that  
14 these markets are also subject to very often dual  
15 regulation because you have physical regulators  
16 who will be looking after the physical side of the  
17 business. And I think that's important.

18 The systemic risk argument is probably  
19 critically important in all of this. And that is,  
20 I think -- it's a little bit of a sort of unfair  
21 comparison, but I'll make it anyway, which is  
22 Northern Iraq when compared with Enron. And that

1 gives you an example of where the public  
2 perception and the systemic risk lies in the  
3 difference between these two groups, if I may put  
4 it that way. And I think that's quite a graphic  
5 example of that.

6 So, I would argue that the systemic  
7 risk, the risk that's posed to the system because  
8 they're not involved in payment systems of these  
9 type of organizations is less. And that needs to  
10 be taken into account. If we say we have a  
11 risk-based regulatory structure, then that has to  
12 be taken into account when we decide what is the  
13 appropriate level of regulation.

14 I've probably gone on for too long, so  
15 I'll pause there just as a sort of kicker and  
16 quick response.

17 CHAIRMAN LUKKEN: Craig, did you have a  
18 comment?

19 MR. DONOHUE: I just had a question --

20 CHAIRMAN LUKKEN: Go ahead.

21 MR. DONOHUE: -- for David. Thank you  
22 very much. David, the question -- I had a couple

1 questions. One was what are the metrics that you  
2 plan to use to measure success or failure of  
3 MiFID.

4 MR. WRIGHT: Well, the first metric is  
5 -- I would argue is what happens to the markets.  
6 Do the markets develop? Do costs come down? And  
7 what are the -- what is the macroeconomic and  
8 microeconomic impact? We're very strongly of the  
9 view that if that happens, the European economy is  
10 sustainably stronger. And if that happens, we  
11 think we have the balance then to look at that  
12 benefit against what Anthony has just been talking  
13 about, the costs of implementation.

14 Now, there have been all sorts of wild  
15 estimates about the costs of all this. And it's  
16 not an easy thing to measure, not an easy thing to  
17 measure at all. But, I think some of them  
18 certainly of the estimates I've seen require a  
19 good dose of sorts. The FSA has done a good piece  
20 of economic work looking at the benefits and the  
21 costs. And under a reasonable scenario, they  
22 would say payback time is three to four years, of



1 that order. And perhaps, I'm not being entirely  
2 -- but of that order.

3           However, that does not take into account  
4 the dynamic, innovative effects in the market,  
5 which are very difficult to capture. So, I don't  
6 think you can judge MiFID for two or three years  
7 out, but I think it's precisely those types of  
8 metrics, as you describe them, that you want to  
9 look at.

10           And the other point here is that if we  
11 see that such and such provision, whether it's in  
12 the commodity derivative space or transaction  
13 reporting, whatever it is, is not working, we now  
14 have the decision making processes inside the  
15 European Union to make changes.

16           And where there are what we call  
17 delegated powers to my institution to make those  
18 changes and specifically in the technical areas,  
19 we can do that quickly or we can do that in a  
20 reasonable time frame. So, I think we've got a  
21 flexible system, and the cost and benefits here  
22 will be very important.

1                   Now, you know, I -- when I look at the  
2 evidence over the last, let's say, five years  
3 about what's happened in Europe in the derivatives  
4 markets, in the trading and IPOs and the way the  
5 bonds markets have developed, and in many venture  
6 capital as well and risk and private equity hedge  
7 fund development, you know, I do see a dynamic  
8 space which was not there before.

9                   The other thing I would be looking for  
10 just to (off mike) is of course, from our  
11 perspective, we would like to see the markets join  
12 up, and Mario will talk about how we want to see  
13 that in the settlement areas. So, we would like  
14 to see these benefits widely spread, widely  
15 spread. And again, looking forward, If MiFID  
16 drives down the cost of capital, improves the  
17 returns on investment funds, pension funds,  
18 insurance funds, and so forth, those are the sorts  
19 of things that we will judge to -- we will use to  
20 judge whether we've got it right.

21                   A final comment, you know, you never --  
22 and I'm sure my colleagues from the CFTC, you

1 never satisfy everybody with a piece of work like  
2 this. But the volume of discontent that has  
3 decreased dramatically. And I think, again, it's  
4 been a result of the way we have tried to work  
5 with the industry, with Anthony, his colleagues,  
6 and many others to get the calibration right, with  
7 investment firms on how to deal with block  
8 trading.

9 So, this has been a long, long process.  
10 So, there's a lot of things here. I can only  
11 point to empirical evidence, some fragmentary  
12 empirical evidence today and I hope much stronger  
13 evidence in the future.

14 MR. DONOHUE: Just as a follow-up, the  
15 costs that you speak of, are they the costs of  
16 brokerage commissions or exchange fees or the cost  
17 imposed by clearing settlement and custody  
18 providers or are you looking at the total cost of  
19 liquidity or transaction costs in the aggregate  
20 for end users of the market? And if it's the  
21 later, how will you measure that given the  
22 fragmentation of liquidity across a multitude of

1 different types of execution venues? Do you have  
2 the capability to do that and is that your --

3 MR. WRIGHT: Well, we would, in those  
4 conditions -- I mean, in this sort of area, what  
5 we would typically do in my institution would be  
6 to outsource external work. We would say that we  
7 want to measure the costs and benefits of MiFID.  
8 We would provide a budget, and we would seek  
9 academic and advisory services to do some of this  
10 work.

11 Now, the first -- the first cost is the  
12 cost to firms, the cost of implementation to the  
13 firms. And that is what we would be looking very  
14 much on the cost side. All the other things  
15 you've been talking about, if, for example,  
16 liquidity was to decrease or if markets were to  
17 shrink, we would obviously include those on the  
18 cost side of the balance sheet. And I'm being  
19 optimistic. I don't think that's going to happen.

20 But clearly, what you have to separate  
21 here is are all the costs of MiFID in terms of the  
22 implementation costs as opposed to the overall

1 economic benefits to financial markets as a whole.  
2 Now, it's not an easy task. I don't pretend to  
3 say it is. And I don't -- I know that the FSA,  
4 for example, who is the most advanced, I must say  
5 in terms of doing this type of cost benefit work,  
6 there is -- there are margins of error and margins  
7 of uncertainty, which I don't think any brilliant  
8 set of economists in the world would completely  
9 agree on.

10 So, you know, you've got to look at the  
11 holistic picture here. You can't just look at one  
12 piece of it.

13 CHAIRMAN LUKKEN: Anybody else?

14 COMMISSIONER CHILTON: I have a  
15 question.

16 CHAIRMAN LUKKEN: Yeah. Bart?

17 COMMISSIONER CHILTON: Well, first of  
18 all, I just want to thank you, Mr. Wright. That  
19 was a great presentation and real educational,  
20 particularly to somebody who hadn't looked at  
21 these things before, so thank you so much.

22 And while I take your point about not

1 making sort of a seat of the pants judgment,  
2 principles-based also has the added benefit of  
3 making it be a little bit nimble and the ability  
4 to sort of look around the corner and anticipate  
5 changes.

6 And I'm wondering with specific regard  
7 to electronic trading and energy. You know, in  
8 the U.S., we've seen what some people contend are  
9 for sure problems; others will debate it.

10 But, you know, if MiFID is not going to  
11 get done for another year and a half or so, is  
12 there something that you might be doing on that  
13 issue or is there at least -- if you're not going  
14 to full out regulate these things, is there  
15 something you might be doing to at least add  
16 transparency to these issues so that you could  
17 potentially stop a problem before it begins?

18 MR. WRIGHT: Well, we think the right  
19 approach here -- let's be clear about the timing.  
20 MiFID enters into force the first of November.  
21 Our commodities review will be completed by the  
22 end of next year.

1           Now, you can go fast, and as I said, I  
2 think you -- we should take -- as policy makers,  
3 we should take great care. I don't believe  
4 evidence from anywhere around the world of fast  
5 policy making has resulted in particularly good  
6 policy making in financial markets over the last  
7 few years, but so, we wanted to look at this  
8 question completely properly. The issue is  
9 extremely complex. It covers both pre-trading,  
10 post- trading.

11           We have to look at the consequences  
12 across MiFID as a whole. We have to consider what  
13 Anthony is saying about the links with the capital  
14 requirements. And I think that is the right  
15 approach. Now, do we have such an urgent problem  
16 today that would force us to move faster? And  
17 here, of course, what I'm referring to is the gas  
18 and electricity supply contracts and their  
19 derivatives.

20           Well, I'm not sure it's of -- I'm not  
21 sure it's a sort of emergency situation. So, we  
22 have something in Europe called the Better

1 Regulation Agenda, and that is a genuine political  
2 effort by the European institutions develop policy  
3 in a coherent way, bottom up, evidence from the  
4 market, evidence from regulators, hearings,  
5 consultations, and then options, looking at the  
6 costs and benefits and in the end, deciding on the  
7 way to act.

8           And I don't want to move out of that  
9 cadre. I don't want to move out of that  
10 framework. It's extremely exhausting framework.  
11 It's exhausting for Anthony and his members, but  
12 in the end of the day, we think we eliminate -- we  
13 eliminate major mistakes, can't guarantee that,  
14 but I think that the more open the policy making  
15 we have, the better the outcomes are.

16           There's an awful lot of people around  
17 this table whose views on commodity derivatives or  
18 energy trading or whatever the subject are a value  
19 to my institution. I want to hear them, and I  
20 can't do that in five minutes or five months.  
21 I've got to take my time, and then I think we'll  
22 get to a good and -- a good outcome, which, by the



1 way, has got to end up in a situation where we  
2 have a level playing field for all market  
3 participants.

4 We cannot avoid -- we cannot have a  
5 situation where some parts of the industry, some  
6 parts of the market are favored over the others.  
7 So, again, that's another thing, the calibration  
8 of this is extremely difficult. And therefore,  
9 again, I plead for a little time to do the job  
10 properly.

11 COMMISSIONER CHILTON: Yeah. And I  
12 appreciate your response -- and I'm sorry,  
13 Richard, just real quick follow up -- and I take  
14 your point also about things being -- decisions  
15 being made too rapidly. And I think that's the  
16 reason in the U.S. why we're here to begin with on  
17 these energy markets. And we didn't have the full  
18 debate, and it wasn't in public. And so, that's  
19 why some of us are concerned about trying to fix  
20 it, and we don't want to go too far.

21 What we hear from the other side that is  
22 concerned about these issues is we're going to be

1       anticompetitive, we're going to shoot business  
2       someplace else. And so, we've got a double edged  
3       sword that we're working with too. You know, some  
4       believe there is a problem, and it's just a  
5       question of how rapidly can we do it but doing it  
6       right. So, I guess it's a matter of degree, but I  
7       didn't want you to think I didn't take your point  
8       about getting right. That's why we're here,  
9       because we didn't do it right the first time, so  
10      thank you.

11               MR. WRIGHT: And if I may add to -- I  
12      don't want to enter into the domestic situation in  
13      the U.S., of course, but I think what's very  
14      important is -- far from it -- what's very  
15      important too is that, of course, we have here the  
16      confluence of different regulators. The financial  
17      markets in our case, we just set up a bringing  
18      together the European Union's energy regulators  
19      together in a network.

20               So, we really want -- we need to get  
21      this advice from these people first and then work  
22      out what is the appropriate policy response, if

1 anything, because we don't want to start from a  
2 position that you do have to do something. We  
3 want to look at the evidence in a totally unbiased  
4 way.

5 CHAIRMAN LUKKEN: I'm going to turn to  
6 Richard. Before I do that, I wanted to recognize  
7 Barbara Matthews, who joins us at the table.  
8 Barbara is our Financial Attaché from the U.S.  
9 Department of the Treasury and is really our eyes  
10 in ears in Europe and for the European Commission.  
11 We welcome you. She's normally, in Brussels but  
12 we lucked out that she was here in Washington  
13 during our meeting. So, welcome and please join  
14 the discussion.

15 But I'll go ahead and turn to Richard.  
16 I know he has a comment or a question.

17 MR. BERLIAND: Yeah. I've got one thing  
18 I just would like to add to the points that  
19 Anthony has said, which is really an observation  
20 around how MiFID is affecting the futures markets.  
21 As we have discussed many times in the past, I  
22 think the regulatory structure in Europe allows a

1 lot more fluidity of influence from what goes on  
2 in one asset class into another.

3 And as I think a lot of the bias and the  
4 concentration around MiFID has been cash equity  
5 generative. It is very interesting to note how a  
6 lot of the innovative initiatives that have come  
7 in the cash equities world as a result of MiFID  
8 are starting to influence the futures world.

9 You could argue MiFID itself is not  
10 forcing the futures world to change in any  
11 material way. But it is the innovation that has  
12 come cash equities that is starting to spill over.  
13 And I think we will see a lot more competition in  
14 systematic internalizers and so on in futures,  
15 which perhaps wouldn't have occurred if this  
16 hadn't been driven by the MiFID initiative.

17 And it goes back to the same point, if  
18 you look at the sort of market structure  
19 differences today in securities in North America  
20 compared to futures in North America, where there  
21 has been, I would argue, a much more sort of firm  
22 wall that prevents the (off mike) and vice versa.

1           So, I fully endorse his comment about  
2           innovation. I definitely think it will have  
3           influence way beyond the sort of immediate areas  
4           of cash, which is where much of the trading side  
5           has influence. And indeed, when we talk about the  
6           code of conduct, again, a lot of the initial focus  
7           is around equities rather than around fixed income  
8           or around (off mike). So, I fully endorse the  
9           comments there and I think it's been a great  
10          initiative to drive change.

11                 Thanks, Chairman Lukken.

12                 CHAIRMAN LUKKEN: David, obviously, the  
13           concept of transparency comes up in a lot of  
14           different respects. That's obvious from your  
15           presentation. It's obvious.

16                 Without going into a whole lot of detail  
17           or repeating some of the aspects of the  
18           presentation, could you just touch upon, you know,  
19           the concepts that the commission has of  
20           transparency, in other words, its pre-trade,  
21           post-trade issue?

22                 And also, I think a lot of times

1 transparency gets portrayed as a black or white  
2 kind of thing. It's either transparent or it's  
3 not. And I think, what we've often tried to argue  
4 is that there's a range of transparency depending  
5 on the type of instrument, the type of market, the  
6 type of market participant. And I think MiFID has  
7 been sensitive to some of those differences and  
8 perhaps you can elaborate on that.

9 MR. WRIGHT: Well, this has been one of  
10 the very right at the center, as I said, of the  
11 MiFID deal and getting the right calibration both  
12 of pre-trade and post-trade reporting. If you  
13 look at the pre-trades base, of course, regulated  
14 markets, MTFs are posting their prices. And the  
15 question here was a political one, whether by  
16 opening up and allowing big investment firms and  
17 other institutions to come in and compete for  
18 order flow and business, whether they should be  
19 subject to similar pre-trade transparency  
20 obligations.

21 And there was a ferocious rattle about  
22 it. Let's be quite honest. A lot of firms, big

1 investment firms were extremely worried about  
2 those provisions. And in the first rounds of the  
3 political discussions, feathers flew and people  
4 were worried, particularly in London, about some  
5 of the emerging compromises.

6 But in the end, the imposed pre-trade  
7 obligations on systematic internalizers, i.e. big  
8 investment banks -- let's just -- I'm giving an  
9 example here. But the big investment banks want  
10 to trade and compete for securities order flow.  
11 We required them to post prices but in a specific  
12 category where retail business primarily would be  
13 carried out. In other words, anything that was of  
14 a bigger size or block trading would not be  
15 required to pre-trade -- posting pre-trade prices.  
16 And the deal really focused about what was the  
17 segment that the internalizers should post.

18 On the post-trading side, I would say  
19 this was less difficult. All reporting of our  
20 financial instruments required on regulated  
21 markets and so forth two regulators, exchange of  
22 information among regulators to ensure that home

1 state regulator has the full picture. The less  
2 controversial the area that held us up  
3 considerably here was the determination of what I  
4 said earlier, of what constitutes block trading,  
5 in other words, how much time should be allowed  
6 before disclosing block trades to the market or  
7 different segments of higher volume trades to the  
8 market. That was a technical issue, but it was an  
9 important one for a lot of firms and for some  
10 member states.

11 I should also say that one of the  
12 critical things that we had to decide was what was  
13 a liquid market. We had to come to decisions  
14 about how do we define liquid markets because the  
15 pre-trade obligations and systematic internalizers  
16 affected those trades in liquid markets, not in  
17 e-liquid markets and small trades of small stocks.  
18 Obviously that would be not sensible. So, again,  
19 a lot of technical work here about calibrating and  
20 trying to find out.

21 We've ended up with a reasonable  
22 compromise. I think clearly there will be people



1 who say that these disciplines should be extended  
2 beyond classic equities and instruments on  
3 regulated markets, so trading on regulated markets  
4 onto -- into the wider bond trading, for example,  
5 that I mentioned at the end.

6           And here, again, we've looked at this  
7 carefully and we don't think that there's a  
8 compelling case at this stage. I think that's  
9 certainly our view to impose very costly demanding  
10 obligations on that part of the market.

11           However -- however, we are encouraging  
12 the industry to take initiatives to provide the  
13 information to clear for retail and for liquid  
14 bonds. And this is something that may well  
15 develop over time. So, that's where -- that's how  
16 we've gone about -- gone about the job. There's  
17 been fears that the transaction reporting system  
18 will lead to fragmentation and the data sets won't  
19 be brought together. We don't believe that for  
20 one minute. We think there will be plenty of  
21 operators out there, I'm already seeing that, who  
22 will consolidate the tapes and bring the complete

1 picture to the market.

2 So, again, this is a question going back  
3 to the first question I had from my right here  
4 where we'll have to judge the outcome in a few  
5 years time. But we're reasonably confident we've  
6 got it about right.

7 CHAIRMAN LUKKEN: Turn to Commissioner  
8 Dunn, then Barbara, Adam, and George.

9 COMMISSIONER DUNN: David, this is more  
10 of an elementary question to help me understand  
11 your presentation a bit. Could you elaborate a  
12 little bit on the definition of the home competent  
13 authorities and that of the exchange local  
14 regulator and the relationship between the two?

15 MR. WRIGHT: Well, the home competent  
16 authority is -- I'm trying to look very quickly  
17 for the definition here. But the home competent  
18 authority is the authority of where the investment  
19 firm is based, where it's legally, if you like,  
20 established.

21 So, if it was a firm established in  
22 London, the home regulator would be the FSA. The

1 passport would be given by the FSA, and upon the  
2 basis of that passport -- upon the basis of a  
3 control of the firm, what it wants to do, what  
4 services it wants to provide, whether the  
5 personnel are fit and proper, whether the firm is  
6 organized correctly and so forth according to the  
7 rules that are in the directive. But that is the  
8 home competent authority.

9           Once that passport is given, that firm  
10 can sell its services around the European Union  
11 without any further impediment. It's what we  
12 would call the free provision of services under  
13 our treaties.

14           Now, there has been a lot of discussion  
15 about the relationship between the home country  
16 and the host. Where the host has a host country,  
17 let's say it's the UK is regulating a firm but  
18 that firm has branches in another member state,  
19 what role does that branch have -- what role does  
20 that host country have to regulate part or parts  
21 of the business?

22           And there's been a long discussion about

1 the calibration here of whether the host  
2 regulator, let's say the UK based firm is selling  
3 services to Paris, should the Paris regulator, the  
4 French regulators have any sort of role in  
5 checking about what's going on? And we've had a  
6 long discussion here and not an easy discussion,  
7 but the text does give responsibilities to the  
8 host country in the cases of branches to carryout  
9 analysis and making sure that, for example, the  
10 conduct of business is being correctly carried  
11 out.

12 Now, interestingly here, the country  
13 that was extremely insistent on these provisions  
14 was, of course, the UK because the UK has an awful  
15 lot of branches of firms doing business in London.  
16 So, the FSA in this particular case, the UK  
17 Government, are negotiating on behalf of the UK,  
18 wanted to have some possibility of looking at,  
19 let's say, a big bank, Deutsche Bank, branching  
20 doing all its wholesale business in London. So,  
21 there's -- again, there's some fine detail here,  
22 which is calibrated in the text.

1                   And we've had not an easy discussion  
2                   about how the home and host have to collaborate  
3                   here. You don't want two sets of rules. You  
4                   don't want two sets of regulators. So, in the  
5                   end, we've worked out a system where the two  
6                   regulators cooperate together. And again, we'll  
7                   have to see if that functions in public.

8                   Sorry. Your second question?

9                   COMMISSIONER DUNN: I was asking about  
10                  the exchange local regulator, the relationship  
11                  between that and the home competent authority.

12                 MR. WRIGHT: Yeah, which is the point  
13                 that I've -- which I've been dealing with here.  
14                 And again, I mean, MiFID -- MiFID -- at the heart  
15                 of MiFID, you know, it requires regulators to  
16                 cooperate on the transmission of transaction  
17                 reporting. So, the home country that would have  
18                 the monopoly of trading in a particular stock, if  
19                 the trading was carried out in another market, we  
20                 want to make sure that those reports, those  
21                 transaction reports can be codified and collected  
22                 in (off mike), so there's a requirement to

1 exchange transaction reports. There's a  
2 requirement to help each other in terms of market  
3 abuse.

4           So, there, again, through this directive  
5 and other directives, we are encouraging our  
6 regulators to work much more closely together.  
7 And at the end of the day, if this is to all work  
8 on the ground where it matters, we must have  
9 cooperation among regulators, and we must have  
10 consistent implementation as the point I made  
11 earlier.

12           We can't have a particular provision  
13 being implemented in a scattered way. That is  
14 why, for example, we are very keen and we  
15 encourage regulators to work together and where  
16 necessary come to some agreements about what such  
17 and such provision means.

18           So, all of this is quite a cooperative  
19 effort, right down from the political  
20 determination of the main axes of this proposal  
21 down to the day to day implementation of it. And  
22 I'm not going to tell you today that everything is

1 going to be hunky-dory and smooth from day one, of  
2 course not, but things will smooth out. And then,  
3 in a few months time, I think the markets will  
4 settle, regulators will get used to it, and I  
5 think that the benefits that I talked about  
6 earlier will start to flow.

7 CHAIRMAN LUKKEN: Barbara?

8 MS. MATTHEWS: Thank you very much. And  
9 first, let me thank you for the invitation because  
10 it's nice to be home, even if it's only for a few  
11 days but also to see my friends who I see more  
12 regularly in Brussels.

13 I have mostly an observation and a  
14 congratulation as well to the CFTC. This is an  
15 organization that for a long time, for as long as  
16 it's been around actually has been innovative in  
17 the US regulatory space, in part because the  
18 markets demand it. And it's also been very global  
19 in its outlook from the beginning.

20 And so, I think it's extremely important  
21 that you've organized this session to go through  
22 and sum up with Europe is thinking about because

1       frankly, it's not just an internal debate. The  
2       internal processes, the internal standards that  
3       the European Union has developed for itself,  
4       either with respect to the balance of power  
5       between home and host regulators or understandings  
6       about transparency will have global implications.

7                 And it's very good that we understand  
8       that here in the United States because it will  
9       spill over into the global discussion. And I  
10      encourage everyone in particular to think about  
11      the transparency issues because transparency can  
12      vary depending on who the audience might be for  
13      the transparency. And in the commodities context,  
14      that can mean one thing. It can mean quite a  
15      different thing in the equities context. I know  
16      that you're struggling with those issues in the  
17      commission now, and those are issues that have  
18      long been part of the debate -- the regulatory  
19      debate here in the states.

20                So, I encourage you to think about the  
21      -- not to view this solely as an internal European  
22      exercise but think about how it implicates how we



1 do our business in the United States and  
2 conversely, what views we may have for how things  
3 are going in Europe.

4 Thank you.

5 CHAIRMAN LUKKEN: Well, thank you very  
6 much. I think, Adam, you're next in the queue.

7 MR. COOPER: Thank you, Mr. Chairman.  
8 I'll be quick. Mr. Dunn really addressed the  
9 question I wanted to ask. First, is it November  
10 5th for the trade reporting? I had understood  
11 that the trade reporting was just a few days  
12 later. Dates matter.

13 MR. BELCHAMBERS: Slightly tricky issue,  
14 this one. But I think we're allowing a weekend.

15 MR. COOPER: Thank you.

16 MR. BELCHAMBERS: Sorry about that,  
17 David.

18 MR. WRIGHT: (off mike).

19 MR. COOPER: I wanted to pick up on  
20 Commissioner Dunn's point --

21 MR. WRIGHT: (off mike).

22 MR. COOPER: Understood. On the

1 consistency of implementation and the  
2 harmonization of cross border, you've explained  
3 sort of the mechanism. Is there an intervention  
4 mechanism or a trigger or a lever that you have  
5 available to you to intermedate and intervene, if  
6 you will, if there are terribly inconsistent  
7 implementation mechanism? Because markets will  
8 over time adjust, but I think, you know, time is  
9 of the essence at the outset, particularly as it  
10 pertains to costs, efficiencies, firms  
11 accommodating, you know, the structures.

12 MR. WRIGHT: Well, the implementation of  
13 this directive, like any directive or rule is  
14 absolutely fundamental. And, as I pointed out, of  
15 the complexity of this -- of these rules, the  
16 complexity of this -- the magnitude of this  
17 project means that it's particularly important  
18 that our regulators work together.

19 So, let us assume we have really  
20 serious problem that an investment service  
21 provider, let us say from the UK, was unable to  
22 provide a service having been duly authorized to

1 country B. Well, what's the first thing that  
2 should happen? The first thing that should happen  
3 is that country A and country B should try to  
4 resolve the particular problem. If that can't be  
5 the case, the matter should be quickly taken up  
6 within the context of the European Securities  
7 regulators and also, we should be notified.

8           If we think that there is no  
9 justification whatsoever for that practice, the  
10 commission could immediately call in and would, I  
11 think, in such a circumstance if it was of  
12 sufficient gravity, would call in the regulators  
13 and the member states in question and say, you  
14 know, what the hell is going on here, please  
15 resolve this quickly having probably got the  
16 advice of our regulators, the commission of the  
17 European Securities Regulators.

18           However, if the -- if that particular  
19 member state said look, I'm very sorry, my  
20 interpretation is this, and I disagree with you,  
21 the commission, me, we are in a -- we are in a  
22 potentially conflictual situation. There is a

1 mediation mechanism, by the way, which CESR has to  
2 try and bring the parties together and resolve  
3 exactly that type of problem. But let's assume  
4 that didn't work either.

5 Well, the first thing the commission can  
6 do legally and quickly would be to send out a  
7 letter, a formal or legal letter saying that we  
8 want an immediate explanation of what's going on  
9 here. We would receive comment from the member  
10 state, saying we think what we're doing is  
11 perfectly legal. We would have to contest that if  
12 we disagreed. And at the end of the day -- and  
13 this process can be quite quick. At the end of  
14 the day, we would say, please, you know, dismantle  
15 this immediately or else we will take you to  
16 court, the Court of Justice.

17 Of course, that's a last resort. That  
18 isn't -- that can be quick if it's particularly  
19 urgent, but it sometimes is not, like any supreme  
20 court, immediately available. But, at the end of  
21 the day, if we do that, we win the cases, by and  
22 large. Our record is extremely good. I think

1       between 80 to 90 percent of the cases we take, we  
2       win.

3                   And of course, that member state or that  
4       regulator that has blocked that business from  
5       flowing open him or herself up to if they lose the  
6       case, serious liability damages or the potential  
7       of it. So, it's not a thing to be taken lightly.

8                   So, there is a formal, legal procedure  
9       for the commission to act. You hope, of course,  
10      that good sense will prevail, that mediation would  
11      work, that the offending regulator would back down  
12      and allow that business to flow. But at the end  
13      of the day, we don't roll the tanks across the  
14      lawns. We go to a court of law. And that is the  
15      right way to approach any difference or dispute of  
16      that form.

17                  Can it be quick? It can be in certain  
18      cases. Mario, you'll correct me, but I think  
19      there are means of obtaining injunctions pretty  
20      quickly for urgent cases. So, last resort, the  
21      legal procedures are there.

22                  CHAIRMAN LUKKEN: I'd like to turn to

1 George and De'Ana and maybe one last question  
2 after that, and then we'll have to get going on  
3 clearing codes.

4 MR. CRAPPLE: My question is related to  
5 Adam Cooper's question, only with respect to the  
6 application of a principles regime to the firms,  
7 rather than between the jurisdictions. How will  
8 the application of the principles to the specific  
9 factual cases be elaborated? Would it be through  
10 enforcement actions or private litigation or  
11 pronouncements by MiFID?

12 MR. WRIGHT: I think as Anthony was  
13 saying -- he might want to comment on it. But as  
14 Anthony was saying earlier that, you know,  
15 principle -- principles- based approach to  
16 regulation is in theory quite different from a  
17 rule based. A rule is a rule and you apply the  
18 rule, and if it doesn't say it in the rule, you  
19 can do it.

20 Now, we think that principles put the  
21 emphasis, as Anthony right said, on firms to adopt  
22 a right approach to the intent of the law and the

1 intent of the provision. And if firms are unclear  
2 about the intent of a provision, they should ask  
3 their regulators. And their regulators, we would  
4 hope and we will certainly intend to insist, will  
5 give evidence and guidance to that firm on a  
6 consistent basis.

7 And that is why, for example, we have  
8 set up a database where we've been asked all sorts  
9 of questions about MiFID and we've given  
10 non-binding guidance as to how we think such and  
11 such a principle, such and such a provision should  
12 be interpreted. So, at the end of the day, the  
13 emphasis is on the firms, but also at the end of  
14 the day, on regulators to apply those principles  
15 in a consistent way.

16 And again, if there's -- if nobody  
17 agrees, if there is a difference -- a profound  
18 difference of view, the matter could be referred  
19 back to my institution. We could engage in  
20 discussions with the industry, all interested  
21 parties, and if necessary, as I said earlier, we  
22 could provide clarifications, whether that would

1 be in the form of a statement by the commission or  
2 even eventually if some thing is so ambiguous and  
3 unclear with further clarification of the law.  
4 That would be a last resort.

5 But at the end of the day, I think that  
6 we just do not see in modern capital markets the  
7 possibility of doing anything but providing broad  
8 principles, broad intents of showing what the  
9 intent of those principles are and making firms  
10 responsible for those actions, subject of course  
11 to proper supervision.

12 So, it is a difference of emphasis on  
13 firms and not all firms feel comfortable with  
14 that. But I think it gets you around the problem  
15 that if you make a rule in this sort of space,  
16 it'll be out of date by the time it's even got  
17 into print.

18 CHAIRMAN LUKKEN: De'Ana?

19 MS. DOW: Mr. Chairman, I'll be brief.  
20 I was here at the commission when principles-based  
21 approach to regulation was adopted, and we  
22 struggled with a lot of the same issues that



1 you're dealing with now, including, you know, the  
2 reporting of these large trades. The options  
3 range anywhere from five minutes to eight hours in  
4 terms of what was the right approach.

5 So, you know, it's intriguing to see  
6 that these same issues are still being bantered  
7 about --

8 (Off mike comments)

9 MS. DOW: Yeah, absolutely. And I also  
10 have an observation. As these principles-based  
11 regulations stay in effect for several years, I  
12 see that there is often the temptation to go back  
13 and adopt guidance and other clarifications and  
14 put prescriptive acceptable practices around these  
15 core principles that, you know, are at risk of  
16 taking you back to where you started.

17 So, you know, that's something that I  
18 think we all should be careful about because  
19 obviously the core principles -- the  
20 principles-based approach has been a phenomenal  
21 success as you can see by the growth in the  
22 futures markets here in the U.S.

1           And then I did have one question. In  
2 terms of your best practices rule, I was just  
3 wondering how that -- I mean, not best practices,  
4 best execution rule.

5           MR. WRIGHT: Yeah.

6           MS. DOW: How would that work? For  
7 example, would a firm be required to send his  
8 customer's order to the exchange where the best  
9 price is located? For example, would it be a  
10 choice between a WTI Ice futures contract or WTI  
11 Nimex futures contract?

12           MR. WRIGHT: Okay. On the first point,  
13 I think you make a very good point, that there is  
14 a natural tendency -- a natural, if you say, a  
15 tendency or propensity to add clarifying details,  
16 interpretive guidance, and so forth. And in the  
17 end, you can -- you can slip back to perhaps more  
18 prescription than you wanted through the  
19 principle.

20           So, I think that's a very good point.  
21 That is precisely why we have been so keen to  
22 limit the possibilities of member states to add in

1 further guidance, rules, interpretations, what we  
2 call the gold plating brigade. We've always said  
3 that we prefer to keep the gold-platers in the  
4 jewelry shop.

5 Now, the point is here that some member  
6 states still feel that their own rule book is the  
7 best. They naturally don't want to change bits of  
8 it. And sometimes the markets don't want to  
9 abolish practices either. But, again, there's a  
10 fine balance here. At the end of the day, Europe  
11 has to move forward with 27 member states. I need  
12 to find a majority, a qualified majority of my  
13 member states. So, there's always a -- in any  
14 public policy making, there are elements of  
15 compromise.

16 And so, we tried to keep this natural  
17 bureaucratic tendency to add more detail to the  
18 minimum. I would much prefer, much prefer to  
19 amend actually than to have a proliferation of  
20 loose, non-binding guidance, which in the end  
21 might provide more confusion than clarity.

22 The second point you make about best

1 execution, as I said, was one of the critical  
2 provisions of MiFID. Requirements of best  
3 execution, those requirements of course are  
4 particularly prominent for retail customers and  
5 less required obviously in the professional  
6 markets where professional business can look after  
7 itself.

8 Now, you'll see in MiFID a whole lot of  
9 provisions about what firms should do. And firms  
10 have to lay out their best execution. Policy  
11 doesn't mean they have to survey every single  
12 market trading opportunity in Europe, but they  
13 have to very clearly declare what their policy is.  
14 They have to show that they have got the best  
15 price including commission, including commission,  
16 including in other words, what we call total  
17 consideration, price plus clearing and trading --  
18 clearing and settlement fees plus commission.  
19 They have to show and be able to show to  
20 regulators that on a consistent basis they have  
21 done that.

22 Now, I think it's absolutely

1 unreasonable to expect in every single  
2 circumstances that to be the case, but they have  
3 to show that they have followed the policy that  
4 they have outlined and that consumers have been  
5 treated properly and fairly. And there's whole  
6 lot of disciplines in MiFID which explain exactly  
7 what those provisions are.

8 CHAIRMAN LUKKEN: We have time for one  
9 quick last question. I think, Johnathan, you're  
10 next.

11 MR. SHORT: Thank you. I just wanted to  
12 make a brief statement and agree with Mr.  
13 Wright's, I guess, suggestion that there needs to  
14 be care in obviously assessing the level of  
15 regulation in any market. At ICE, we have the  
16 benefit of being on, it seems like, every side of  
17 every issue given our regulatory structure, so  
18 I'll be careful on what I say here lest I be hung  
19 out to dry by my colleagues.

20 We do obviously applaud the efforts that  
21 have gone into MiFID and I would just, I guess,  
22 put one other point on the table in a minor

1 rebuttal, with all due respect, to Commissioner  
2 Chilton's statement about whether the CFTC  
3 actually got the level of regulation right.  
4 Echoing something that Mr. Donohue said, I think  
5 it's very important to look at metrics and I --

6 (Off mike comments).

7 MR. SHORT: The only point I wanted to  
8 put on the table in minor rebuttal to one of the  
9 statements that Commissioner Chilton made was I  
10 think the CFTC and congress largely did get it  
11 right on the front-end with the CFMA and interview  
12 markets. When you look at those markets at the  
13 time and the benefits that have been derived from  
14 both product innovation and the competition and  
15 the transparency that ICE has brought to the  
16 markets, I -- and the resulting benefit from the  
17 competition offered by Nimex, who is our --  
18 obviously our competitor, I think there are very  
19 real benefits to the marketplace that are often  
20 overlooked.

21 And I think getting back to this issue  
22 of metrics and how you judge a piece of

1       legislation, I think it's very important to look  
2       at all metrics and all benefits to the  
3       marketplace. And when you look at some of the  
4       tighter markets that have developed through  
5       electronic trading and the introduction of  
6       clearing to OTC markets and the benefits that  
7       that's brought about to the marketplace, there are  
8       very real dollar savings that have gone into the  
9       pockets of U.S. and foreign companies as a result  
10      of that.

11                So, I think before anything is judged, I  
12      think you need to look at all of the metrics. And  
13      that's not to say that there isn't room for  
14      refinement in deference to what Commissioner  
15      Chilton said, but I think there are some very real  
16      benefits that have been overlooked.

17                CHAIRMAN LUKKEN: Well, we're going to  
18      have to cut off debate on the first part of our  
19      topic today, but as you all know and I have a list  
20      of questions we never got to, these are important  
21      matters for all of us to consider as we go  
22      forward. Because I think Barbara is correct that

1 we are -- and we're losing Barbara. Thank you for  
2 stopping.

3 MS. MATTHEWS: Duty calls and I have to  
4 go.

5 CHAIRMAN LUKKEN: Okay. But these  
6 matters are going to impact us all. And we have  
7 to be engaged. So, I encourage you, when you do  
8 get to Brussels, to look up David and follow up on  
9 some of these matters with him because I think we  
10 have a unique perspective from the futures markets  
11 here in the United States that we can offer the  
12 Europeans as we go forward.

13 So, with that, we thank David. We'll  
14 save our thanks to the end. But I would like to  
15 turn it over to his colleague, Professor Mario  
16 Nava, to give us an overview of the clearing code  
17 of conduct.

18 MR. BELCHAMBERS: Chairman, I wonder if  
19 I could just front run Mario for a few seconds?

20 CHAIRMAN LUKKEN: Oh, I apologize.

21 MR. BELCHAMBERS: The only reason I say  
22 that is I've got to rush and catch a flight rather



1 like Barbara has just had to go. So --

2 CHAIRMAN LUKKEN: That is perfectly fine  
3 with me. We'll front load you, Anthony.

4 MR. BELCHAMBERS: It will literally only  
5 be a few minutes. And it was really just, as they  
6 say, putting the cart a bit before the horse,  
7 because the code of conduct, as I think Mario will  
8 be telling you in some detail is really focusing  
9 on those little roadmap targets of  
10 interoperability, access, choice, unbundling of  
11 services, transparency, prices, separate  
12 accounting, and so forth.

13 And all I really was going to say in  
14 response to what he was going to say was the  
15 question about at the moment it's restricted to  
16 the asset class of cash equities. There's clearly  
17 a view I think on the part of the commission that  
18 given that it is capable of running efficiently,  
19 they would like to see it extended to cover other  
20 asset classes.

21 And I would just -- if I may, just add  
22 one or two cautions to that, which is, although

1 these headline targets look extremely attractive  
2 at the face of them, clearly, on the other hand,  
3 this is designed for cash equities. We have not  
4 yet had a chance to look at the small print of any  
5 form of extension and therein often lies, as well  
6 as know, the devil, so to speak.

7 So, in a sense, because derivatives are  
8 so fundamentally different to cash equities, it's  
9 terribly important that we actually take a  
10 measured view about this. I'd make that point. I  
11 think it's critically important. And you will  
12 hear from different sides of the industry  
13 different views being expressed about this. The  
14 exchanges will have one view. Some of the  
15 clearing houses will have a view. The firms will  
16 clearly have a view.

17 And I think, therefore, what I would say  
18 is let's engage in a debate about this, but let's  
19 not make too many assumptions about it at this  
20 early stage. And I think that is very much the  
21 commission's approach too. So, I would just -- a  
22 little bit of caution about falling for the

1 headline bits and pieces that sit there, which I  
2 think are very welcome but we need to take a very  
3 careful measured view about it.

4 I won't say anymore because I've got to  
5 go get a plane.

6 CHAIRMAN LUKKEN: Thanks very much.  
7 Yeah, you've teed it up great for Mario, so thank  
8 you.

9 MR. NAVA: Thank you very much.  
10 Chairman, Commissioners, Jackie, and all guys,  
11 thank you very much for the invitation.

12 I really would like to join in David in  
13 his initial comments at least in two respects.  
14 One, of course, is the thanks and the feeling of  
15 privilege that we have of being here today to be  
16 able to discuss with you and to get your feedback  
17 on this. And the other is the sentiment that  
18 there is a commonality of issues. I mean, that's  
19 very clear to us whenever we go around in this  
20 town and whenever you come around in Brussels and  
21 whenever we discuss. It's quite obvious that we  
22 are very much discussing the same thing.

1           The code of conduct is in many respects  
2 a novelty. I would say it is an innovation in the  
3 regulatory armamentaria of the commission in many,  
4 many respects. For a start, it does not have an  
5 acronym to joke with because if you did, it would  
6 be COCO or something of that kind, so probably  
7 would be worse. So, for start, I opposed with all  
8 my forces for any acronym for the code.

9           But apart from that and apart from any  
10 joke, it's truly an experiment because basically  
11 what we did in the code is that we extended some  
12 credit to the industry of they being able to do  
13 this in exchange of what did we take as a  
14 collateral. As a collateral, we took essentially  
15 their credibility, I would say and their  
16 reputation.

17           So, that is a major -- is a major  
18 novelty. Of course, the approach is not without  
19 risk as we all know it, but as you teach me, I  
20 mean, no risk, essentially no return. So, we have  
21 taken these (off mike). Time will tell us whether  
22 we were right or wrong. But we are saying in this

1 new part well knowing that we were going down a  
2 risky road.

3 The -- what I want to do with you today  
4 is essentially to look at two things. One is the  
5 content of the code and the other is the procedure  
6 through which we have got the code and the  
7 learnings we have got from the code at least until  
8 now.

9 The -- let me not spend too much time.  
10 It was quite obvious is that thanks to the FSAP,  
11 another of these acronyms cleverly engineered by  
12 David, the European markets has boomed in the last  
13 five or six years, physically getting up to a  
14 level not so different from the American market.

15 But what we realized, of course, is the  
16 more the markets were growing, the more evident  
17 were coming the points where the inefficiencies  
18 were greater and greater. And there is no doubt  
19 that frustrating was essentially and surely one of  
20 the points where there was a major inefficiency.

21 Major inefficiency in which sense? In  
22 the sense that the domestic level -- domestic in

1 Europe means Germany on Germany, France on France.  
2 The domestic level, it work well, but at the cross  
3 border level, France on Germany, Italy on Germany,  
4 it worked much less well. And we, of course --  
5 there has been various estimations of cost, but  
6 essentially up to six times across border, so  
7 France and Germany business, with respect to a  
8 domestic business, Germany on Germany.

9 Of course, six times is far too much.  
10 That led to simply the nonexistence of some  
11 markets, typically the retail market for cross  
12 border equity in high street banks simply did not  
13 exist -- not a investor or a saver -- no saver in  
14 his or her right mind would enter in a bank in  
15 Milan and ask to buy a share 500 kilometers north  
16 in Concorde because it costs simply too much.

17 So, the nonexistence of a market is  
18 probably the most obvious market failure you can  
19 prove. We did some analysis, as you know, the EU  
20 way of doing legislation is based on two pillars.  
21 Pillar number one is the so-called impact  
22 assessment, where we have to study the issue and

1 to come up with some numbers normally related to  
2 GDP because that is what politicians understand  
3 fast and best.

4 And the second pillar is stakeholders'  
5 consultation. That means talking and talking as  
6 David said until exhaustion with the different  
7 stakeholders.

8 What the impact analysis told us --  
9 well, what the impact analysis told us is -- a  
10 model like this graph is that if we were able to  
11 get a reduction in trading costs in the order of  
12 10 to 20 percent, that means passing from 6 times  
13 more expensive to 5 times more expensive, so not a  
14 great deal, one would say, but if we were able to  
15 kick in that type of reduction in costs, the  
16 potential for the reduction in GDP would be  
17 measured in billions, essentially.

18 What matters in this graph is not the  
19 dotted line you see but the small dotted line that  
20 you hardly see, because those are the borders of  
21 the estimation and basically tells you that, for  
22 example, for a 15 percent reduction, you may have

1 benefits with a confidence interval of 95 percent  
2 or you may have benefits which go from 20 to 60  
3 billions, so quite an important amount of money to  
4 deal with.

5 But the second most important thing is  
6 that when it came to stakeholders' consultation  
7 and we did it a lot extensively. I remember a  
8 meeting, for example, in Brussels with the CEO of  
9 many of the companies represented here.

10 The industry -- the stakeholders gave us  
11 a very clear message. The message they gave us  
12 was that they wanted to progress. They were  
13 unhappy and unsatisfied with the situation as it  
14 was and they really wanted to progress, and they  
15 were ready to put their resources to that, which  
16 makes the task for us much easier because  
17 basically it convinced us of the fact that the no  
18 policy option was not an option at all apparently,  
19 because we as commission, we were convinced that  
20 something was needed but because also the industry  
21 was obviously in favor of something to be done.

22 Leaving aside the structure



1 intervention, which would have meant creating a  
2 novel -- a single clearing or a single CSD in  
3 Europe for which a commission does not have the  
4 power and neither presumed the case at this  
5 juncture, we were left essentially either with the  
6 very standard route, the one that might have been  
7 followed in 99 --95 percent at least of the cases,  
8 which is community legislation or trying for  
9 something more a novelty, which is exactly the  
10 quote.

11 What is the trade off between those two?  
12 If you want the community legislation, it's a much  
13 "safer" option because the community legislation  
14 delivers legal certainty as a start, because the  
15 community legislation allows by the process that  
16 David has described, allows to try to take into  
17 account all the possible issues, allow for  
18 strengthened enforcements, strengthened  
19 cooperation, and on and on.

20 But the community legislation has a huge  
21 but, which his of course time. And time is  
22 essence here in these issues. And time would have

1 probably been measured in terms of years if we had  
2 gone through the route of community legislation.

3           So, basically, we offered to the  
4 infrastructures, we offered the deal. We spoke  
5 already about a key dealer and here is where we  
6 offered the deal. And the deal was essentially  
7 time against credibility, against commitment. So,  
8 we said to the infrastructure on the 7/11, on the  
9 11th of July, we said to the infrastructure, we  
10 plan to go down a code, but you need to deliver  
11 fast.

12           The infrastructure on the 11/7, so on  
13 the 7th of November, four months later with two  
14 months of summer, that as you know in Europe tends  
15 to be rather important period of the year where we  
16 like to relax and take our time off, so including  
17 the two months of the summer, we managed to in  
18 four months -- or rather, they managed, because  
19 the industry should be credited for this, they  
20 managed in four months to come up with a code that  
21 we thought was very robust.

22           So, that was the major tradeoff

1 essentially, was self-regulation in exchange of  
2 serious commitment. What are these serious  
3 commitment? What did the industry committed to?  
4 The industry commit to essentially four areas.

5 One is price transparency. So, the  
6 industry committed to deliver price transparency  
7 by the 31st of December of 2006, so of last year.  
8 Then the industry committed to deliver  
9 interoperability and access by the 30th of June,  
10 2007, so a couple of months ago. And the industry  
11 has also committed to deliver unbundling of  
12 services among the different layers, trading,  
13 clearing, and settlement and within settlement,  
14 between five different services, and accounting  
15 separations, again, between the various layers by  
16 the 1st of January 2008, which means starting with  
17 the accounts of 2008.

18 And also, quite interestingly, the  
19 industry committed to a serious monitoring process  
20 because of course, we said okay, we have a soft  
21 law but we are not going to have a soft  
22 monitoring, we said, soft law but quite serious

1 and credible monitoring, mostly because behind all  
2 of this, of course, there were many, many people,  
3 probably the Parliament, who would have liked a  
4 hard instrument, would have liked much more a hard  
5 legislation than a self -regulation or than a soft  
6 law, probably because the role of the Parliament  
7 in soft law is less clear, so to speak, than the  
8 role of the Parliament in legislation.

9 So, to get the Parliament to buy in, we  
10 need to make sure that the Parliament is satisfied  
11 of the level of monitoring which is put into this  
12 process. Anthony introduced one of the crucial  
13 points, which is that the code at present does not  
14 extend to the all space but it stops at cash  
15 equities and it does not extend to bond and  
16 derivatives. True, absolutely true.

17 Essentially, the reason for that was  
18 essentially a negotiating reason. When we sat  
19 down with the industry to negotiate that, it was  
20 quite clear that we could strike a deal well and  
21 quickly on cash equities but that a deal on bonds  
22 would have required longer time and it probably

1 would have required on the side of some  
2 infrastructure more time to accept it.

3 I said some because actually this is  
4 probably one of the few areas where the industry  
5 was divided. The proof is that some of the  
6 infrastructures have decided unilaterally to  
7 extend the code from the very beginning to bonds  
8 and derivatives. So, this is an area where we  
9 take -- we of course acknowledge that the code is  
10 right now only to cash equities. Next week on  
11 Wednesday, we will have the first discussion on  
12 the possibility to extend the code to bonds and  
13 derivatives.

14 What Anthony said is absolutely true and  
15 it goes without saying that nobody of ours will go  
16 to any infrastructure with the code as it is and  
17 say sign it for bonds and derivatives. That's  
18 obvious. What we will be doing is exactly what we  
19 have done until now, which is to engage in the  
20 talk with the infrastructure on the basis of the  
21 existing code and engage with them and say to them  
22 how can we work together to extend this to bonds

1 and derivatives.

2           So, the point of Anthony, I think, is  
3 very clear. I would say it's merely a trivial  
4 point. It goes without saying that that is  
5 exactly what we intend to do.

6           To whom the code applies, the code  
7 applies to all those who have signed it. The code  
8 is not a piece of law, so it does not apply in  
9 general. It applies to those who have signed it.  
10 Interestingly enough, the code is a voluntary act,  
11 of course. Nobody could force anybody to sign it.  
12 Once you have signed it, as I said, is a credit  
13 extension and the collateral we have in the end is  
14 the reputation, so once you have signed -- all  
15 those who have signed are serious enough to  
16 respect it, of course. But interestingly enough,  
17 everybody has signed.

18           All the infrastructure of Europe has  
19 decided, I repeat voluntarily, to sign up to the  
20 code and even beyond Europe. We have the Swiss  
21 signing the code. We have had the Balkans signing  
22 the code. And not later than last week, we have

1 had a press release from Norway saying, you know,  
2 the relationship between Norway and the EU is very  
3 good, but Norway for twice has decided that they  
4 didn't want to join the EU, but they look at the  
5 document very carefully, and they said that they  
6 really like it and they decided to sign the code  
7 and to extend it immediately and unilaterally to  
8 bonds and derivatives, which is quite interesting  
9 that we have someone outside of Europe, look at  
10 the code and decided it was managing an extension  
11 immediately to bonds and derivative.

12 Of course, the code is complemented by  
13 competition policy, and we will see it in a second  
14 when we look at the monitoring. What is the  
15 monitoring of the code? I mean, in my -- in the  
16 initial part of my presentation, I put some  
17 emphasis on that. The monitoring of the code is  
18 made at least at three levels.

19 The first level is the monitoring group,  
20 which is chaired by us, by the G market and  
21 particularly by David. He is the chair of the  
22 monitoring group. To that monitoring group, there

1 are -- there are crucial actors. There is the G  
2 competition and that shows to you the  
3 interrelation between the G market and the G  
4 competition. There is of course the G of economic  
5 affairs. And there are the two other actors that  
6 we have been talking about this morning, CESR,  
7 which is the Committee of the European Security  
8 Regulators or the national regulators and the ECB.

9           So, this is -- the monitoring group, I  
10 would say is very comprehensive. How does the  
11 monitoring group works? The monitoring group has  
12 meeting every quarter. As I said, next one will  
13 be in a week time. And at this meeting, we have  
14 in front of us about 70 or 80 people, participant  
15 all from the signatories, of course, but also and  
16 most importantly from the users of the markets, so  
17 those who are supposed to benefit from the code.  
18 And they all sit in front of us and we have, I  
19 would say, a frank discussion about how the code  
20 is doing, about how the different phases of the  
21 code are being implement.

22           There are therefore then two other



1 levels. One is the level of the external  
2 auditors, for which we are in the process of  
3 drafting the (off mike). But basically the idea  
4 there is that every infrastructure should go  
5 through a self assessment phase, so a kind of  
6 comply or explain, and then the external auditors  
7 will comment on the self assessment phase.

8           And then, there is the role of the  
9 national regulators, which is of course an  
10 explicit role because they will receive all the  
11 accounts of the infrastructures but is also an  
12 implicit role because of course the national  
13 regulators have a stake, quite an important one  
14 actually in the evolution of the market structure.

15           What are the three areas the code  
16 focuses on? The first one is price transparency.  
17 And within price transparency, we have five areas,  
18 which essentially tend to cover the totality of  
19 price transparency, which is publication of fees,  
20 publication of discount schemes, (off mike)  
21 discount schemes, publication of rebate schemes,  
22 billing reconcilability.

1           That's quite a future victory, I would  
2 think to say of the users when we discuss the code  
3 with them. The users made clear to us that very  
4 often they were receiving bills and being the  
5 bills high or low doesn't matter, but they had  
6 difficulty to understand the bill and especially  
7 to reconcile the bills with the tariff that they  
8 were published or with the price they thought they  
9 would have paid. So, we obtained that at request  
10 every user can ask a billing reconcilability to  
11 the infrastructure and can ask to the  
12 infrastructure how that particular bill was made  
13 up and then, of course, price comparability.

14           I would say that the results on price  
15 transparency are quite telling. I didn't put here  
16 a slide with (off mike), but we are on the range  
17 of 90 percent, so we believe that about 90 percent  
18 of the commitments have been delivered. And that  
19 is both our assessment but also and very  
20 interestingly, the assessment of the users. The  
21 users themselves have done this analysis. They  
22 have presented to the MOG and they have -- the

1 users have a knowledge that basically all  
2 infrastructures are following the guidelines quite  
3 carefully for price transparency.

4 We come therefore to the core of the  
5 code. The core of the code is the access and  
6 interoperability issue. That was probably where  
7 people would have -- or let's say those who did  
8 not like the code would have expected the code to  
9 fail because with the access and interoperability  
10 guidelines to is essentially they open up the  
11 market. And they do it in a very simple way,  
12 which is a bit reminiscent of what European Union  
13 did in other areas and most particularly, I would  
14 say in the telecom areas.

15 The telecom area was probably one of the  
16 greatest success in Europe of opening up market.  
17 How did we manage to open up market in the telecom  
18 area? Essentially, forcing -- there was a  
19 directive essentially forcing interoperability and  
20 making clear that there could be challenger in  
21 every single market and not all incumbents. And  
22 so that if you wanted to do a phone call from

1 Brussels to Paris, you didn't need necessarily to  
2 go through Belgacom or France Telecom, but you  
3 could use a third provider, a challenger which had  
4 all the rights to be linked to the other two  
5 incumbents.

6 And the very same logic was -- is  
7 applied here, and we have gone through a work of  
8 definitions to define what is access, what is  
9 standard access, what is customized access, what  
10 is interoperability, and on and on. Standard  
11 access is a right, an undisputed right, an  
12 unconditional right.

13 Interoperability is a conditional right  
14 where conditional means that the parties have to  
15 discuss the process together, and they have to  
16 look at the ways of doing it. They have to look  
17 at how they are going to share costs, but it is  
18 very clearly said in the code that business  
19 considerations or loss of market share on the part  
20 of the incumbent cannot be used as an excuse not  
21 to become interoperable with a challenger.

22 So, basically what the code does is to

1 fix a transparent process for handling all these  
2 requests, so there is a process in terms of days,  
3 weeks, that needs to pass, when -- when a request  
4 is there. And if all this fails, if the process  
5 fails, we have a mediation mechanism, mediation  
6 mechanism that the industry sets up at the very  
7 beginning where the commission may or may not  
8 participate depending on the needs.

9 What is the assessment of the  
10 guidelines? As I said, the guidelines are very  
11 fresh, very new. They were signed up on the 28th  
12 of June. We have had two months, again summer, to  
13 test them. Well, our assessment was very  
14 positive. Immediately, the 10th of July, we had a  
15 meeting of the monitoring group and we welcomed  
16 the guideline. We thought that the major comments  
17 we made were taken on board. We thought that  
18 there was some minor comments and some minor  
19 issues remaining that should have been taken on  
20 board but hopefully will be taken on board at the  
21 first possible revision of the code.

22 But most importantly, it is not our

1 assessment but the assessment of the market. And  
2 the assessment of the market on access and  
3 interoperability has been overwhelming, I would  
4 say. There has been an explosion of link requests  
5 in these three months, of which are summers, I  
6 repeat that they've elapsed since the signature of  
7 the guidelines.

8           Before, for example, you had a single  
9 market or a single provider for LSE trades, LCH  
10 Clearnet (off mike). And since then, we had four  
11 requests for clearing the LSE trade. And it is  
12 not only London which has seen that. It is for  
13 example the same for virt-x trades, is for example  
14 the same for Borsa Italiana. It's for example the  
15 same for the Frankfort Stock Exchange. So, I  
16 mean, the market has in a way, if you want, voted  
17 with its feet, in the sense that it has really  
18 shown that they were believing in these guidelines  
19 and they have all been very much busy over July  
20 and August in sending letters to each other and  
21 asking request -- interoperability requests to  
22 each other.

1           Most of these letter were replied by  
2           saying yes, of course, we are very open to you and  
3           by the way, we also would like to be linked to  
4           you. So, one was asking interoperability to  
5           another one and the other one was responding great  
6           idea, let's do it in a reciprocal way. So, I  
7           would say we are not at the moment where we can  
8           claim that these interoperability links work  
9           because we haven't been seeing -- we have not seen  
10          them in action yet, but we are at the moment where  
11          we can claim that the industry believes in this  
12          interoperability -- these interoperability  
13          guidelines to the letter.

14                 And then there is the third part of the  
15          code, which is on service unbundling and  
16          accounting separation that will come in few months  
17          time. Essentially, the issue there is to  
18          unbundled among the different services and to --  
19          if you want to give full implementation to the  
20          price transparency requirement and to make sure  
21          that if someone wants to buy only one part of the  
22          services, if it wants to buy only clearing but not

1 settlement or only trading but not clearing and  
2 settlement, it can do it.

3 We have -- for the time being, we have  
4 no reason to think that these will be implemented  
5 with delay. The other two deadlines were  
6 respected with some days of other advance and we  
7 have no reason to think that this will not be the  
8 case now in the (off mike). What is the learning  
9 of all of this? And then I come to the  
10 conclusion.

11 The learning of all of this I would say  
12 is essentially that this has been a tremendous  
13 experiment but this has delivered already  
14 tremendous results in terms of education. I mean,  
15 I say that in the most frank way. I believe that  
16 we, as the commission, we have benefit  
17 dramatically of these last 15 months of intense  
18 discussion, negotiations, sometimes tough  
19 negotiations with industry for the drafting of the  
20 code and for the drafting of the guidelines.

21 But I would say that in this period, we  
22 have really learned a lot. If we were to do a



1 directive today for any reason -- I don't think we  
2 will be doing it, but if we were to do it today,  
3 it would be a much better product than it could  
4 have been 20 months ago, simply because we have  
5 learned a lot from that. And I think this is,  
6 again, to the merit of the industry, but this is  
7 also to the benefit of the industry, of course,  
8 because the industry knows that it can rely on a  
9 much better regulation.

10 On the other side, of course, we have  
11 also learned a lot about the industry. So, we  
12 have learned very much what are the points to be  
13 looked at, of course, and what are the issues  
14 which are more crucial. And this has evolved over  
15 time. I mean, the issues which are crucial today  
16 may not be those that we thought were crucial some  
17 times ago.

18 But the second aspect is probably one of  
19 trust. I believe what is evident here in these 20  
20 months is that we have established really lots of  
21 trust. People -- the critics of the code often  
22 say to me but if something goes wrong, what do you

1 do? Can you go to court? And I have normally two  
2 replies is that first, I don't believe anything  
3 will go wrong. I don't believe that anything will  
4 go wrong but for very good reasons, because I have  
5 in the end the reputation of Roger Liddell, for  
6 example. I have in the end the reputation of LCH  
7 Clearnet. They signed up for the code. They made  
8 it very public.

9 So, honestly the collateral we have is  
10 an important one. I mean, this is not sub prime.  
11 This is prime, prime, prime, prime market. We  
12 have a great collateral in the end.

13 But the second thing is it's true we  
14 cannot go to court because this is not a piece of  
15 law; this is self-regulation. But, we can go to  
16 the Financial Times because this was very public.  
17 And of course, going to court is legal certainty,  
18 but going to the Financial Times may also be  
19 effective in some circumstances.

20 So, I would say the learning process we  
21 have been through has been fantastic. And I would  
22 say the code has now all the chances to work. As

1 I said in the very beginning, it cannot work  
2 alone. It need to be accompanied by many things,  
3 one of which is MiFID. We could have never dreamt  
4 to do the code without MiFID. That's very clear.  
5 I mean, MiFID -- if you want, what MiFID did was  
6 to put out the rights, the rights of being  
7 interoperable one with the other.

8           And what the code did was to translate  
9 those rights in practical guidelines, to say okay,  
10 you want to exercise that right, fine. These are  
11 the guidelines in order to exercise those rights.  
12 So, it's clear that the code is there only because  
13 there is MiFID before. It is also clear that the  
14 code addressing only part of the problem, which is  
15 essentially the competitive part of the problem.  
16 It does not address other issues which are  
17 essentially the legal and the tax barriers, so  
18 they are the safety issues. And those are  
19 addressed by the Giovanni barriers and by the  
20 standards. And I will stop here.

21           CHAIRMAN LUKKEN: Great. That was a  
22 great overview. Before we turn to Richard, I know

1 he has a question, I want to take my chairman's  
2 prerogative and ask a question as well.

3 A lot of the clearing code deals with  
4 transparency for pricing. And being at the CFTC  
5 over five years and our audits of clearing houses,  
6 we know that not all clearing houses are created  
7 equal. We see differences in the value that  
8 clearing houses may add to the different  
9 organizations.

10 How does the clearing code address these  
11 differences -- the value structure of clearing?  
12 There may be certain clearing houses that do  
13 things better but cost more money versus others  
14 that may be less costly but add less value.

15 Is there some transparency part of this  
16 equation that I'm missing that talks about the  
17 value proposition that clearing may bring to the  
18 structure?

19 MR. NAVA: Thank you for that. This  
20 was, of course, one of the crucial requirements.  
21 I mean, we didn't want that we engage only in a  
22 price competition. Of course, there is the issue

1 (off mike).

2 And in that respect, I would say we have  
3 responded at least in two ways. One is price  
4 transparency accompanied by unbundling of  
5 services, and therefore, by description of  
6 services. So, it's clear the price you pay for  
7 which type of service. And that we have made it  
8 very clear from the beginning because as we said  
9 many times this morning, Europe is 27 countries, a  
10 number of clearing houses, a number of CSDs. And  
11 what is, for example, clearing services for one is  
12 not for the other.

13 So, we had first to go down and try to  
14 clarify all of that. And then, we could move to  
15 the price issue. So, that is taken to the point,  
16 for example, that the settlement houses are now  
17 doing quite an interesting exercise, which may  
18 expand also to the clearing houses at a certain  
19 moment, which is doing what they call convergence  
20 tables. Convergence table is essentially an (off  
21 mike), where you have all the -- on my column, you  
22 have all the different services which are offered

1 than by role, you have all the different  
2 providers.

3 And what this convergence table tried to  
4 do is exactly to explain what is the service which  
5 is provided by everyone and how does it converge  
6 to a general notion and without the differences  
7 one with another. We have seen a first draft of  
8 that which was very encouraging and we will see  
9 the next draft next week.

10 That is quite an important experiment  
11 and the point you make actually is the point that  
12 the council always makes. I mean, in the council  
13 conclusion of next week of the 9th of October, it  
14 is likely that there is a mention to this issue  
15 and there is a mention to the effect that we need  
16 to be -- to have clearer and clearer price and  
17 service compatibility. So, the point, I think,  
18 it's very, very clear to us.

19 MR. BERLIAND: First of all, just if I  
20 could highly commend the work that has been done  
21 so far. I think it indeed is quite impressive by  
22 European standards the speed with which this has

1       been achieved is very commendable. I guess the  
2       question I'd like to ask you is, as you rightly  
3       pointed out, very strong emphasis on cash  
4       equities.

5                   I should declare an interest, as I said,  
6       on the supervisory board of (off mike) and my  
7       personal view is that I think most of the  
8       infrastructure operators in Europe saw it as  
9       inevitable that if they did not act on a voluntary  
10      basis, it would be imposed.

11                   I think as we move into the fixed income  
12      and the derivative space, the emotions and the  
13      stakes rise a lot. And I'd be interested to hear  
14      your thoughts about what you think the big issues  
15      are that are different in those two areas relative  
16      to what's already been achieved in the cash  
17      equities world.

18                   And we're not asking you to predict the  
19      outcome. I think that's not fair, but I'd like to  
20      hear your view on the issues.

21                   MR. NAVA: Well, I believe the main  
22      issue is that, as you said, I mean, the -- on the

1 cash equities was inevitable and there is no  
2 doubt. But also, there is a convergence of views  
3 by the firms.

4 On the bonds and derivatives space,  
5 there was not a convergence of the views by the  
6 firms. Some firms thought these is a great  
7 opportunities and let me weigh how we see. We  
8 think that firms should avail themselves the  
9 opportunities, which are here to be taken if the  
10 code is extended to bonds and derivatives.

11 But, I'd say the vast majority -- I hope  
12 you don't disagree -- the vast majority of  
13 infrastructure in Europe was in favor in moving it  
14 to bonds and derivatives. Some, but important  
15 markets was not in favor of moving to bonds and  
16 derivatives. I think we do see the differences,  
17 not I think, I'm sure. We do see the differences.  
18 We do see the differences, and that's why I said  
19 in my presentation that nobody was -- I mean,  
20 David would never go to any of these firms with  
21 the code and ask for signature.

22 But once again, I do hope that the firms



1 will not lose the opportunity to come at the table  
2 and discuss with us about a code for bonds and  
3 derivatives. So, not maybe we should start  
4 changing the language, so not about the extension  
5 of these code, but a code based on this one, of  
6 course, because I think there are many things that  
7 can be extended, for example, the mediation  
8 mechanism, for example, the transparency process  
9 for handling requests, which is quite important.

10 I mean, imagine, let me just crack an  
11 anecdote, but in the middle of July, 7th of July,  
12 Roger Liddell sent a letter to Borsa Italiana.  
13 Now, I am born in Milan, and I lived in Milan to  
14 the age of 22. I never stayed in Milan the 7th of  
15 August. I mean, I can tell you, the 7th of August  
16 in Milan, there are three dogs, two cats, and  
17 that's it. The town is empty. There is nobody  
18 there, okay. Football teams are not playing, so  
19 there is really no reason to go in town in August.

20 And the court says that within 15 days  
21 you have to reply. Believe it or not, Roger got a  
22 reply within the 15 days of August. I mean, that

1 quite -- that's quite amazing, of course.

2           So, I think there are things there. The  
3 process for the request, remediation, the  
4 transparency issue, which of course, I agree with  
5 you must be tailored to the different markets, the  
6 access and interoperability, and that is for  
7 example, when we say the commonality. I mean, in  
8 this country there is nearly a (off mike) for  
9 derivatives. And if we extend the code to  
10 derivatives, of course, there will be the issue of  
11 -- the competitive issue of in case of reciprocity  
12 with the derivative infrastructure of this  
13 country, how can we deal with it?

14           So, I think we should not foreclose  
15 ourselves of the opportunities to discuss. I  
16 mean, we -- what the commission will do is to  
17 offer a table to the infrastructure for discussing  
18 a code for bonds and derivatives. And the  
19 commission is serious on that. I mean, the  
20 commission in Madrid has made it very, very clear  
21 from day one. When we proposed the code, we said  
22 initially cash equity because those were the terms

1 of the deals, but in time, we wanted moved also to  
2 the other asset classes.

3 And I always like to recall that the  
4 original speech says in time should be moved to  
5 other asset classes, open bracket, so that  
6 everybody understands derivatives, not bonds,  
7 derivatives, so it's just mentioned there.

8 MR. BERLIAND: I think highly relevant  
9 to this table inevitably is the debate that will  
10 be occurring in Europe during the next 12 months,  
11 which is around the energy space in particular,  
12 where we actually now have a firm date set in  
13 stone with respect to obviously ICE in Europe in  
14 its intentions, which I think the user community  
15 has now got highly focused upon.

16 I think probably you will find there is  
17 a much more informed opinion now than there was  
18 six months ago. I think this catalyst of the  
19 notification of termination of contract with LCH  
20 will, in my view, galvanize an opinion that just  
21 was absent.

22 I think this is very timely and I hope

1 that you will get a much more energetic opinion  
2 around derivatives than you have before.

3 MR. DONOHUE: I have a few questions  
4 also on the same topic of cost and how you  
5 calculate costs. On your slide that shows the  
6 sort of GDP impact of the improvements in trading  
7 costs, you refer to them as trading costs. Do you  
8 really mean trading costs or do you mean the costs  
9 of post-trade services?

10 MR. NAVA: Well, we --

11 MR. DONOHUE: I'm sorry. In other  
12 words, are you netting out or how are you  
13 factoring in -- how are you factoring in at least  
14 the potential for degradation and transaction  
15 costs themselves if you saw, for example,  
16 fragmentation across a multitude of execution  
17 venues where perhaps the liquidity was not as deep  
18 or efficient?

19 Have you thought about that? Is that  
20 part of your assessment?

21 MR. NAVA: Just the first question. You  
22 said you had more?

1                   MR. DONOHUE: Yeah. Do you want them  
2 all?

3                   MR. NAVA: No.

4                   MR. DONOHUE: I'm going to fly back to  
5 Italy with you.

6                   MR. NAVA: Fortunately, I am not flying  
7 back to Italy, but how did we calculate the debt?  
8 What we did was to look at the best proxies we had  
9 for all the trading costs. As you know,  
10 collecting numbers on post-trading costs is close  
11 to impossible. I mean, we had something which we  
12 used of course, so that is not particularly  
13 reliable.

14                   So, we used that little, but also we  
15 used a lot the spreads. And using a lot the  
16 spreads, we could see what was the impact of  
17 increasing or reducing the spreads and in  
18 particular, what is the impact of that on the  
19 volumes and then the volumes on the cost of  
20 capital and then the cost of capital on the GDP.

21                   So, this is, if you want, is a system of  
22 essentially three equations, which is embedded

1       into the same -- is the big study to which David  
2       referred in his presentation, which was the London  
3       Economic Study about the FSAP. That study  
4       concluded for a much higher figure, of course, of  
5       the order of 1.1 percent of the GDP in case of  
6       removal of most of the barriers.

7               And the idea was that five years down  
8       the road, once the other barriers have been  
9       removed and we are stuck with these barriers in  
10      cross border terms, what is the impact of these  
11      barriers in cross border terms? So, the minimum  
12      was zero and the maximum was 1.1. And what we got  
13      to was 0.3.

14             We, of course, do not think that the  
15      fragmentation of the liquidity due to MiFID or due  
16      to whatever will lead to any degradation of  
17      liquidity whatsoever. Because as David said, the  
18      quid pro quo for that is announced transparency,  
19      of course and all the best execution mechanisms  
20      which has been put in place.

21             MR. DONOHUE: That's a set of  
22      assumptions that are based on empirical evidence?

1           MR. NAVA: It is based on -- this is  
2 based on numbers and this is based on numbers  
3 collected between -- is the same data set of the  
4 big studies. So, if I'm not wrong, it goes from  
5 '98 to 2000 or 20001 or something like that.

6           So, we really wanted to use the same  
7 database. This has been an option that we have  
8 discussed a lot, especially when we tested this  
9 with academics and was one of the first issues to  
10 be brought to the floor.

11           We could have taken a new data set, but  
12 then we would have lost the basic comparability  
13 with the 1.1 or we could have taken the old data  
14 set and be still compatible with the 1.1. So, it  
15 is a choice that we made but of course is based  
16 on little.

17           It's -- you can criticize that. We can,  
18 as you know, two economies in a room make three  
19 schools of thought, so we could discuss that. I  
20 think at the end of the day we were quite happy of  
21 this choice that was taken exactly because of its  
22 comparability, comparability attitude. And

1 actually, whatever that period you take is that  
2 period. I mean, there's nothing to say. If you  
3 take two years, there are always two years at any  
4 point in time, so you can play and then in a  
5 particular moment it goes up and another goes  
6 down. The impact on volume to when it goes up or  
7 down is not very clear. You may have moment that  
8 it goes down and still you have a great impact on  
9 volume as we have seen in recent (off mike).

10 So, we thought that to have a dataset  
11 that has already been tested because the great  
12 advantage of course was that that dataset had  
13 already been tested, so it was quite clean in  
14 economical terms. We thought that the advantages  
15 prevailed over the disadvantages of the fact. It  
16 was honestly two years and a half for the three  
17 year (off mike).

18 MR. DONOHUE: The other question is had  
19 is if you used U.S. settlement costs in securities  
20 markets versus cross border settlement costs in  
21 Europe as sort of the benchmark for how much cost  
22 you would like to take out of the system and that



1 defined the total addressable costs, you mentioned  
2 that this is really intended to deal with the sort  
3 of competitive aspects of it but doesn't deal with  
4 the Giovinini factors that drive costs in cross  
5 border settlement in Europe, I'm just curious, you  
6 know, what percentage of the total addressable  
7 cost do you think is related to the sort of  
8 so-called competitive aspect versus the actual  
9 cost drivers that have been well-evaluated and  
10 well-substantiated in the Giovinini reports? Just  
11 you know, what percentage breaks down, what of it  
12 is Giovinini, and what of it is this potentially?

13 MR. NAVA: We discussed that issue  
14 longly in this exam group, which is the group of  
15 advisory and monitoring of the Giovinini barriers.  
16 The sense we had around the table was that the  
17 comparison with the U.S., just to take the U.S.  
18 settlement costs and put it into the European one  
19 was unfair, basically.

20 The infrastructure providers told us it  
21 was genuinely unfair because there is nothing to  
22 say that France and the UK speak two different

1 languages, for example or because we have  
2 different tax systems, different legal systems.

3 In many, many respects, I mean, the  
4 legal differences are very subtle, for example,  
5 one that they always like to mention, when it  
6 comes to calling people to a general assembly,  
7 which is one of the functions that the CSD should  
8 do, there is one country that says at maximum, you  
9 should call these people 15 days before. Because  
10 if you call them three weeks before, they forget,  
11 so, at maximum 15 days before. And there is  
12 another country which is much more organized and  
13 says at minimum 15 days before because they need  
14 to pencil it in to their agenda, so if you wait  
15 too long, they will not have time to go there.

16 So, what we were told basically is that  
17 the differences there are very genuine and the  
18 taking the U.S. comparison right away was  
19 impossible.

20 Now, the question is how much of debt is  
21 your percentage.

22 MR. DONOHUE: How would you define the

1 universe of addressable costs whether --

2 MR. NAVA: Exactly, how much of the  
3 addressable cost you can define and how much you  
4 can reduce them and how much is inevitable cost of  
5 Europe because of the fact that we have 27  
6 countries with 21 or 22 languages or something  
7 like that?

8 The sense we have is that basically it's  
9 half and half, which is an obvious reply to give  
10 but this is the sense that the industry has given  
11 us in the work of the Giovinini. For example,  
12 there are things like the standard, the barrier  
13 one, which is the barrier on the informatics  
14 standard on messaging and so on, where many things  
15 seems solvable and where probably at a certain  
16 point will arrive to something extremely close to  
17 United States with no more legal differences.

18 But there are other barriers, for  
19 example, the fiscal one. Some countries have a  
20 transaction tax and some others have not. And  
21 it's very simple. Those countries who have a  
22 transaction tax apply it on their own CSD, in a

1 way, do not allow other CSDs to become  
2 interoperable. So, there is the issue of link  
3 between the two or unless -- unless they allow the  
4 other CSD to raise the tax, which is a possibility  
5 but is a mind change having a CSD, foreign CSD  
6 raising the tax and what happens if the owner of  
7 that CSD escapes with the cash in the pocket and  
8 all these issues.

9           So, the sense was that for some of the  
10 barriers, we could really eliminate them and  
11 basically for the other half was very difficult to  
12 do it. And the half where it's difficult to do it  
13 is essentially the legal and the tax. Though, I  
14 must say on the tax, in a month's time, we are  
15 having -- not actually a month, less than that.  
16 In three weeks time, the 23rd of October, we will  
17 be having in Brussels the presentation of the  
18 final fiscal report, which will be a report giving  
19 some ideas to member states on how to solve this.

20           And I don't want to anticipate anything  
21 of that report of course, not to take out the  
22 surprise of that, but the ideas we will be giving

1 in our opinion should be about really to reduce a  
2 bit of these costs. But there are inevitable  
3 costs --

4 MR. DONOHUE: Do you say half of the  
5 barriers or half of the costs because each of the  
6 barriers presents different costs?

7 MR. NAVA: This is another -- this is --

8 MR. DONOHUE: Sorry. That's the last  
9 question I'll ask.

10 MR. NAVA: No, no, no. I think your  
11 question is very much correct. We are doing now  
12 an exercise which is trying to account the  
13 progress made in every barrier. And one of the  
14 major discussion with that is should we evaluate  
15 everybody at one or should we give weight to the  
16 barriers.

17 We are in favor of giving weight to the  
18 barriers and we are also in favor of giving  
19 numbers to progress. Now, those who work at the  
20 elimination of those barriers are a little bit  
21 less keen. I mean, it is a bit like a school. We  
22 want the number and they would like better

1 judgment. It's good, could be better, you are on  
2 the right way, these kind of things.

3 So, our view is that most probably we  
4 should come to weight in the barriers. If we come  
5 to weight the barriers, it's likely that the  
6 industry barriers may matter a bit more at the end  
7 of the day than the legal barriers and the tax  
8 barriers. So, it is likely that the pictures gets  
9 a bit more positive than now.

10 But we haven't yet come to the -- to  
11 having a procedure that was agreed by the industry  
12 to weight the barriers. We have proposed one idea  
13 at the last exam. We are going to propose the  
14 refinement of the next exam. And I hope that by  
15 the first exam of 2008, probably we will have  
16 fixed a methodology to give weight to everybody.

17 MR. PICKEL: I have a general question  
18 which really is for either of you, but I think it  
19 is particularly relevant in the clearing and  
20 settlement area, and that is the role of the  
21 European Central Bank, which Professor Nava  
22 mentioned.

1           And I realize they don't have a direct  
2 regulatory role, but certainly, it's observed that  
3 they don't have this data either publicly or  
4 behind the scenes to weigh in on any number of  
5 issues that you're addressing.

6           And I guess what exactly do you view as  
7 the role that they play? And realizing you can't  
8 speak for the Central Bank, what do you see as the  
9 issues that they seem to take the most interest  
10 in?

11           MR. NAVA: I must say -- I mean, the ECB  
12 has been of -- has been always in our group. I  
13 mean, from the very beginning has been in this  
14 exam as an observer, has been in the MOG, and I  
15 think it is the fact that we have worked together  
16 that has brought the two of us to propose a  
17 project at the very same time.

18           Of course, the ECB has a very direct  
19 interest in what the article of the treaty says,  
20 which is the stability of the financial system, of  
21 course. And that is really the issue on which the  
22 ECB is concentrating.

1           And I think that the work the ECB has  
2       been doing on the standard until now is a very  
3       important work. I mean, we really regret that the  
4       standards have not yet seen the light. In a way,  
5       we hope that sooner or later we come out of that  
6       situation and that we manage to have EU standards  
7       like there are Yosco standards. We have tried to  
8       have our EU formulation of those standards and for  
9       some reasons, they were blocked, not at the ECB  
10      level. The ECB was in favor. But the old ECB,  
11      the old governors of the ECB but that the CESR we  
12      have some blockage.

13           But obviously, I mean, the ECB is  
14      crucial and is a partner that I don't think we  
15      could even imagine a second not to have for all  
16      the issues of safety and stability, which is what  
17      the article of the treaty asks them to do.

18           MR. WRIGHT: I think I would add that if  
19      you look at Target 2 securities, I think the ECB  
20      thinking has evolved a lot from perhaps some  
21      people thought rather over rigid approach to  
22      something now which is much more in tune with



1 working with the grain of the market and  
2 encouraging to set up a really deeper set of  
3 consultation and committees. We've got the  
4 governance of the project right.

5 But we're encouraged by that project.  
6 We see what Mario has been describing as clearing  
7 and settlement space. We've got a four-pronged  
8 strategy, as he said. We've got the Giovinini  
9 barriers. We expect that on October the 9th that  
10 there will be pressure building up from ministers  
11 to put some time frame around some of the  
12 remaining barriers, which is helpful because it  
13 puts pressure on all those who've got to deliver  
14 something to get on with it.

15 The second obviously is the code. The  
16 third is the Target 2 securities, and fourth  
17 strand is this -- these ECB CESR standards, which  
18 we want to progress and again, hopefully, we'll  
19 get some more momentum behind that.

20 So, we work extremely closely with the  
21 ECB, and we think they've done a very good job  
22 moving their project forward as part of this

1 four-pronged strategy.

2 CHAIRMAN LUKKEN: Roger?

3 MR. LIDDELL: Thank you. If I can just  
4 perhaps offer a few comments. First of all, we at  
5 LCH, now fully support the code and are keen to  
6 make it work. But that wasn't always the case.  
7 Of the three different elements to it, we all were  
8 strongly in favor and support of the right of  
9 access, all were strongly in favor of and support  
10 of price transparency.

11 We've had some significant problems with  
12 the whole interoperability component of it for two  
13 reasons frankly. First of all, that as a  
14 technician embracing something that actually  
15 increases complexity and increases cost just felt  
16 fundamentally wrong initially. And secondly, we  
17 had some real serious reservations about the  
18 likelihood of the code being actually adopted by  
19 exchanges who owned their own clearing houses and  
20 felt that there was risk that this would be  
21 something that would make us vulnerable but would  
22 not give us anything in return.

1           The reason we changed our mind was for a  
2 couple of reasons, but the main reason was the one  
3 that Mario mentioned near the end of his  
4 presentation, which is the whole, you know,  
5 visibility and publicity element of it. We now  
6 feel much more optimistic than we did before that  
7 individual countries or the infrastructure in  
8 countries and particularly exchanges would be  
9 unwilling to not facilitate the working of the  
10 code of conduct.

11           We became convinced of that through  
12 discussions with Mario and two of his colleagues  
13 but also with other people in the industry and so,  
14 now feel that even if it might not be necessarily  
15 attractive in many cases for exchanges to embrace  
16 the code, that they probably will. So, that was a  
17 big difference.

18           And the second thing, I think which  
19 speaks to one of the questions that Craig had  
20 before is this whole thing -- the relativity  
21 between price and cost. So, our view is that this  
22 part of the code will actually increase costs but

1 it will decrease price. And of course, one  
2 month's price is another month's cost.

3 And the reality of the situation in  
4 Europe and in the U.S. is that, you know, as  
5 volumes of activity have gone up on all the  
6 exchanges and all the other platforms that provide  
7 transactions and as the costs remain reasonably or  
8 relatively fixed, then the margins in providing  
9 clearing services has actually gone up  
10 dramatically. I mean, clearing now is a very  
11 profitable business. So, there is a lot of margin  
12 that I think will be eroded through the  
13 interoperability and the competition that comes as  
14 a consequence of it.

15 So, cost can go up, but price will still  
16 come down is our view, and that's definitely true  
17 in cash equities. It's particularly true in  
18 derivatives, which of course, is why clearing  
19 derivatives is becoming so financially attractive,  
20 which obviously is one of the things that ICE is  
21 concerned with.

22 So again, we're keen that it is made to

1 work. It's not without reservations, because as I  
2 say, there is something still a little bit  
3 uncomfortable about increasing costs as a means of  
4 bringing price down. But as a means to an end,  
5 we think this is going to be helpful and look  
6 forward to embracing it.

7 CHAIRMAN LUKKEN: Adam, do you have a  
8 comment?

9 MR. COOPER: Just a quick question.  
10 Should a user have any concern that the unbundling  
11 might give rise to issues on the net ability of  
12 the contracts across various link participants  
13 that might not be there under the current regime  
14 netting of contracts now, comparability of, you  
15 know, contract?

16 MR. NAVA: The users did not raise this  
17 issue yet. On the unbundling -- sorry. The users  
18 did not raise this issue yet. On the unbundling,  
19 what we did was both a vertical and horizontal  
20 approach. The vertical approach is unbundled  
21 between trading venues, CCPs, and CSDs. And the  
22 horizontal approach is within CSDs, unbundled the

1 five main services which are provided.

2 This is crucial for the price  
3 transparency, of course. These links in with this  
4 price transparency. Now, what you ask is whether,  
5 for example, two CCPs which are linked or become  
6 interoperable whether the contracts of one users  
7 with the CCP would be in a way touched by the  
8 interoperability of their CCP with another CCP.

9 That is, I'd say, a question that we  
10 should probably discuss also with the CCPs, but at  
11 present, no user has made that worry clear to us.  
12 And actually, most of the users have told us that  
13 these kind of picture, the one we are seeing here,  
14 they like it.

15 Of course, they share lots of sympathy  
16 with what Roger said. They said -- I mean, it's  
17 not immediately clear if you pass from one to four  
18 providers with the same trade flow, it would  
19 immediately reduce prices. It is true it is not  
20 immediately clear. There will be some competition  
21 within them, probably because we'll go down and so  
22 on and on. But on your legal question, I would

1 say for the time being, nobody has raised the  
2 issue.

3 MR. SHORT: We too look forward to the  
4 debate. I'm sure it will be a robust one. I just  
5 wanted to add that -- or really ask the question  
6 about whether there have been any studies done on  
7 product innovation and the potential impact on  
8 product innovation of interoperability and  
9 clearing.

10 One of the reasons that ICE is pursuing  
11 its own clearing strategy is to bring more  
12 products to the market more expeditiously, and we  
13 view that as a benefit to the end customer in the  
14 marketplace. And I was just wondering where that  
15 fit into the mix.

16 MR. NAVA: In this particular area, we  
17 have -- in this particular area, we haven't yet  
18 made any study. But in the other area I was  
19 referring to in telecom, that is quite interesting  
20 because as a result of interoperability, we have  
21 seen lots of product innovation which is also due  
22 to technology, which is also due to many other

1 different things.

2 But if you think of the typical  
3 incumbent operator, which usually had this image  
4 of being a bit (off mike), normally it was an  
5 incumbent operator offering standard service with  
6 no fantasy and anything at all. Well, that has  
7 changed quite dramatically. I mean, Belgacom is  
8 offering many, many things.

9 So, the interoperability and the  
10 challenges that come from that seem to have acted  
11 at least in the telecom areas as (off mike) for  
12 other services, needless to say at very high value  
13 added, because when Belgacom offers you the number  
14 recognition or all the other services, they're all  
15 very much value added services.

16 So, in the other markets, I would say  
17 the reply is positive in the sense that there is a  
18 correlation between interoperability, challenges  
19 of the market, and innovation, which is what one  
20 would tend to expect from theory.

21 In this market, we haven't yet any  
22 proof, also because we haven't had an



1 interoperability as such by now. The only thing  
2 we have now are requests that we follow very, very  
3 carefully on a regular basis. We phone to those  
4 who have requested and to those who have been  
5 requested, and we ask how we are proceeding with  
6 that.

7 MR. SHORT: Thank you very much. I  
8 would just add that, you know, one thing that  
9 concerns ICE is really the different in, I guess,  
10 the relative maturities of the markets. I mean,  
11 obviously the cash equities markets have been  
12 around for many years. And while derivatives have  
13 been around for many years, I think we're right at  
14 the forefront of, you know, significant expansion  
15 in the derivatives markets and significant product  
16 innovation.

17 And one concern we would have obviously  
18 is an impact, you know, on that product innovation  
19 and ultimately the -- you know, the impact on the  
20 market and the end user of the market.

21 MR. NAVA: As I repeat, theoretically,  
22 we don't have any -- I mean, the economic

1 literature does not conclude against innovation in  
2 case of increased competition, so there is no --  
3 there is no evidence, neither from the theory nor  
4 from the empirics that if you have more  
5 competition you hamper or you put obstacles to  
6 innovation.

7 MR. SHORT: Well, I know presenters and  
8 our participants have planes to catch. And we've  
9 come to that hour where we're supposed to close.

10 I would like to ask one final question  
11 on this issue. And it really deals with the  
12 concept of mutual recognition and how in the  
13 United States obviously there is a lot of cross  
14 Atlantic business between our markets and your  
15 markets. The mutual recognition is based on the  
16 concept of broad comparability.

17 Is the clearing code of conduct going to  
18 be part of that comparability analysis in the  
19 future where if, you know, ICE has decided to  
20 start a clearing house in Britain but they  
21 certainly could have decided just to keep the one  
22 they have here in the United States and link to

1 that clearing house, would this be subject to the  
2 clearing code of conduct? Is this something we  
3 need to be thinking about as we look forward to  
4 this mutual recognition idea between our two  
5 bodies?

6 MR. WRIGHT: Well, Chairman, you're  
7 thinking like a good chairman, way forward here,  
8 if I may say so. And I think that, as you are  
9 aware, there is a real interest in this country at  
10 government level to seek -- to move forward the  
11 mutual recognition of securities. And that's been  
12 signaled in the G7 process and it's been signaled  
13 in the context of our bilateral relationship  
14 between the EU and the U.S. and what we call the  
15 Merkel Initiative, the chancellor of Germany  
16 having agreed a new transatlantic economic council  
17 to integrate and to work towards the removal of  
18 barriers to trade.

19 So, this is one of the big subjects of  
20 the future. And I think we in the European  
21 Commission in broad terms very much favor trying  
22 to break down these barriers and mutually

1 recognize each other. So, there's a very positive  
2 spin and orientation from our side on the basic  
3 principle of that.

4 The important thing is that we've got to  
5 get the detail and the framework right. We're  
6 discussing very intensely. We did so yesterday  
7 with our colleagues from the SEC, who on the  
8 securities side obviously were leading. You've  
9 been, in a sense, doing this work for some time  
10 with foreign jurisdictions.

11 So, I think the key issue here is how  
12 are we going to make progress, what's the right  
13 approach, what products should we concentrate on  
14 first, should we, for example, concentrate on the  
15 professional markets, broker dealers on the  
16 professional side, stock exchanges, some people  
17 say, and why not in the future carrying a  
18 settlement, asset managers, and so forth.

19 So, you know, I think all of this is now  
20 being thought through. I think the really  
21 interesting thing is that this is -- it's really  
22 coming on the agenda, the transatlantic agenda for

1 the first time. If we're going to -- if this is  
2 going to work, both sides -- and here I'm talking  
3 bilaterally, but of course this is -- could be  
4 plural lateral, global, everybody has got to feel  
5 comfortable with the process; everybody has got to  
6 understand the objectives.

7           It may well be that if we, you know, if  
8 we try to sort of do a -- do this in a gradual  
9 way, we might be more successful than trying to  
10 take on everything including retail business in  
11 the first thing.

12           So, all that is being very much thought  
13 through. And your thought on the clearing and  
14 settlements side is a very interesting one. And I  
15 think, to be quite clear, we want to see real  
16 progress next year. I mean, you know, once we get  
17 the basic framework out there, the regulators have  
18 got to get on and decide who should and should not  
19 be able to mutually -- be mutually recognized, and  
20 it will obviously be on a reciprocal basis.

21           I think our real concern -- and it's not  
22 really a concern but our real -- the thing we want

1 to get right is get the framework right. Once you  
2 get the framework right, we understand each other,  
3 then I think the technical details can follow.

4 So, a very interesting thought and  
5 something that might bring us back for further  
6 discussions, I think.

7 CHAIRMAN LUKKEN: One very quick comment  
8 from Arthur.

9 MR. HAHN: Yeah. Thank you. I would  
10 encourage you guys to pursue that agenda. I think  
11 your good work on MiFID and the code, I think make  
12 it much easier to interface with you as opposed to  
13 dealing with half a dozen different countries and  
14 different regimes. And this is an opportunity and  
15 it needs to happen and look forward to your  
16 pursuing that.

17 MR. WRIGHT: If I may, I thank you for  
18 your encouragement and I think we entirely agree  
19 with your sentiments. But let's also be -- keep  
20 our feet on the ground here because political  
21 aspirations are there. We share those. But the  
22 devil is in the detail here.

1           The legal systems of the United States  
2           and the approaches in Europe are different. And  
3           so, you know, we have to, for example, think  
4           carefully about, you know, whose laws apply where,  
5           whose -- who does the inspections. All those  
6           sorts of difficult issues have got to be worked  
7           through.

8           So, let's get the framework right and  
9           then I think 2008 could be a real breakthrough.

10           MR. HAHN: Yeah. I mean, for whatever  
11           it's worth, maybe just a closing comment. CFTC  
12           has gotten that pretty right so far --

13           MR. WRIGHT: Yes, yes.

14           MR. HAHN: -- and made some good  
15           progress, so we would look for other agencies to  
16           try.

17           MR. WRIGHT: I think you're -- I think  
18           -- I fully agree with that. I think we're in  
19           great admiration for the very smooth way the CFTC  
20           has managed these sorts of arrangements. And  
21           there's a lot to be learned.

22           But, you know, what is being talked

1 about by some people in the industry is a big  
2 agenda here, and it's ambitious. But let's go for  
3 it. I think that's the view from Europe.

4 CHAIRMAN LUKKEN: Well, Commissioner  
5 Chilton unfortunately had to catch a plane.  
6 That's why he left a little earlier, but on his  
7 behalf and that of my fellow commissioners, we  
8 want to thank the presenters. You really gave us  
9 a lot to chew on today, and we may have to do a  
10 part two in the spring, to follow up on both these  
11 issues with you. And we hope we can.

12 So, join me in thanking our presenters  
13 today.

14 (Applause)

15 CHAIRMAN LUKKEN: With that, I do want  
16 to offer a quick thanks to all the folks at the  
17 CFTC that helped put this together, Jackie and her  
18 shop as well as Erin Shaw, Trabue Bland. We  
19 couldn't have done it without them and also our  
20 administrative folks who are always very valued  
21 here at the Commission. So, thank you.

22 And with that, we are adjourned.



1 (Whereupon, at 4:08 p.m., the  
2 PROCEEDINGS were adjourned.)

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