UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

PUBLIC ROUNDTABLE

Washington, D.C.

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PARTICIPANTS:

GARY BARNETT, DSIO, CFTC, Moderator

KEVIN PICCOLI, DSIO, CFTC

CAMDEN NUNERY OCE, CFTC

BOB WASSERMAN DCR, CFTC

Panel 1

SAM TELZER, PricewaterhouseCoopers

ANN CHEESEMAN, Ernst & Young

MIKE JAMROZ, Deloitte & Touche

RICH FLOWERS, Grant Thornton

JOHN HAGUE, McGladrey

MARK HOLLOWAY, SIFMA/Goldman Sachs

BILL TIRRELL, SIFMA/Merrill Lynch

EILEEN FLAHERTY, Newedge

YVONNE DOWNS, Jefferies

HOWARD ROTHMAN, Vision Financial Markets, LLC

WILLIAM DE LEON, PIMCO

ANNE BAGAN, CME Group

DAN DRISCOLL, NFA

ANAND RAMTAHAL, FINRA

STEVE RICHARDS, PCAOB

RON FILLER, New York Law School

PARTICIPANTS (CONT'D):

Panel 2

MARK HOLLOWAY, SIFMA/Goldman Sachs

BILL TIRRELL, SIFMA/Merrill Lynch

ALESSANDRO COCCO, JP Morgan

EILEEN FLAHERTY, Newedge

YVONNE DOWNS, Jeffries

HOWARD ROTHMAN, Vision Financial Markets, LLC

WILLIAM C. THUM, ICI/The Vanguard Group

CHARLEY COOPER, State Street Global Markets, (eExchange)

DAN DRISCOLL, NFA

RON FILLER, New York Law School

WARREN DAVIS, Sutherland Asbill & Brennan

TODD KEMP, National Grain and Feed Association

CHRISTINE AYOTTE-BRENNAN, Fidelity Management and Research

NEVIS BREGASI, ICI/MFS Investment Mgmt

DAVID YERES, CIEBA/Clifford Chance

MIKE DAWLEY, FIA/Goldman Sachs

MAUREEN BURKE, FIA/BAML

KEVIN FOLEY, FIA/Katten Muchin Rosenman

WALT LUKKEN, FIA

PARTICIPANTS (CONT'D):

ROSS PARK, Barclays Capital Inc.

KIM TAYLOR, CME Group

Panel 3

ALESSANDRO COCCO, JP Morgan

HOWARD ROTHMAN, Vision Financial Markets, LLC

WILLIAM C. THUM, ICI/The Vanguard Group

CHARLEY COOPER, State Street Global Markets

DAN DRISCOLL, NFA

RON FILLER, New York Law School

WARREN DAVIS, Sutherland Asbill & Brennan

TODD KEMP, National Grain and Feed Association

BOB RICHARDSON, RGRichardson Consulting

CHRISTINE AYOTTE-BRENNAN, Fidelity Management and Research

NEVIS BREGASI, ICI/MFS Investment Mgmt

DAVID YERES, CIEBA/Clifford Chance

STEVE HURST, Merchants Data Repository LLC

MIKE DAWLEY, FIA/Goldman Sachs

CHRIS PERKINS, Citi

MAUREEN BURKE, FIA/BAML

PARTICIPANTS (CONT'D):

KEVIN FOLEY, Katten Muchin Rosenman

WALT LUKKEN, FIA

JOHN L. ROE, BTR Trading Group, Inc.

KIM TAYLOR, CME Group

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P R O C E E D I N G S

(9:32 a.m.)

MR. BARNETT: Good morning, everyone. Welcome to the Staff's Public Roundtable to discuss Customer Protection Requirements for Futures Commission Merchants. This Roundtable follows, and is in addition to, the Public Roundtable we held at the end of February, beginning of March. And our objective today is to gather public input on a variety of issues and ideas to further protect customers.

In terms of specific topics today, we'll have three panels. Our first panel is broken into two parts. First we will focus on the SRO requirements for examinations of FCMs. And second we'll look at the CFTC's oversight of SRO examination programs, and in both of those topics, we will be looking at the role of the independent CPA whose is engaged by the FCM in the examination process.

Our second panel will focus on various questions staff has for our panelists regarding customer protection proposals that we've been working on.

And our third panel of the day will take stock of the various alternative models for seg. That are being discussed in the industry. A discussion, evaluation of those various alternatives comparing values and feasibility comparing and contrasting, and frankly, making the participants in those efforts a little easier to find should others wish to join them.

In terms of housekeeping items, the bathrooms are in the back, down the stairs, around the corner. In terms of breaks, we have one scheduled at 10:30 but we may adjust based on how the discussion in the first panel is progressing.

In terms of questions from the audience, we have cards on the side over here in which you can submit questions in writing, and then those questions will be brought up to us. In fact, you can drop it in the corner next to Cam and we'll field it amongst ourselves in an appropriate time.

Lunch is at 12:45. It's short. We will

begin again at 1:30. You'll be on your own. There are several restaurants around the area to run out and grab a bite.

Of course, we are creating a transcription of the dialogue today. To make this work, when one of our participants is going to speak, first state your name so that we can pick it up and get it correct in the transcript.

And last, because of ongoing enforcement cases, we are not going to talk about specific market events, whether it's MF Global or Peregrine or otherwise, there is really not a need to do that in order to look afresh at customer protection in this space.

All right, so let's start the first panel. And by way of introduction, we know that our Oversight System is for decades that SROs are the front line regulators of FCMs. In 2000, Congress affirmed the Commission's reliance on SROs by amending section three of the Commodity Exchange Act to state:

"It is the purpose of this Act to serve

the public interest through a system of effective self- regulation of trading facilities, clearing systems, market participants, and market professionals under the oversight of the Commission."

So, as part of its Oversight responsibility then, SROs are required to conduct periodic examinations of their member FCM customer funds in seg. and secured accounts, and the CFTC oversees the SROs examining them for the performance of their duties.

And just to get the rubric right, because SROs share the same members, to avoid subjecting FCMs to duplicative examination we have a permissive system that allows the SROs to agree how to allocate FCMs amongst them. An SRO who is allocated certain FCMs for such an examination is referred to as the DSRO for those FCMs.

In any event, when we review SRO examinations, we do so on a periodic basis. Currently the CFTC does quarterly reviews of an SRO's FCM examination program in which the agency selects a sample, a small sample, of the work papers to review, and we also do some limited scope reviews of FCMs in a for cause situation.

Also, under CFTC rules FCMs must have their annual financial statements audited by an independent CPA using GAAS Standards. As part of this annual report, the independent accountant must conduct appropriate reviews and tests to identify any material inadequacies in systems and controls that could violate the Commission's Segregation or Secured Amount Requirements.

So, given this two layer examination process, SROs examining FCMs and the CFTC Oversight of the SRO examination process, it makes sense to look at each of these layers with fresh eyes; which is what we're going to do now with the help of our panelists.

So, before we start asking questions of our panelists, let's go around the table and for the transcript state your name, your title, and the institution you work with. I'll start. My name's Gary Barnett. I'm the director of the

CFTC's Division of Swap Dealer and Intermediary Oversight. And Cam, I'm going to go this way.

MR. PICCOLI: Kevin Piccoli, Deputy Director, DSIO.

MR. RICHARDS: Steve Richards, Special Advisor to the Chairman of the PCAOB.

MR. RAMTAHAL: Anand Ramtahal, Senior Vice President, Department of Risk Oversight and Operational Regulation at FINRA.

MR. ROTHMAN: Howard Rothman, President Vision Financial Markets FCM.

MR. TELZER: Sam Telzer. I am a partner with PricewaterhouseCoopers.

MR. TIRRELL: Bill Tirrell, here for SIFMA Capital Committee.

MR. JAMROZ: I'm Mike Jamroz. I'm a partner at Deloitte & Touche.

MR. HOLLOWAY: I'm Mark Holloway and I'm Chairman of the SIFMA Capital Committee.

MR. HAGUE: Good morning. I'm John Hague. I'm a partner with McGladrey.

(Recess)

MR. NUNERY: And I'm Cam Nunery. I work in the Office of the Chief Economist.

MR. BARNETT: Let's wait a second and see if we can get this side of the table working.

(Recess)

MS. FLAHERTY: I'm Eileen Flaherty, Global Head of Compliance and Financial Crime Prevention at Newedge Group.

MR. FILLER: Ronald Filler, Professor, New York Law School.

MR. DRISCOLL: Dan Driscoll, Chief Operating Officer, NFA.

MS. DOWNS: Yvonne Downs, Global Chief Operating Officer, Jefferies Futures Division.

MR. DE LEON: Bill De Leon, Managing Director PIMCO.

MS. CHEESEMAN: Ann Cheeseman, Audit Partner with Ernst & Young.

MS. BAGAN: Anne Bagan, Managing Director Audits, for CME Group.

MR. BARNETT: Great, thank you very much. All right, so, we're going to start with some questions. We've given you guys the questions already, but we're going to go through them and get your thoughts now. We know how you're going to answer. And some of them are basic, but you know what, we're going to start from the beginning, right? And we're going to build up from it. So, we appreciate your patience with us, and, you know, so, for instance, our first question: What's the purpose of an examination? What are we trying to accomplish?

We're talking about SRO requirements for the examination of FCMs. What should they hope to accomplish and what should we not expect from an examination of an SRO?

Who wants to take the first shot at it? Dan?

MR. DRISCOLL: Dan Driscoll, NFA. So, from NFA's perspective our objective in doing an audit of an FCM is to achieve reasonable assurance of compliance with relevant NFA and CFTC rules, and that all of the balances in the financial statements that are filed with NFA and the CFTC are properly stated.

I would point out that while our objective is to achieve reasonable assurance of compliance with CFTC and NFA rules, we don't believe that the goal is to guarantee compliance, or to ensure against violations of the rules.

MR. TIRRELL: Bill Tirrell, SIFMA. I think from the industry side we look towards the -- first of all, let me just say that from the industry side we, I think we share common cause here of trying to make sure that the firms are compliant, that we are protecting clients, assets, and so on. So, we do have a shared interest in this, and we look to see if the processes, controls, within the organizations are meeting the current standards in compliance.

So, we look at this, I think, more as an asset test, if you will, if we are doing what we should be doing in order to protect clients, to stay in compliance with both capital and client protection rules. So, it's kind of a check and balance, if you will, from the perspective of the firms.

I would also say that, our expectation is that examiners that have the benefit of going around to multiple firms and seeing different processes, controls, competencies, and so on, that they would be able -- that we as an industry should be able to leverage that in order to ensure that we are all meeting high standards of best practice.

So, from an expectation from an industry side, I would say best practices is high expectation as far as compliance, competency, controls, and processes.

MR. BARNETT: Thank you.

MS. BAGAN: Gary.

MR. BARNETT: Go ahead. Ron?

MR. FILLER: I agree with Dan. I mean, the main purpose of an exam is all registrants including FCMs, but all other registrants are subject to not only statutory provisions, but all the regulatory provisions established by the CFTC and NFA, but there's also a further step that the regs and the policies in the industry also impose internal standards.

Meaning each FCM, each registrant have to have their own policy manuals in place, and so, part of the exam should govern not only compliance with the laws and the regulations, but making sure the individual firm's FCMs, in this case, are following their own internal policies as well.

MR. BARNETT: What do we mean by "their own policies and procedures?" What standards should apply to those policies and procedures? Is it off again?

Okay. Cam, could you go hit the door (inaudible). Maybe we should come back to you on that. I don't want to lose the thought on it.

SPEAKER: Anne's mic is working.

MR. BARNETT: Anne, go ahead.

MS. BAGAN: Anne Bagan. And I also echo what Dan was saying. Our audits, our examinations are incredibly detail oriented, but I did want to remind everybody that they are, as of a point in time. So to Dan's point, it is not a guarantee that the balance will always (off mic).

And as far as CME Group, because the audit function is part of our Clearing House, we consider the whole audit function part of our risk management procedures in getting to know our firms and understanding their business expertise.

(Recess)

MR. RAMTAHAL: Anand Ramtahal from FINRA.

MR. BARNETT: Yes, go ahead.

MR. RAMTAHAL: Responding to the examination question. From our perspective the examination is an opportunity to ensure that the systems, processes, controls in place at registered broker dealers that are subject to our examination program are working as intended, and that the member has adequate resources in place to ensure that they are accomplishing compliance with federal securities laws and SRO rules and regulations. From our perspective it's also a really good opportunity to educate our members on how they can and should comply with federal securities laws, obviously, when we think that their systems and processes are weak or deficient.

MR. PICCOLI: So Anand, when you look at the policies and procedures you're actually going and testing the controls, the underlying processes themselves that are there, is that right?

MR. RAMTAHAL: Yes, and that could be both qualitative and quantitative depending on what areas or reviews we're looking at.

MR. BARNETT: Let me challenge that a little bit because I'm hearing -- and I think there's the focus on controls and sort of risk management orientation, not just counting obviously seg. secured capital. I mean, it's core, and basic, and obviously, hugely important, but also I'm hearing discussion about controls. To make sure that things are being operated -- "working as intended" was the way somebody just said it.

What's your view about the balance between the substantive, you know, counting the amounts that are there and then the risk man -- or the control orientation to make sure that things are set up to work as intended?

MS. FLAHERTY: Again Eileen Flaherty, Newedge Group. I think that you're correct. There is a balance. I don't think that I'm saying that that's not proper, to also look at the framework, and the control framework, because I think the audits do that.

But again, when it gets down to it, in addition to looking at that, looking at the organization, the governance of an organization, overall how the organization is managed, that's all part of the audits too.

But, also, again, there is a very, very high and heavy focus on tying out and looking at particularly, you know, the seg. and secured amounts, both from the FINRA side and again the DSRO for the CME Group in this instance.

MR. BARNETT: Other reactions to that? Thoughts?

MR. DE LEON: Bill De Leon, PIMCO. I agree and I think that while it's very important to focus on the process and that the rules being imposed by the regulatory bodies, as well as the self-denominated rules by each entity are being followed, I think given what we've seen, as well as the expectation by end users is that the standard of care has to be considerably higher in terms of ensuring that the money is where it's supposed to be.

So, as to Eileen's point about seg., our expectations would be that every FCM is guaranteeing that the money is where it's supposed to be on a daily basis, and someone's checking it. And to the extent that certain investors may impose or ask their FCMs to guarantee that for them, I think it's more appropriate to be done at the regulatory level as opposed to investor by investor asking.

So, I think it's definitely falling into the utility function, and I think given the reactions we've seen, it is important to realize that it may not be as clearly delineated as some people have thought. But the expectation is clearly there.

MR. PICCOLI: Just following up on that Bill, because two thoughts. One, I totally agree. I think that's certainly a reasonable expectation of the users to make sure that the money's there all the time. But two thoughts, one, a lot of times, you know, we'll come in and look at point in time. So, we'll go and we'll say, okay, yep, the cash is there. We confirm it, tie it all out, agrees with the general ledger, that's great.

I think, but it's balancing that with looking at the controls to make sure, okay the cash is there today. Will it be there tomorrow? And there I think, I would think that what we need to do is look at the controls to make sure the controls are sufficient to ensure that cash will be there tomorrow.

We're looking at one point in time, so, instead of just a substantive view of, okay, is the cash there today? Great. What are the controls to make sure the cash is there tomorrow?

I think building that in, and if I could just, just following on that, how much reliance should be placed on the CPA, the independent CPA coming in and doing the financial review?

MR. DE LEON: There are a lot more people here who are much more versed in some of this. I would say from where we sit, that the concept of point in time is incredibly important and I think that that is for a deep dive into sort of all the nuts and bolts of everything. There is clearly the importance on having the surety and reviewing the process and making sure it's followed on a daily basis.

However, at the end of the day, the expectation is that each FCM meet its seg. Requirement and someone has to go, "okay, we did a deep dive three months ago, or six months ago, or two weeks ago. They have a good process in place. They have good controls. We did a deep dive." That's great, but we need to know every day that seg. is there, because we've seen that someone can go from being in a good seg. situation to a lot of money missing really quickly. And I would argue that investors expect that degree of confidence and are asking the questions for that.

So, I agree the deep dive should be done less frequently because it's a much more complicated thing, however, at some point someone needs to go, "Yes, seg. is met every day," because if it's not met and there's a violation and you don't act on it, that's when things can go really badly, both for the end user who has put money in, as well as the financial system in general, which I know are two of your concerns.

MS. BAGAN: Anne Bagan. I'm going to reiterate what Eileen said, too. I don't want anybody to think that we don't take internal controls into account on our regulatory audits. They are primarily financial, but in order to assess what areas we are going to look at on any regulatory audit, we do look over the firm's controls and procedures and that helps us assess where we need to focus our energy on any audit.

To my point of view, if you go through that process and then you do the regulatory audit and things tie out the way they're supposed to, I think you can rely on the firm's procedures at that point. Not to say somebody won't break it later on, but we don't have a guarantee of that.

MR. BARNETT: I want to come back to that question about how -- thank you -- how people test the efficacy of controls. I mean, because it's kind of like if you count it and the money's there, then the controls must be. I'm not sure. I want to come back and get people's thoughts on that. But, Dan, go ahead.

MR. DRISCOLL: Dan Driscoll, NFA. I just wanted to make a few points. One is that while the audit date is as of a particular date, sort of a balance sheet look at the firm on that date, I don't think anybody should think that when we look at transactions, when we test things, that it's only on one day. There's the transactions that we look at are over time, but we just tie everything out, hopefully to the penny, on the audit date.

So, it's not just a one day sort of

thing. On the question about, which is more important: Controls or testing? I think they're both important, because I think one without the other just wouldn't get you anywhere near where you need to be.

MR. TIRRELL: Bill Tirrell. In my 30 plus years' experience, I can appreciate the fact that the NFA and the CME do have processes to look at controls and so on, but in practice I can also tell you that most of the time, the examiners are spending their time ticking and tying numbers, and not having conversations with the folks that are actually involved in these processes.

And as an example, we just had a recent request come in to look at our bank accounts and our reconciliations. And there are over 50 plus bank accounts that need to be reviewed, and the request is for all 50 plus bank accounts in hard copy and reconciliations. And we employ an automated reconciliation utility that most of those reconciliations go through.

So, to look at 50 plus, to spend those

hours and we were told by two different examiners that that exact same process would be for four examiners for ten weeks and two examiners for four weeks.

So, there's a big dispersity there of time and commitment, but if they have an automated utility that reconciles that's separate and distinct from the operations and some of the other aspects of the business, one would wonder if you're really spending enough time evaluating the controls and processes, or are you really concentrating on ticking and tying the numbers back to reconciliations? And following those reconciliations through into the actual seg. coms and what controls and oversights and escalation processes around it. I have not seen that in my current processes, or in my past processes.

MR. BARNETT: Thank you. Bill, let me jump back to Bill De Leon. So when you talk about wanting to make sure the cash is there every day, taking what Bill Tirrell just said, with the 50 accounts and the reconciliations that have to be done automated.

So, is it that you discount controls and that you would, for instance, in this case, you would have somebody on a daily basis going through the accounts, or I'm trying to understand the balance between --

MR. DE LEON: We are not discounting controls, and we're not discounting the fact that there have to be good processes and they need to be followed in any way. However, at the end of the day, you want to put as many controls or checks in place to ensure that they're being done. And given the sizes of money involved here, and the issues associated with where that money goes, and how quickly it can moved from one entity to another, we want to make sure that it's checked.

So, I agree with you, 50 hard copies every day is incredibly difficult to verify. I would point out, though, and several people at this table can tell you that they do it every single day for thousands of accounts, because every one of our accounts, when we clear, they tick and tie at the FCM every single penny. And if we're off, we get a phone call. And we're not the only client of these large institutions.

So, we're talking about tens of thousands of accounts that are automated, that are verified, and ultimately those numbers go into the CME or LCH or ICE or whoever it is, and they are verifying those numbers at the entity level.

So, I'm just saying that if each FCM has that standard of care for every one of its clients, because I can tell you if we underpay on initial margin or variation margin, we're getting a lot of phone calls, and there're a lot of issues that the standard of care in our view should be commensurate.

MR. BARNETT: We need some help from the big accounting firms, okay? Sam, and Anne, and Mike, and Rich, we need some help. Controls versus substantive testing, we need some help.

Thoughts? Mike, you want to go first?

MR. JAMROZ: Well, let me start by saying that I don't do audits. I'm actually in the -- my background as you know, is a former SEC employee in that area that writes the rules that the broker dealers are subject to. And I am my technical advisor to our audit practice. I'll make a comment but I would really like the rest of the folks here that actually do the audits to supplement this.

But it's basically going to echo what has been said already, in that, you know, that both are important. You need absolutely to look at controls and a good, not only culture of -- first of all I would say that the compliance and control culture of the firm itself is important, in addition to the control themselves, but also you have to supplement that with the appropriate amount of testing. And I would expect that most of the other firms here would say the two go together. I mean, what you are supposed to do is design your testing around your evaluation of the controls, right?

MR. BARNETT: Sam, you want to take a response?

MR. TELZER: Sure. Sam Telzer, thank you. From an audit standpoint, the audit standards really talk about evaluating the control structure at an entity. And if we all step back and say, audit standards are generic for all entities that are subject to the audit. So, there is no specific audit standard that applies to an FCM as an FCM.

So, we start off with a very broad brush. I think the other panelists have made a lot of good points, is that, you do have to look at the mix between what is the control environment. What are the policies and procedures? Who has authorization? What technology supports the process? How much of it is what I'll call spreadsheet based versus more automated technology based?

And I think you get a lot of granularity when you start looking at different organizations, and I'll take up on what Bill said is when there's automated reconciliations, an auditor can test those and get a lot of comfort if those automation controls are appropriate and can be tested. There's no reason to go test those things in a more substantive manner with deep dives if you can rely on the controls.

The issue you typically get into in almost any organization is there is some mix of controls and more human elements, and the human element, just because we're all humans and humans can make mistakes, is the human element is often what affects the balance between controls and what auditors call substantive testing. So, I think, you know, from a overall quality perspective it would really be terrific if there was, you know, incremental information on what expectations are.

I clearly hear Bill with what he said from PIMCO of what the expectation is from the users, and I think the auditors are trying to meet those expectations, but there can still be a gap given the volume, given the human element, given the way the organization sets itself up. So, I echo what Mike said as well which is that there is always a desire to be able to rely on what an organization does; because that's the highest level you can get to.

However, you could always see where a human being, without proper guidance, without proper expertise, would not maybe make the same decision as a technology system that's supporting that same structure.

MR. BARNETT: Thank you. Go ahead, Ron.

MR. FILLER: I want to throw in another intangible element, and Mike mentioned it just briefly, but I think it needs to be talked about or discussed, and that's the culture of the firm. I mean the culture of the firm in dealing with the audits, when I was at Lehman our DSRO was the Board of Trade, I, as a managing director, and another senior officer, were always assigned to work with the audit staff who came in from the Board of Trade to making sure we were in compliance with and working with them to determine whatever procedures.

I also had the opportunity when I was at Lehman to be a member of the CME Clearing House

Risk Committee, so, we knew, I knew what they were concerned about also looking at other FCMs and so forth. And I think it's the culture making sure that the firm has that necessary intangible to ensure that they, not only from the internal controls, or testing perspective -- and I think, I know we're not supposed to talk about specifically two recent firms, but I think if you look at those issues, and some of them, and drill down, it's really the culture of those firms that causes as much of the problems. A lack of controls at those firms, and it's an intangible.

You can't regulate a culture, but that is still a very significant role in making sure the firms are in compliance with the appropriate regulations.

MR. PICCOLI: Yeah, I think that's a great point, Ron, because it goes to the risk profile. How do you establish the risk profile of a firm and from there determine your ordered approach? So, that's a great observation, thank you.

MR. BARNETT: Let's go back to John, too. Sorry about that, go ahead.

MR. HAGUE: No, just from a historical standpoint in auditing FCMs for the last 30 years, we, as auditors, have basically by default gone to substantive testing. Yes, we're required to gain an understanding of the internal control structure as Anne had basically said, and make a risk assessment, but a lot of times because of the point in time nature of our report, including the internal control reports, historically, we've defaulted to substantive procedures versus really testing controls.

So, there's a huge difference between gaining an understanding of the controls and being able to make a risk assessment, and actually testing those controls. And I'm sure later on in this morning's discussion we'll talk about the recent proposed SEC and PCAOB rule changes for broker dealers.

MR. RAMTAHAL: I'd like to, Anand Ramtahal, comment on internal controls and testing on exams. And a large part of the scope of our exam is driven by what our survey on staff knows about a given firm. So, to your last comment, Kevin, what is the risk environment? How do we view the staff? What is our history with this firm?

Sam mentioned spreadsheet controls. You know, do they have systems, proper systems, in place to ensure compliance with specific rules, or is it done manually? What is the quality of the staff? And I'll talk a little bit later about our surveillance program, but really, our examination and the scope of our examinations are driven, and generally at most (inaudible) clearing firms are out there once a year. But we're in touch with our firms throughout the year, so that we understand their business, the risks, the quality of the staff, and it's an accumulation of information throughout the year that will drive the scoping of our examination when we're on-site.

So, it may be a review of internal -- a review and testing of internal controls. What are the controls in place? What are the escalation processes? What is the corporate governance environment? And that will drive whether or not we actually test during the course of our financial operational reviews. None of us has unlimited resources, so we have to find the most efficient ways of executing our programs.

MR. BARNETT: Let me ask, say a smaller BD versus one of the large BDs, would the smaller BD that has a smaller compliance department and presumably could it have as good a control structure as a larger one? Does it drive you towards more substantive testing versus control based reliance? I mean, how does that factor in?

MR. RAMTAHAL: Well again, it's all about what we know of the firm and what we identify as risks. And, as I said, that's always ongoing. So, the scope of the exam will not necessarily be smaller depending on the size of the firm. In fact, it could go either way.

So, size doesn't matter. It's what we know of the firm, what we identify as risk, what we know of the internal control environment.

MR. DE LEON: Gary?

MR. BARNETT: Thank you.

MR. DE LEON: I just want to comment on that, and maybe I'm jumping ahead. Our view has been that regardless of the size of the firm, there's a standard of care that has to be held, and it shouldn't matter whether it's a large firm or a small firm. The standard of care needs to be met. So, a larger firm may have more assets and more resources, however, there's just got to be a basic standard of care. It's sort of analogous to a car, right?

You buy a car; it has to have certain safety standards. Doesn't matter, you know, if it's a Prius or if it's a Lexus, it's got to have that certain basics.

MR. BARNETT: Okay, thank you. And for the record that was Bill De Leon. Okay. Some more from the accounting firms? Who have we not heard from?

MR. PICCOLI: Rich. Also you came a

little bit late. I know you had plane trouble. Can you just introduce yourself? Thank you.

MR. FLOWERS: I'm Rich Flowers, a partner with Grant Thornton. Been in the industry about 40 years and previously was the engagement partner on a number of major league FCMs which have, unfortunately, gone the way of the Washington Nationals as far as I'd hoped anyway. But it includes EF Hutton and other big firms.

I think that the assessment of the overall environment of a client is excellent, the risk looking at it that way. If we want to look at the actual controls, though, the distribution between what's underneath the monitoring controls and then the various fundamental controls that might flow into the monitoring controls. And don't rely simply upon monitoring controls. That's an easy way to -- well don't forget he reviews the reconciliation. So you have to sign off on that.

No, what were the fundamental controls that were actually in place? That's where we get down to the details, and I think that the selection of the extent of the testing of those fundamental controls is important. Certainly they then transmit up to what monitoring controls you are going to have in place.

MR. HAGUE: You know, another point that needs to be made is that we are in a very competitive environment. The CPAs in this room do get paid for providing those professional services. So, we're tasked with providing an efficient and effective audit that meets the standards.

And again, it gets back to whether or not we're going to test controls. Once we gain that understanding, if we spend a lot of time testing controls, but don't reduce the amount of substantive testing that we perform, we're spending more time and not necessarily improving the results of the audit. Could, but potentially not, and then again, we are For Profit Organizations and we also have clients that are very demanding on us to be, and to provide as an effective and an efficient audit as possible.

So, by testing controls and not reducing in the amount of substantive testing we're going to be doing anyway, again, as a point in time, auditors lean towards provide just doing the substantive testing.

MR. BARNETT: Howard?

MR. ROTHMAN: Howard Rothman, from Vision, and I want to kind of go back to Bill's point a little bit. I think there's got to be a little sensitivity that we have gone, all of us, from I call it a batch environment where it's an end of the day or end of the month or end of the year environment, to where we're all on real time. And certainly at the CME and with the CME Clearing House on trading of our customers and SPAN margin, they're able to assess the risk and the P&L of various customers on a real time basis.

And firms today and I'm sure all of them that are here today, all have real time monitoring of their customers. So, the question is when we're asking a point in time, I think that diminishes at the end of the day the usefulness. If you're auditing once a year, if you're auditing once a month, but as the world's changing all day long, I think that, and again we're going to get into ideas later on, but obviously, especially at the CME, my DSRO, they see the vast majority of the customer trading and the SPAN margin.

But, we need as an industry to allow them, as a regulator, to have access, and I know, Bill, you have a legitimate point about 50 different bank accounts, but, and are much smaller. But, we basically have two bank accounts; I don't see any reason why the tool of real time view access into our bank accounts, for our customer bank accounts, aren't available to the regulators, whether the CFTC, the NFA, at all times.

They, obviously, view all of our customer trading at the Clearing House real time all the time. It's again, nothing is going to be perfect, but we need to give everybody the tools so that if they're counting on the regulators to say the money is there and the controls are there, you've got to give them the real time monitoring tools. And I think that will go back to Bill's point of being able to ensure at the end of the day that the money is there for all our benefit.

MR. BARNETT: Thank you, Howard. Ann, can we get your thoughts on this topic?

MS. CHEESEMAN: Yes. My thoughts are probably a little bit redundant, but I would agree with my colleagues that we follow the auditing standards. We follow, there are some example audit procedures in the AICPA practice aid, and you'll see in there that they are a mixture of control procedures and substantive procedures. And I'm also keen to see, we've been listening to the debate related to the SEC's upcoming 17a-5 rules, and it's a similar debate.

And so, I know there's been struggles on that, and I think we should leverage those discussions when we're talking about how much control testing and the cost et cetera.

MR. BARNETT: Great, thank you. Others

on this question who want to weigh in? Okay.

All right, so let me ask you a question. Again, it's kind of a basics question, but I want to talk about examinations and fraud. And if examinations, I assume they -- I need you to correct me, advise me, but to what extent do examinations under, I guess, GAAS look at fraud? And to the extent they don't, given issues we've seen, can fraud audits be done practically? If not, what other kind of mitigants should we be thinking about implementing?

Bill?

MR. TIRRELL: Bill Tirrell. Quite honestly, Gary, I don't see much difference between doing an examination and doing a fraud examination. I think they are somewhat hand in hand. And again, it goes back to looking at some of the fundamentals, if you will, the blocking and tackling of the controls. You know, are there separation of duties? Are there supervision and escalation policies in place? How much automation is in place? Things of that nature that would prevent fraud, as well as the competency of the people.

Do you have a clerk, that if you asked them what happens if you do this wrong? He says, "well, I don't know. Talk to so-and-so." There's a good chance that that individual is not going to pick on something that looks a little odd, or could be influenced by someone else.

So, I think when you look at the overall culture, as we talked about, the controls and processes in place, the competency of the individuals, the separation of some of those blocking and tackling things, I think that's all wrapped up into an exam. There is no, in my opinion, no difference in doing a fraud exam versus a regular exam.

MR. BARNETT: Other views?

MR. RAMTAHAL: Yeah, I, Anand Ramtahal. I would agree with Bill and while we do have a fraud element in our exam program, again it's going to be risk based driven. And so, what do we know about the broker dealer? In addition to the things that Bill mentioned, who is the public accountant? What is the quality of that accounting firm or individual that we know? How are customer statements generated? We've seen broker dealers where they're done manually.

They're generated on a Word document. What is the profile of the customers? What is the relationship of the senior members of the firm with those customers? There has to be red flags there before we choose to execute a fraud review during the course of our exam. And again, if we know the firm and know the firm well enough, we should be able to make those decisions if and when we do fraud reviews.

MR. BARNETT: Okay, thank you. Sam?

MR. TELZER: Sam Telzer. I think there may be a nuanced point that you may be getting to Gary, which is, when you look at the GAAS standards which is the audit standards the auditors follow, there are specific standards about the auditor responsibility relative to designing programs to detect fraud and there's a lot of expectation issues in the user community about what is the auditor role in detecting fraud.

One of the things I think the profession has tried to do, and I'm not talking about the DSROs or the SROs, more the independent auditors, is we've worked with forensic type auditors to try and improve our audit procedures. Because we think that that clarity, that additional step, actually improves the quality of the audit. There is probably some measure where others who do examinations of FCMs or broker dealers, to the extent they're not already using that type of skill, that might be something that can improve the audit process to really bake in fraud detection mechanisms, and really help the overall examination process.

MR. BARNETT: Thank you. Others want to --

MS. BAGAN: I have a question.

MR. BARNETT: Yep, Anne.

MS. BAGAN: So fraud audit seems to be the popular term right now that keeps getting thrown around. What specifically are we talking about there? What type of steps are we looking at? Is it just an internal control review? Or when you say, you look for fraud, what do you look for?

MR. JAMROZ: Actually, this is Mike Jamroz. I just want to supplement the question Anne is asking because fraud, the definition of fraud is actually very, very broad. And it could cover anything from just simple embezzlement to other things that don't really even touch the accounting financial control process.

So, I think, actually what would be good, would be to frame the discussion with respect to the types of fraud that you would like us to discuss. What kinds of fraud are we talking about here?

MR. BARNETT: I'm not sure I want to frame it.

MR. DE LEON: Hey, Gary?

MR. BARNETT: Yes?

MR. DE LEON: If I can jump in.

MR. BARNETT: Bill.

MR. DE LEON: You know, I guess, two things. One, we sort of take the view of trust but verify. And I know that that's sort of a basic concept, however, the question of verification, I think, becomes more difficult and needs to be more fleshed out, and, as Sam mentioned, sort of more real time independent information as opposed to relying on things.

Question of what auditors are used, and what standard of care is applied to them? Right? You don't want Bob, in his basement, being your auditor, so, who's the auditor -- how is that selected, what standard of care is there is another question in terms of that I think is relevant to giving a degree of confidence as well.

So, those are sort of the two things that we think about because, obviously, there's the process, there's the checking, but there's the fraud concept. And unfortunately, if someone really wants to spend a lot of effort doing fraud, they're going to get quite creative. So, you need

-- it's sort of a battle. So, I don't know if you can ever prevent it. However, you want to have as much in place, and enough standards of care, and sort of ways of thinking about things, that you're catching the obvious ones, or they're flags that are being caught.

And, you know, having an outside auditor come and look at the process, who's checking who that outside auditor is? What standard of care is there to make sure it's not Bob, in his basement?

MR. BARNETT: Dan.

MR. DRISCOLL: Dan Driscoll, NFA. I just wanted to basically expand on what several other panelists have said.

First of all, from NFA's perspective, we view it as our job to be looking for fraud when we do our examinations and other work. And in fact, over the years, we've uncovered dozens and dozens of frauds, some small, some big, and we'll continue to do that.

I do think that it's important to, you know, always be looking for ways to do things better. And as Howard mentioned that it would be good to give online view only access to regulators of seg. and secured amount bank accounts. I just wanted to say that next week, NFA has got a Board meeting where the Board will be considering just such a requirement, where every FCM would have to provide online view only access.

And that's really only the first step. Ultimately, what we're going to achieve is an automated system that would receive information daily from all of the seg. and secured amount account systems. Match it up to the seg. Information we get from firms every day and to give us alerts if there's any material differences between what the firms reported to their DSRO and what the banks confirm.

MR. BARNETT: What kind of variances are you talking about when you talk about material differences, given all this stuff about reconciliations and so on?

MR. DRISCOLL: Well certainly, there are going to be recon -- especially when you're talking about hundreds or maybe thousands of accounts. They're not all going to tie out penny for penny, so there will be reconciling items that would be normal. Frankly, we're still in the early planning stages of this, so I couldn't tell you what those parameters will be. But we'll reach out to the FCM community, to the Bank community to figure that out.

But that's our goal, which we hope to have in place sometime next calendar year.

MR. BARNETT: Okay. Eileen?

MS. FLAHERTY: Eileen Flaherty, Newedge. Again, going to Mike's point, fraud is a very broad term. But if we're narrowing that down to talk about is the money actually in the accounts or is it missing, what Dan has said, what Howard said, and what others have said, and I think will be discussed this afternoon, is this idea of reach or view only access to the bank accounts is something that, you know, is a very important and a good step. And while it will take some time to get the technology and to get all the feeds to the regulators, it's absolutely a good thing, and a necessary thing.

There are some regulatory authorities elsewhere that currently do this. So, it is possible. And I think NFA will have some challenges, as well as the other DSROs, will have some challenges because it's not just the bank accounts. You've got accounts at foreign brokers, and balances around the globe, but focusing on what NFA is doing as a first step would be a really good first step for the industry.

MR. BARNETT: Thank you. Yvonne, is -- others who have, you know, Steve, and you, and you guys have a -- go ahead, Mark.

MR. HOLLOWAY: I just wanted to add a thought here and we would think, too, that the access to information about bank accounts would be a big step forward. I'd just like to comment that, you know, we at Goldman Sachs have gone through a number of internal control reviews and very typically, by independent auditors and others, and very typically those reviews begin with a study of our transaction flows from the beginning of the system to the end of the system.

If you will, from trade entry all the way through the customers account and, as you would expect, the reviews include the auditors actually seeing the transaction flow each step of the way to the end. And, while I understand that those audits and reviews are not intended principally to capture fraud, I would think that they would make the commitment of fraud or particularly the hiding of funds much more difficult to do.

But again, these reviews typically begin with a complete flow chart, for want of a better word, of the processes, all of the processes that the FCM or the broker dealer relies upon, and then just test to see that all that really, really happens. And I would think, and I want to acknowledge that I have not tried to commit a fraud, but I would think that it would be -- that type of review would make it far more difficult to mask a transaction or to funnel money in another direction or whatever.

MR. BARNETT: Not just because you've laid out the flow, but because you've put in things around that flow. For instance, if you've two people to enter a swap, for instance, into the system, or call to their counterparty the next day to verify there's a live trade, or something like that, I mean there's --

MR. HOLLOWAY: Yeah, and that's all part of it, Gary. To see that the -- if we say that a transaction has to get from point A to point B, is step one the review would entail a review of that system and actually looking at records to see that indeed it went from A to B. And so on down the line, but yeah, but seeing that entails making sure that the personnel there, and there's a procedure to take it the next step and whatever.

MR. BARNETT: Great, thank you. John.

MR. HAGUE: If the question is whether or not there needs to be a special fraud audit, I would tend to disagree and suggest that that's not necessary. As Sam has talked about, the profession, the audit profession, has looked at that as a material risk of the statements, the financial statements, and, obviously, the loss of assets, and have responded accordingly.

I mean, we now have a focus on testing journal entries, identification and testing of related party transactions. Looking at the segregation of duties to make sure that the people in the front office aren't in the back office, so to speak. Making sure that there's monitoring controls in place. And there's a huge word out there called professional skepticism that the audit profession now has to entail.

And corroborative audit testing. We're not just relying on inquiry anymore. We're doing a lot more testing to make sure that what we hear and understand is actually in place. And I would assume, Anne, that that's in place in your testing of, and auditing of your participants.

MR. BARNETT: Thank you. Yvonne.

MS. DOWNS: Yvonne Downs, sorry, Jefferies. I think for me as I sit here and listen, I think I come at it from where the customers, who are the ones calling us and asking, that they want to be assured that what they see and hear at firms is true. And given the, my concern is given the complexity and the continuous complexity and additions in the business; I don't think we go back enough to the simple basics.

So, I call it back to basics. I mean, we all talk about trust but verify. I think that, yes there's lot of systems and automation, but I think we lose focus on all the different controls and procedures in a very complex an organization, and need to focus a little more on the central core pieces. Who's got the money? Where is it? Is it verified every day? And to me, I think that's what our clients are asking to know. And I think as we talk about this, we need to focus from that perspective.

MR. BARNETT: Thank you. Go ahead, Howard.

MR. ROTHMAN: Howard Rothman. One thing I'd like to add, and I think a lot of clients have a misconception in is that of firms like myself and Jefferies and others, we're members of the CME and therefore are part of their Clearing House and of other exchange Clearing Houses. And there's another party that comes to the table and that's known as the settlement bank. And that piece is not in the structure of your non-clearing FCMs. And I think it adds a more challenging layer for the NFA and Dan, because they don't have the ability of what a settlement bank can do.

And before you can belong to a Clearing House, you've got to get a bank to act in that fashion and they act in a role that they're providing you credit, even though technically they don't have to make a variance call or margin call. But they keep their eye on the financial condition, your liquidity, and various other factors and they're in contact with the Clearing Houses. And it may be something that I think it can be done. It would have to be thought out, but there is no reason that non-clearing FCMs can't be put under that role. They may clear at a certain

FCM and they could be set up with their own sub-clearing number. So they could have a midday margin call if necessary.

So, there's technology would allow for it, but I think what it also will do is it will bring, again, another protector or another set of eyes to the table, and that -- the last instance of what happened in this industry came from a non-clearing FCM and, obviously, fraud can happen anywhere. But I think that's something that the Commission should think about, just putting everybody on a level playing field where a settlement bank is required just to be in the FCM business.

MR. BARNETT: Thank you. One last question, then we'll take a break, okay?

The role of the CPA, the FCM's CPA. How much reliance should be placed on the review of the financials performed by the CPA? What qualification standards should exist for, this goes to your verification question I guess, or --

MR. DE LEON: Bob, the auditor.

MR. BARNETT: Yeah, Bob, the auditor. Yes, so, let me throw that out there. So, what do you think about the FCM's CPA? How much reliance should be placed on the review of the financials performed by the CPA, including the statement going to the controls that are in place?

MR. DE LEON: I apologize. I didn't mean to insult Bob. And this is Bill De Leon at PIMCO, and, Steve, obviously your organization does a lot of work on certifying firms and we rely at our firm on that. So, I think that there is a standard of care, but it's not uniform. And there's not certification in terms of what a firm needs to do. I think the big firms here have very high standards, but it's not clear that every FCM that hires an auditing firm is hiring an auditing firm that meets a certain standard.

I'm not an auditor, and I'm not an expert in that. However, I can tell you that there should be some standard that needs to be met to say that you've got an auditor to come in and do an audit of your books. Well, did that auditor meet some standard that people are comfortable with? That's, of course, no guarantee, but I think it is another control. So, I would defer to the experts on that one and to Anne as well.

MS. BAGAN: This is Anne Bagan. We definitely would support some type of standards for the CPA firms that our FCMs are using. However, I think it needs to be an industry standard so that there's no arbitrage going on. And I think we need to look at both big FCMs and small FCMs. We don't want to have it be so cost prohibitive that smaller firms have to use big CPA firms, but definitely we would support some type of standards, and would be willing to work with the industry on setting those.

MR. BARNETT: Other reactions?

MR. RICHARDS: Yeah, let me give the regulator caveat here. PCAOB doesn't currently, the brokers and dealers in the FCM world aren't subject, the auditors, are not subject to PCAOB registration. At the moment the current rule that we have is a temporary inspection program and it only relates to broker dealers registered with the SEC.

Having said that though, I think some of the things that we look at when we look at underlying firms just in the evaluation part of our inspection program, is we look at does the firm have the right skill set? Does it have the right complexity? What is the workload for the respective partners? Is it realistic to be able to do a GAAS, in the FCM world, a GAAS compliant audit given that workload? Do they have the right leverage? Do they have the right financial wherewithal to be able to service that particular issuer or in our temporary inspection program, the broker dealer?

So, those are different elements that we think about as we're looking and could be leveraged into a program with industry-wide under it for the FCMs.

MR. BARNETT: Thank you, Steve. Other thoughts? Okay, why don't we take a break? Let's take a ten minute break and then we'll come back at 10:46.

(Recess)

MR. BARNETT: Okay, we are going to restart. We're actually going to need Steve for the next question. Just like we're going to need Rich.

So, first question in this second part of our first panel is in an audit how do you assess the risk of a fraud? How do you integrate that?

MR. PICCOLI: So, looking at the risk profile of a firm, how do you determine, what are the key elements when you do your risk profile? What do you look for, and then how does that impact your audit program that you're going to execute?

MR. BARNETT: Rich, do you want to start first? Then I want to ask Steve as well.

MR. FLOWERS: I think you need to understand that the fraud triangle needs to be assessed in the firm, actually the transactions of the firm should be evaluated in that fraud triangle, that's saying that first is there an opportunity for fraud? Is there an incentive related to that opportunity? And is there rationale, rationalization of the transaction?

Oftentimes, frauds start out as minuscule, but they tend to grow as we tend to rationalize those transactions. We do not have a specific standard that says; well this is a requirement for the auditor to look at. But certainly under ordinary standards 316.505, I think the emphasis is on the amount of journal entry testing that would be examined relative to those transactions.

And to sort those transactions out, stratifying them by related party transactions, transactions in unusual or generally inactive accounts, transactions which made by their nature, not necessarily be the maximum amount or a large amount, but might be an aggregate amount that the similar type transactions that are rated together.

These translate into unusual items which require some investigation to satisfy that the transactions themselves are actually valid and appropriate. I think some of the other firms would want to chime in on what type of things that would go with, but certainly I think the extent of journal entry testing and the actual examination of that would, in general, assist in validating the existence or non-existence of fraud.

I don't know if Sam or John want to comment on that.

MR. TELZER: Sam Telzer. I think if you go to the guidance that Rich talks about which are the audit standards, we generally think of what are the conditions that can create a ripe opportunity for fraud to exist? So, if you just permit me, I'll just lay that out, because I think it's important to have a foundation in it.

Is, the guidance talks about there's an incentive because people are under pressure. So, you have to have an exigent event with the fact that somebody sees the opportunity for gain that they could do this. Then you have to have, if you will, ineffective or absent controls. We've talked a lot about that in the first half of the panel. And then the third step is that you ordinarily see a rationalization by the individual committing it.

Now, that can take a lot of different manifestations in that broad definition of fraud. You have to look at, can management override controls, because they really know, because they design controls, whether or not they can override them. They know where the weak spots are. So, how do you assess whether or not that weak spot is so weak that it's ineffective?

How do you look at the information that's needed to make that assessment as to whether or not there could be a fraud indicator? So, I just go back to what Rich said, is that it's a little judgmental in how you approach it. The reason for that, and I think a number of the other panelists have talked about this, is it really starts off with what is the company like? What is their culture? What is their style? Can they be viewed as reliable? Are they ethical? Do they promote this throughout the organization?

When you look at the ways things can occur, you start to step back and say, do employees have the ability to rationalize the fact they've been given an order, and they just march without thinking about it, versus do they have the ability to raise an issue and have it acted on?

So, I'm not commenting about any particular organization, it's more just there are risk factors that we all need to be thinking about. I think it's good whether it's the external auditor, the DSRO, the regulators, because these are all the prime indicators of when you could see fraud being manifested. And how those are chosen to be addressed is really a fact and circumstances individual entity level issue.

MR. BARNETT: That's very helpful. Thank you. Other thoughts on this point?

MR. PICCOLI: If I can just maybe, I'm sorry if there are any other thoughts, but I was thinking of just sending it over to Bill for one second. Put you on the spot, but just from a --

because I'm thinking yes, there's a risk profile that the auditors needs to do, but there's probably also a risk profile or due diligence that the users do. And maybe we need to combine those two in really looking at the firm from our perspective.

Are there things, in particular, from a user perspective, Bill, that you would look at a firm and doing your diligence or your risk assessment of that firm?

MR. DE LEON: We do several things, and as I say, I look at the world from a risk standpoint, less from a formal accounting standpoint, so, please bear in mind my expertise where, certainly, or lack thereof in some of these areas.

One of the things we do, and we consider sort of a concern, is to make sure that when we say we have money somewhere, that's it actually there. So, not only do we think about, at the top level, where is segregation money? How are they monitoring, how are they controlling it? We want to make sure that what we think an FCM has on behalf of our client is what they think they have. And we check that regularly because we're concerned to make sure that we're in agreement.

And, you know, going to the fraud or going to the control issue, we've found from experience that the sooner you identify an issue, the sooner it is to resolve it or to escalate it. And when you have an issue and it ages, it's much harder to figure out what happened, why, and you have to start digging through things, and the resolution is much longer. So, to the extent there is an issue which is malfeasance as opposed to just an accounting issue or something that is just clerical in nature, you don't know for a longer period of time.

So, given that we're talking about sort of the real time things, we try to do this daily. And that's one of our concerns in terms of that. And I also know that we ask, in terms of some of our FCMs and how we think of the world, what are they doing, what controls do they have in place, who's signed off on financials to say that they've checked that seg. is good on a given day? Because we want to make sure that someone at a senior level at that firm is owning it. Now it doesn't mean that they won't take the risk of going to jail, or take the risk of lying, however, it is an incentive. So, you want to have those things.

So, we think about it not only at the top level, what is the firm doing? What are their controls? Who's auditing them? But we want to audit or have controls in place for our accounts.

MS. BAGAN: So, Bill, how do you do that daily? How do you confirm it daily?

MR. DE LEON: We ask our FCMs to send us a tape every day for every account with collateral balances.

MR. BARNETT: Steve, could you weigh in on Rich and Sam's points on this fraud look.

MR. RICHARDS: Yes, so at the PCAOB, we are inspecting the audit firms who are doing the audits of issuers and on a temporary program, broker dealers. So, in and of itself, we're looking to see certain areas within those auditors and how they executed the work relative to the standard.

One of the things, though, I think would be helpful to the discussion, when we think about how we go about executing our work, is, how do we think about our selections and where to look? Because what we try to do is take many different disparate data sets, you know, internal information that the firms provide on how the partners do, external things, actions by other regulatory agencies about particular partner's office's events, and then try to marry it with underlying, in the issue program, issue information. And we try to bisect those two things to say, you know, there may be particular risks in a particular office of a particular firm. Are there heightened risks because of particular clients in that office?

And trying to bisect those two things and say, well here is where the greatest risk is, and where our inspection will provide the best benefit for investor protection in the issuer program. So, I think when we think about some of things that have been talked about here, there are a lot of different data sets out there. It's about getting them into a digestible format and leveraging out those risk factors that people have talked about. And say, where do I need to look? Because we're all dealing with finite resources. So, we want to maximize that ability to make that resource count.

MR. PICCOLI: Taking your thought, Rich, and moving it towards the accounting firms and how, when they go in and do their initial and their planning stage, how they evaluate and determine what's the risk profile of that firm? What are the key things you look for, look at to determine the risk profile and then, I assume that would then dictate what your auditing procedures are?

So, we can just sort of focus maybe more on the planning stage, and are the things we should be thinking about and planning an examination of an FCM that would be appropriate for us?

Sam, I'll pick on you. Thanks.

MR. TELZER: Thank you, Kevin. Sam Telzer, being picked on.

When planning is done you typically take a step back and assess what are the things that are subjective or judgmental? Because anything that is subjective or judgmental is inherently more risk prone. Once you look at that inherent risk, it then needs to be evaluated as to whether or not that inherent risk could be driving some element of fraud risk.

When you start parsing that down, it starts looking at, from a planning standpoint is, is there a risk of material misstatement of the financial statements, and by extension, if you're in a regulated entity like a broker dealer or futures dealer, whether or not those risks attach to any of the regulatory computations that carry on with that audit.

Then you take the next step in looking

at how you take all those risks and align them with the financial statement items and make a determination as to what level and type of testing needs to be done. Because that really drives the execution of the audit in terms of, are there controls? Are there reviews? Are things automated? Are they manual? Are there appropriate segregation responsibilities? Are there reconciliations? What's the quality of the judgments? What's the quality of the subjectivity to an item, and then you use that to really drive a lot of the other pieces of the actual execution of the audit program.

The GAAS standard pretty well lays that out in a very succinct way of what the auditor is required to do, and I've just tried to capture that to give the committee a sense of that in framing the discussion.

MR. BARNETT: Thank you. I want to move on to another question here, okay?

Very different question. Should the examination approach differ when you're examining a standalone FCM versus when you're dealing with a joint FCM BD? Is it different? Is it the same?

Bill?

MR. TIRRELL: Bill Tirrell. I think it's not only different, I would suggest to you that I think you would need to even dissect that further between the larger say bank holding company FCM BDs versus more middle of the road FCM BD, to a large say FCM, standalone FCM and a small FCM. And I say that because if you look at the larger firms, there is an army of regulators that are marching through that firm on a daily basis.

So, there is a tremendous amount of oversight at various levels by different regulatory bodies, and I think there should be some comfort in the fact that, with everybody looking at that entity, that the chances of having something go wrong are, obviously, extremely small at that point. Not that it can't happen, but obviously when you have a lot of folks focused on liquidity, focused on capital adequacies and so on at all different levels, the chances of having something material happen, I think are diminished.

When you get to the FCM BDs, obviously, their business profile and their clientele may be a lot different. So, for instance, in a standalone FCM may deal more with your ranchers and farmers and so on and traditional commodities, where an FCM BD may be dealing with clients that are more into financial futures or a mixed bag. And so, therefore, their risk profile, their interaction with other regulations from the SEC standpoint, and so on, I think becomes another heightened level of complexity that also would require better coordination across with FINRA and the SEC and so on, in order to ensure that you're covering the full gamut of risk within that entity.

And the same thing, again I think you start looking at it from a liquidity standpoint, what's their lines, what's their durations of their lines and so on, in order to test how much liquidity is actually at their disposal. And the same thing, again as I mentioned with the FCM, as you go from a large FCM down to a small FCM, your client base, the amount of diversity in products and clients, complexity of the organization, the ability to have credit lines and so on, I think is different.

So, therefore, when you look at that structure, I think it's very important to profile in such a way that you are measuring all these different aspects because they are very different in many ways and very unique. And in that structure, I think it also would allow you to cater to the exam in a much different approach as well. Because I think in that scenario, you would need to have an audit scope and an examination sophistication to match the entity in order to get assurances that you're covering the risk and understanding the dynamics of the firm and the potential for weaknesses and impact on the overall marketplace.

MR. BARNETT: Bill, taking a step beyond that statement, then, or applying it, then, should an SRO examine the other parts of the business that are other than the futures side? So, for instance, do they need to look at the securities side in order to understand the risks of that business?

MR. TIRRELL: I think there needs to be a lot more coordination between the securities and the commodities side of the business. They're very much interrelated in the business and in the products. To look at it as us and them, I think, is a completely wrong approach. It should be, it's we and to the extent that there is that sharing of knowledge, Anand talked about the interaction with the broker dealer to get that sense and so on. Well that should be on both ends of the spectrum, if you will, as far as the regulators. So that when you look at that in totality the risk profile should be consistent. It shouldn't that Anand feels that they have a great team over there and everything is fine, and Anne looks and says, you know we've got to really spend a lot of time here because these guys don't know what the hell they're doing.

So, if you don't have that interaction, if you don't have that coordination, I think you're doing yourselves a disservice.

MR. PICCOLI: So, it's a good point. It's coordination, not reliance. So, it's not relying on FINRA to take care of the security side. We've got to coordinate the approach and compare notes.

MR. TIRRELL: I would say it is reliance, too, because as you interact and you look at your audit scopes and you look at what the firms are concerned about, that will give you a comfort level. And if you're not comfortable, then I think you should raise that also up from a coordination standpoint. But you should be approaching this with some commonality that allows you to have that comfort level that says, yes we are doing a complete exam here, and we feel that we've covered things jointly.

MR. BARNETT: But to do that, then you have to -- you're right there -- but to do that you have to understand each other's world, I guess, in order to be able to have sufficient communication, right?

MR. TIRRELL: And what I am suggesting to you is that your worlds are already intertwined, so, yes, you need to have that.

MR. BARNETT: Mike?

MR. JAMROZ: I am going to supplement what Bill is saying by also suggesting, this goes beyond just a risk analysis versus profile to some degree, it touches upon your use of your own resources and where you should devote them. And also, you've got questions in here on training. I think it touches on that as well. And let me mention that because, first of all, I would not suggest that you necessarily, although you could, coordinate the actual exams themselves.

But what you absolutely should do is coordinate your supervision of the firms. In other words, for example, I know FINRA makes a lot of effort to have an ongoing dialogue with the firm throughout the year, not just at the time they do the exams. The bank examiners, in some of the large banks, have their people there all year round. So, in all of the planning stages, and when you start thinking about what are you going to do at a firm and what the culture of the firm is like. What kind of controls are like, because keep in mind, although you might be the only, you and of course your SROs, the only folks looking at the particular seg. aspect of the exam, a lot of what you do comes from the basic financial controls, the balance sheet accounts, and there's immense commonality amongst what people are looking at in those areas.

To the extent you can coordinate with FINRA, perhaps the SEC of bank examiners about what they think of the firm, what they think about the controls, kinds of things that they've already done about areas which you're going to cover that they've already covered. I think that would be good. You should also note that in the international banking community this type of discussion is very common for the SEC, the Fed and the others to meet with the foreign prudential regulators, and to discuss particular firms in terms of how they're structured, and how they risk manage their business.

MR. BARNETT: Bill?

MR. DE LEON: You know, this is obviously a complex question, and there are a lot of interlinkings between different entities at firms. I think one thing, though, that should not be lost is that regardless of whether or not an FCM is a standalone and that's the only business it does, whether it's part of a BD, or whether it's part of a BD that's part of a large bank, ultimately one of the concerns or basic bedrocks is that that FCM is walled off to a high degree and there are the appropriate controls and capital there. Such that, in the case of an unfortunate event, there is nothing leaving the box that shouldn't be, or there's no raiding. And that's one of the basic things and we saw that during Lehman where that worked very, very well in the US, where the BD itself didn't get to pull assets out.

However, when you left the US, there was a lot more confusion about where assets were and things were going on. So, I would stress that no matter what structure you come up with, I would definitely agree coordination is an important thing, and I'm not discounting that. However, the view of the FCM should be that there is a high degree of control and that a more complex FCM based on its parent in its organization needs to have controls in place to make sure that nothing is leaving that shouldn't be, and things are seg.ed correctly. Because we've seen issues with that recently, and you know, that's one of our concerns in terms of whatever structure you come up with, is that the FCM is viewed as a box.

MR. BARNETT: Okay thank you. Anne?

MS. BAGAN: I don't think any of these ideas are actually new ideas. There's always been a lot of coordination between the securities side and the futures side. Since MF Global, FINRA, and CME have had more routine communications and discussions of our firms, which has been beneficial I've heard from both sides, with the relationship managers for the particular firm, the FINRA people are learning more about the futures side. The CME people are learning more about the securities side.

I would want to avoid duplication of efforts. I think that each side does have its experts that should focus on their particular industry, but obviously, there needs to be a lot of discussion about the firm overall. And CFTC does that with the SEC, you share the information with us, we get on the phone with FINRA. So, I think there is a lot of coordination that goes on.

And as far as if it's FCM only versus combo firm, from a seg. perspective, what we're looking at is exactly the same in either kind of firm. It just becomes a matter of how much of the firm's other businesses do you take into account.

MR. BARNETT: Okay, Ron?

MR. FILLER: Okay, just to echo what people are saying. I think we are all somewhat in agreement, but I think it's also you need to break down the question because under joint BD FCM the financials are identical. It's the same legal entity, and whatever the financials are from whether it's the BD or FCM, it's the same, traditionally; it's the same legal entity. Most of your larger firms are jointly registered. So, you have to look at it and break down the financial aspect of it.

And then the other part of the examination, as Anne and others have talked about, there's another part beyond the financials, and that's the sales practices and other things. When I was at Lehman, I had no clue what the securities area was doing, and they had no clue what the futures area was doing. So, I mean, you've got to be careful, you have two separate cultures, two separate divisions.

So, from a sales practice point of view, I think it's kind of hard to coordinate those types of things between the NFA and the CME on the futures side versus FINRA on the broker dealer side. Because it's two separate distinct, at the larger firms, when you get, obviously, when you go to the smaller firms, even if they're jointly BD FCMs, you might not have that as much. But, and the second part of it is, on the futures side, and it's not part of the broker dealer is, obviously, the flavor of the day is segregation and that's strictly a futures component. And so, I think you need to, on that part of the examination, defer to CME, NFA and so forth who are doing the seg. type audits, because they have, by far, the clearer expertise.

MR. BARNETT: Yvonne.

MS. DOWNS: I would just tell you I think since I've been both at a BD FCM and a regulator of such, I would tell you I don't think the level of knowledge, I think the level of knowledge needs to be enhanced on both sides.

I don't think if you walk around a firm and you talk to all the different divisions in a firm, there isn't the in-depth knowledge of the differences between them as people perceive on the outside. And then I think that's true inside the houses and I think that's true of the regulators as well. So, I do think there's a lot of education that still needs to happen.

I think you have lock up one side, you have seg. on the other. Those nuances and the differences between the two are key, in that, I'm not sure both sides understand it as well as people perceive.

MR. BARNETT: Thank you.

MR. HOLLOWAY: Gary?

MR. BARNETT: Mark?

MR. HOLLOWAY: People are talking about coordination and that's, I think, unarguable. I might think that coordination could enhance perspectives on two topics in particular. Two topics that have a lot to do with how well a firm is run and how secure the firm is.

And the two topics would be technology and funding. We are all driven, to say the obvious, by technology, and I think that taking a broad look across the entity from a control point of view through the lens of technology is particularly important. And again, to say the obvious, funding and liquidity are the lifeblood irrespective of all the rules and compliance and so on and so forth. And funding and liquidity are absolutely the lifeblood, and I think a more coordinated approach would allow a more complete picture.

I will say that the folks from FINRA do visit us and talk through those subjects as well as in other subjects, but I think those two topics I think of are absolutely critical importance in evaluating the firm.

MR. BARNETT: I'll come back to that in a second. Was -- Anand?

MS. DOWNS: Can I just add one point? I think it's also P&L trends. So, it's not just funding, but P&L trends across the companies.

MR. BARNETT: Okay. Anand?

MR. RAMTAHAL: So, yes. Just to comment a bit on coordination and that has improved significantly over the last several years throughout the credit crisis. I think there came a realization that none of us has unlimited resources and we have to leverage off of each other and understand what risks -- And from my perspective, regardless of if it's the same legal entity that's the FCM broker dealer, or a separate legal entity that's within the same franchise.

And so, we sit and talk about what are the risks, and what are the interrelated risks? Does the FCM business drain liquidity from the broker dealer or vice versa? What's the kind of business? Is it a proprietary trading business? Is it a customer facilitation business? Is it an agency execution only business?

When we talk through the issues and understand the risks for both sides of the business, that's where we're able to execute and execute efficiently. One of the things we've done at FINRA, at least in the risk oversight group, is we've done what's called householding. So, to the extent, there are five FINRA broker dealers. All of those broker dealers are housed with the same coordinator. That coordinator must understand the risks that are brought into, let's call it the primary broker dealer, from interrelated transactions, maybe funding and liquid movement of resources between those entities. Are there intercompany transactions that cause the risk profile of one entity to be higher than the other?

What is the business model of broker dealer A versus C? So, we want to ensure that we understand the risks of the entire franchise and not just the clearing broker because we handle, primarily, clearing brokers. There could be four other introducing brokers.

One of the other things we've done is that we've increased, in a significant way, our dialogue with not just domestic but foreign regulators. Because we understand that the London based broker dealer can bring down the franchise. And so, we talked to our colleagues at the UK FSA and, quite frankly, a lot of other foreign regulators, IRA, Bundesbank, and so on, so that we understand what's going on in the franchise as a whole, not just domestically, but internationally as well.

MR. BARNETT: Great. Okay, so I am going to reframe a piece of what everybody -- so, we heard lock up versus seg. and funding and liquidity and understanding the risk. I want to throw into the foreign SEC and futures, a piece of what's the risk. I want to talk about what about the non-regulated activity and affiliates? I want to roll that into the conversation.

So, how do you take those into account? If I have prop trading in the FCM, I could have it at an affiliate that is almost standalone FCM, separated from some heavy financing that's going on at a parent, or the prop trading's at the parent, or something of that sort. To what extent do you look at that package of risk?

Bill.

MR. TIRRELL: I think you have to keep in mind the fact that we are servicing clients. And those clients have many needs, and we cross sell across many of the entities by product and such. So, in today's world, although tomorrow it will be different, you do have clients that are looking for protections and dealing in swaps and so on, and going to non-regulated entities. And there is that inter-relationship across all the various entities within an organization, that you need, then, to evaluate the risk associated with that client, regardless of the legal entity, as well as look at it from a legal entity standpoint.

So, again, I think the risk management of the organization, their ability to look at that risk holistically, as well as isolate that risk, I think is critical. And picking up on what Anand and some others have been saying also, I think in looking at the organization kind of holistically across these different jurisdictions, I think is critical, because you may not have a complete view that you think you have. And, therefore, sharing in the information across, I think, is critical. Especially with the large players and the large clients, the ones that have the potential to cause harm, not only to a particular organization but to the industry itself.

But, I think you're also need to understand that from a back office standpoint, a lot of this is interrelated as well, okay? Because we talk about lock up versus secured. The collateral that's moving between is usually using the security side back office in order to do segregation as part of your daily lock up. So, to think of those as being different, I think is a mistake.

Financing that you're providing the clients across their products, across the different organization, is a lot of times interrelated and it goes through a lot of times the security side of the broker dealer, through your repos and so on. So, to think that they're not interrelated; I think is also selling yourself short to a certain extent.

MR. BARNETT: Thank you. Others? Okay.

MR. FLOWERS: I think that it's important --

MR. BARNETT: Go ahead.

MR. FLOWERS: We're assessing the risk

in the totality of the entity. As Bill was saying that you can't just look at the broker dealer side, there may be a lot of other non-regulated entities that also provide the funding that is part of the transaction. I think that looking at them on an independent basis, I think, is an error. I think that you really need to assess it on a group basis and see the overall effect on the financial statements. Because it's not just that putting it in the box for the customer seg. in the box and you're done, no, you've got the whole firm, the financials for the whole firm to be evaluated.

And I think that the assessment at that level is critical for the overall evaluation, and it very much ties back to the fraud triangle if we stated that the rationalization level, we've got that for this particular FCM, I think of that versus the other transactions that the firm has.

MR. BARNETT: Thank you. Anyone else? I want to move to another question. Okay. Alright so, we're talking, we'll move to the second part of the discussion, but right now we've been talking about SRO examination of members. I want to get your thoughts on the standards and procedures that you might think of having in place as part of a programmatic examination program.

For instance, how do we assure that the program is and remains effective? Let's start there I guess. How can we help assure that programs are and remain effective? For instance, currently and then maybe on an ongoing basis, that it stays up with the changes that are going on in the accounting world. Thoughts?

Bill?

MR. TIRRELL: Sorry, I keep going first here. As I mentioned at the opening, we have a common cause here to make sure that the industry is good for our clients, and that we're protecting the clients' assets, and creating a trust factor that allows us to grow this industry. So, I think there's also a great deal of expertise within the industry and some of the organizations, industry organizations, that can be leveraged for that knowledge and expertise in order to remain current with products, with different relationships, and so on.

And, I would encourage the regulators to engage those organizations in order to have that knowledge sharing that would enable to keep the examinations current, up to speed with technology, because I think there's a, I would estimate almost a five year gap between public and private, if you will. So, I think there are a lot of things that can be learned from the industry because at the end of the day, we want to keep this industry safe for the clients. We want to build this on, from a reputational standpoint. We can't afford to have any of these black marks that drive out clients into other regimes and so on.

So, I would encourage you to tap into a lot of this expertise that's out there across the accounting firms, as well as just the organizations themselves.

MR. BARNETT: Sam, do you have thoughts in this area?

MR. TELZER: I think Bill's made a lot of very good points on the expertise because one of the issues, I think, was brought up earlier is there is a cost to all of this versus the benefit that comes out of it.

When you look at the fact that there's a client based trust given to the industry, the client's giving the FCM or the broker dealer cash, they should have an expectation that cash will be under the proper care of that regulated entity. So, the question then becomes, how do you make sure regulation, whether it be through the core regulator, the SRO, the independent auditor, doesn't come at such a high cost that it becomes cost prohibitive to give that level of assurance?

Where the technology stands now, I can't comment on what Bill said, whether it's five years or a different gap, but there's certainly a role here where looking at how the examination is done, the frequency of the examination, the background and competency of the examiner, I think, is all part of that mix, because in order to be effective you need to understand the organization, understand what they're doing, understand how they accomplish the procedures within that organization. That will then lend itself to a higher level of confidence. Because without that level of confidence, clients will not bring the money in, and the markets will start to suffer.

MR. BARNETT: Steve, could you give some thoughts, express some thoughts about how to assure the program remains effective?

MR. RICHARDS: Well, what we do at the Board, and again, we don't have any regulatory authority of the auditors of the FCMs, is we have -- it's about a process. And it's about having a process at the highest level to evaluate evolution in who your constituent is.

So, we have a process both in our inspection division and our risk analysis division by which, we want to make sure we're staying up to date on both the technology aspect, and also how is that technology affecting how the audit is done. So, our examination programs can constantly be updated to make sure that we are looking at what is most valuable.

And as technology has made the world a flatter place, not only looking at the particular firm, but what are its impacts because a lot of the work is overseas now. When I say that, so any US multinational, there's a US audit firm, but a lot of the work is being done by its affiliates. Well, not looking at those independently, but looking at those top down, and saying, for this particular client what's it look like across the organization, across the globe? So, that's an example when I say the evolution.

You know, I think when we first got started a decade ago, it was let's get this up and running and look at these individually. But as we've gotten more sophisticated in our ability to identify risk and look at things, I think you have to have that process to pick up that knowledge and incorporate it into your inspection or, in this case, examination programs. So, I think you have to have processes at the right level to drive accountability.

MR. RAMTAHAL: So, so, Anand Ramtahal, from FINRA. We're presently in the midst of a multi-year program change which is called our risk platform redesign, for exactly the reason that you asked the question. And so, what, effectively what we're doing here is bringing all of the relevant data and information from various sources on to a single platform, so, that the staff can effectively prioritize the risk. It gives them more timely information, electronic information and structured data. It pulls in information that, for example, our office of risk collects and analyzes and brings right on to the platform.

So, we're looking to support a more dynamic risk based regulatory program that focuses on the right areas and to ensure that our program is current, it's relevant, it's assessing and addressing the risks based on the market environment, the profile of the firm, it's regulatory history, and input of data from various independent sources as well.

MR. BARNETT: Off again. We'll get to you in a second. Others over here while we're waiting for this side to -- Mike.

MR. JAMROZ: Mike Jamroz. I'm just going to supplement what Bill said by first saying, that while I was at the SEC, we did with some frequency actually go to the firms, for example, if we were trying to determine what capital charges should be for whatever the product is, perhaps new products, we would visit the firms. I don't know that I would call it training, but it would spend full day sessions learning about how the products trade. I can't say that I was competent enough to become a trader but I certainly learned a lot more about it than I did going into those sessions.

The other thing I was going to mention is I know, and I'm not just speaking for my firm, I'm sure the other accounting firms have done the same thing, is provided training to FINRA or the SEC examiners, in some cases with respect to some of the industry topics, but more frequently training with respect to how just to audit basic blocking and tackling and audit procedures. How audit work papers should be used, reviewed, supervised, things like that, and I don't know if that's something you've considered or done but it's something I'm sure the firms would provide.

MR. PICCOLI: So, Mike, you're sort of relaying to maybe some type of quality control program and helping to establish that? Is that what you're getting at?

MR. JAMROZ: No, I think it's really kind of a supplement to Bill's point of the taking advantage of the training that's available, both, not only at the industry firms, but the accounting firms as well.

MR. BARNETT: Are we live over there?

MR. FILLER: I think Steve raised a very important point and needs to be discussed or reviewed by the Commission, and that is the world we have, especially for the larger firms, is a global one. And as Bill mentioned earlier, to me one of the most valuable lessons we learned from

Lehman is that the system worked fairly well here in the US, but when outside the US, especially with respect to customer protection, the assets, they're still being tied up for almost four years later.

And I know we're not supposed to talk about the merits of MF Global or Peregrine but those were domestic issues, but even MF Global has part of its issues is this what 800 million dollars that's sitting in London and so forth. So, I think it's part of the examination process, are we focusing or should be only focusing on what takes place here in the US, from that perspective, but even with respect to the globalization part of it, our US persons are trading all over the world.

And whether or not the examinations should be expanded or not to cover that type of trading and where the monies is sitting and so forth, should also be addressed.

MR. BARNETT: Dan.

MR. DRISCOLL: Dan Driscoll, NFA. And maybe this is self-evident but I think that each sort of stake holder in the process, so that would be the industry SROs, public accounting industry, and government regulators, we all have to realize that the business and technology and everything else is continually evolving.

So, I don't think what any of us ever want to do is try to come up with some magic bullet, that if we just do this it'll make everything go away, and then we can be on cruise control. I think all of us have to have reflective sort of self-examination of saying, what is it that keeps us from sleeping well at night? Is there anything we're missing here? And you have to guard against the fact of saying, well we're only looking at this every three years, it's really something that we have to do each and every day. And it might seem self-evident, but I think we all have to make ourselves do that.

MR. BARNETT: Bill.

MR. DE LEON: Bill De Leon, PIMCO. And I would just, going back to what Ron brought up, and what I had mentioned earlier, when I was talking about the fact that there should be a box for each FCM, is not referring to the fact that we should not be thinking about the global entity and all the inner linkages. I was accentuating the fact, though, that because of those, the box needs to be tighter, and more structured such that for more complex, or less complex, you still know what's where.

So, that's going back to the point about Lehman, is, and when you look at any FCM, that you know what's in it, where it is, and that it's controlled whether it be a single standalone FCM, or a multinational part of a BD, part of a bank. You need to know, well where are the client assets? How are they controlled? And if something happens, outside of that FCM, because it's the broker dealer, it's the bank; it's a non US part of the bank, what happens and what are those inner linkages? That may be too complex no matter how much coordination there is. Both here in the US and with global regulators, you need to make sure that you understand what's going on in the FCM, and the protection there and the controls there.

I just want to say that I'm not discounting the importance of the other things. I just want to stress that ultimately you need to know what is going on in the FCM and the right controls, so that things don't magically leave.

MR. BARNETT: Okay, thank you. Others? Okay. So, let me go back to the complexity issue, I guess. And also the risk or control emphasis that's been, although balanced, but going back to what we've heard throughout the discussion. You know, our rules require that we're on a -- looking at every FCM on a nine to fifteen month cycle, right? But every nine to fifteen months, every one of them has to be looked at. And trying to dovetail that with a more risk based examination approach, is that how, when you look at entities on a risk basis, that you think it's conceivable that we would look at them every year and every nine to fifteen months we'd look at every one of 115 or 16 FCMs that we have?

What is your reaction to that?

MS. BAGAN: Gary.

MR. BARNETT: Anne?

MS. BAGAN: Anne Bagan, CME. As I mentioned earlier, the regulatory audit function is part of our Clearing House. So, I think it's critical for us to keep on that schedule as far as part of our risk management processes.

That being said, our audits are getting a lot more complicated and are taking a lot more time. We're seeing that we have five months to do an audit, and we're seeing more and more firms that are going to that five month date just because of the complexity of all the issues that are coming up, regulatory changes, that kind of thing. But I still would advocate for the nine to fifteen month period. I wouldn't want to go to the three year period.

MR. BARNETT: Dan?

MR. DRISCOLL: Dan Driscoll, and I would wholeheartedly agree with Anne. I think, at this point, I wouldn't want to go visit FCMs less frequently than we do now. I think one thing in both the CME and NFA have been talking about this is, is the idea of you don't have to do a complete audit with every module every time you go visit a firm.

So, as a complementary thing to the yearly full audit, periodic, unannounced spot checks can be very helpful too. And you're not going to go in and look at everything every time you do that, but it keeps everybody on their toes. It helps ensure that you got more recent information. But I think, that at this point, that I wouldn't be in favor of going to something where it might be every two or three years before we would actually do an examination at an FCM.

MR. BARNETT: When you talk about spot checks, are we talking about spot checks and account balances, or spot check seg. in the middle of the month, that sort of thing? Are we talking about other kinds of elements as well, and in my mind I'm thinking about, again, the risk profile of a firm. Would that weigh in on what you look for, or what are you thinking?

MR. DRISCOLL: Sure. It would weigh in, and I think we really do already go through a risk evaluation process to determine scopes and what areas we'll concentrate on. And obviously, today, when we're talking about risks, we're talking more about financial segregation, secured amount type of risk, but there's other risk as well.

There's sales practice risk, there could be trading risk, and I think that when you go do these spot checks, I think that you might look at something different each time you go in. But you would take into consideration the risk profile in doing that.

MS. BAGAN: Anne Bagan. I just want to add that the audit process is only one component of the whole risk package. We have an entire risk department within our Clearing House that is monitoring the firms on a daily basis for their trading activities. And that goes into helping us determine when we need to go into a firm more often.

So, that type of review is being done. But I agree with Dan that our spot checks would focus on customer funds.

MR. BARNETT: Yvonne?

MS. DOWNS: Well I just heard something that surprised me, and that is that we think we have to spot check sales practice. I don't agree with that. I think we have to focus on the core, that the assets are there, and that the capital is there. I think spot checking or doing random audits of sales practice is not the focus for protecting our customers. I think our customers want to know where their assets are.

MR. DRISCOLL: So, I don't want this to be point, counter point here between the two of us. But you know, and NFA is in a slightly different perspective than the CME here because we have 3500 members, some of them don't even hold customer funds but might pose significant risk to the public.

So, that's what I'm talking about here. I think that certainly with regard to FCMs holding customer funds, I think the emphasis would be on looking at seg.

MR. BARNETT: Howard?

MR. ROTHMAN: I won't get into their argument, but I will say this. That, and I think it's the same for the regulator that comes in once a year, or the firm, there's a certain level of fatigue that sets in on an audit if it's long and drawn out and such. And I think that, obviously, we've all experienced long ones. We've all experienced short ones. But, the short audits, maybe they're pinpointed; maybe they're just on a topic of segregation for a day or two. It seems like there is pivoted attention from the firm and from the auditors to deal with that matter and get it to a closure.

And I just think there's more utility on, not that I want to advocate or go on record that I want more audits, but I think that if you could possibly take the annual audit and maybe tone it down in size, but substitute other smaller audits, I think firms and regulator would, I think they would get better results totally. It's just, that there is a lack, I guess, a problem with long audits of after a certain point there's diminishing returns for everybody.

MR. BARNETT: Bill.

MR. TIRRELL: I would kind of lean towards supporting an audit on a regular basis as well. Not because I like the pain and suffering but, more so because, I think it, again, from the firm's perspective, confirms the processes and control aspects and so on. And there is turnover in the firms. And I think it's important to recognize that even the best of shops, as they have experienced turnover, may have some shortfalls and shortcomings. And it's a good way of checking that.

I would also, though, comment on the fact that any exam that takes five months is almost irrelevant by the time it's done. Let's look at all the things that are taking place, all the added transparency, the move towards automation of doing daily comparisons and so on.

That greatly should diminish the amount of time that we would spend on an audit. If we want to do spot checks and send a SWAT team in there, that SWAT team should be very experienced as far as the technology that the firm uses, what they want to focus in on, get in, review it, and then get out and move on.

We keep talking there's limited resources across all the organizations, across all the regulators, to have teams of auditors spending five months at an organization, I think, is, by the time you get done with that, not only is it exhausting for the firm, and use a lot of resources, but you're now doing a history lesson of things that are already changed, not only within the firm, but also within the industry.

So, you know, I think that we need to be a little bit smarter about how we do it. Again, I'll go back to my example before, not using swift messages to get balances yesterday or last month end, or whatever else, but to ask for hard copy documents, bank statements, and going through and doing 50 of them, that's going to take weeks and weeks of time, is that really a good use of resources? Is that something that we want to encourage and continue?

I just think that you're taking away from the audit itself when you're tying down the firms, and the way the firms view that, both from the business side, especially when they just see this is a, are you kidding me? This is what they want? And then, from a resource standpoint, we have to go back and draw things out of warehouses now, or the systems no longer have that available, and to pull that information, because now it's the final review, it's the four and a half month and they're trying to close out. And now they want to go back and ask a question about something that happened six months ago.

What I think, there's a balancing act that needs to take place here.

MR. BARNETT: Right, and understanding the principles, I guess, under the balancing, I mean, if they're all short term spot checks that wouldn't work either right? So, how do we consider for?

MR. TIRRELL: Again, this goes back, we talked about culture; we talked about the competency of the processes, the controls, the procedures, the individuals and so on. So, as you develop a profile of the firm, what have we looked at, and where do we feel that was comfortable? Are they into new businesses? Was there turnover in particular areas?

So, this is where you send your SWAT team in to take a look at those things based on what is relevant to that firm from risk standpoint, what's changed, and what have I not looked at before, and so on. And I would even suggest to you that part of this is almost looking at what I mentioned earlier as far as best practice. I look at examiners coming in thinking that they've spent most of their careers looking at other firms, getting a lot of experience in the way firms do things.

I'd like to know where I am on that

spectrum. Am I good? Bad? In the middle? Cause I can tell you from a peer pressure, our firm would like to know and I think most firms would like to know if you're on that scale of one to ten, you're a three; you want to improve your processes because your clients are going to expect more. And from a competitive standpoint, the firm that's on top of that, providing the best protection to the clients, have a better chance of winning over those clients and continuing that relationship.

So, I want to know where I am in that. And some of the things the SEC is doing with their inspection team, where it's not an exam; you don't have that stigma of a finding of someone, makes it very easy for firms to make changes to their processes, because, again, we're trying to do the right thing. Ninety-nine percent of us are trying to do the right thing.

So, if you go in with the attitude that we're all trying to do the right thing, we're going to find that one percent and hopefully, collectively, we can squash that before it becomes an issue. But we're all trying to do the right thing and we want to be the best. I want a gold medal, all right? And I want to be the best at what we do, because that helps my clients, and that helps my front office attract business.

So to that extent, yes, I can work with the examiners, but it's not a one-way street.

MR. PICCOLI: So, Bill, you're almost suggesting the report that comes out from the exam, perhaps maybe there's a scale, you know. Okay, here's best practice. Here's where you come out with respect to best practice, and that may be a helpful tool that you can then take to your management. Maybe you need more compliance people. Well, here's where we are on the scale; we're four best practices of ten, we really need to beef up this area.

MR. TIRRELL: Absolutely, and I would suggest to you as we look at some of the core competencies that we talked about, the blocking and tackling, the separation of duties, supervision, so on and so forth, that that becomes part of that, you know. Although somewhat subjective, I understand that. We have to work through some of that. But, yes, to look at that overall and say, you know, from a one to ten, this is where your firm is. And I would say, you know, that also would drive, say, some of your findings. If you're a two, as part of your separation of duties, for instance, well, maybe that should be an exam finding.

MR. PICCOLI: Right.

MR. TIRRELL: If you're a four, maybe your recommendation to do something, but at that level I think it drives some of the reaction from the exam itself so that it helps you, you know, gauge where you need to do things so that, again, I want to be a ten all the time.

MR. PICCOLI: Yeah. So, it's almost changing the way the reports -- right now the reports are very much finding oriented. Where here is the finding issue involved, how did you rectify that? And modifying that to more of okay, here is the root cause, or here's what the, you know, underlying issue is. Here's where you folks stand versus the industry, versus best practices in trying to make it more of a, I don't want to say a conversational type report, but more of a, you know, here's where you stand. Here are the issues. Here's the core control concerns that need to be focused on, and here's where you stand versus others.

MR. TIRRELL: Absolutely. Again, I think that adds a lot more value than -- I mean, two years ago I spent countless hours arguing about a couple of thousand dollars because we didn't tie out to something. It's like, come on guys. We've got about a billion dollars of excess in secured, and you're arguing with me countless hours now, demanding documentations for a couple of thousand dollars. So that's what, to me, diminishes the whole exam process; when you get into that stuff and there's nothing that the firm is taking away other than the fact that you look at this as a burden more then a help.

MR. BARNETT: Thank you. Anyone else? I want to go back to the -- oh, go ahead.

MR. RAMTAHAL: Yeah, so going to our exam -- and I'm Anand Ramtahal from FINRA, going through our exam program. We look at every broker-dealer that holds customer assets every year, and it's not likely that that cycle will change, at least for those types of broker-dealers. But a big part of what we do -- so, it doesn't necessarily mean if you understand the risks at a given broker-dealer that a very detailed review of the reserve formula computation may be necessary because we understand what the firm's proficiency is when it comes to the customer protection rule. And its wire surveillance protection and the relationships we build with firms are so very important.

So, the coordinators are responsible for understanding the firm's business model, for understanding the financial statements, the balance sheet, the revenue drivers, for being up to date with any changes in the firm's business model, and what's going on in the marketplace that might be impacting the firm. What are we hearing from other regulators? What are we hearing from the firms when we meet with them? Many of our firms, we meet with them every quarter, some of them less frequently. What do we know about turnover, to Bill's point? What do we know about the quality of the management? What are their loss trends? And sometimes we put firms on alert-reporting, and what does that trigger? We monitor them more frequently. We ask for weekly-capital computation or reserve-formula computations. But we take all of those things into consideration in scoping the exam, and maintaining the relationship not just throughout the year, but when you're onsite conducting an examination, we don't want to be at a firm one day more than we'd like to be there.

So, it's very important on the relationship side with regards to letting firms know how they did. I make it a point of telling the staff, look, we may not put it in an exam report, but you have a responsibility. We're not only there to tell firms that they don't understand the implications of a certain product on net capital if they started trading this product. But we're there to tell them when they've got a good system, process, and quality staff in place, and they should hear that. It's a big part of what we do is about relationship, and when we build productive relationships, we get all of the cooperation that we expect from our member firms. We get a free flow of information from them.

The other thing is to supplement what we do and make it more efficient is we've been engaged in collecting data independently from our firms. And so, for example right now we have what's -- and it started several years -- what we call our automated exam program. And what we do, we go out to clearing firms. Right now there are about 58 of them participating voluntarily. Mind you, we do have rules that we can demand the information -- volunteering, 58 firms onboard and another 12 or 15 or so that will come onboard onto this platform this year. We get a lot of information and, you know, customer margin debits, customer trial balance, their allocation system for the reserve formula, inventory positions, stock borrow, stock loan, reverse refill. We use that information internally to determine risk and to design to scope of our program. The other thing we do is we get data on firm positions independently from the DTCC, and we compare that to what we get from the firms. It's a significant way for us to approach analyzing a firm and determining risk and scoping our exams, and that really helps to build, ultimately, you know, the productive relationship we seek to have with our firms.

The other things we do. I mean, we have the ability to go in and do, if we identify an issue, or if we think there's an industry-wide issue, we could do a cause exam. We could go and do sweep examinations. At times, we've done thematic examinations. So, our colleagues on the sales- practice side do a lot of these same very things. So, you know, it helps to know the firm to understand the risks, to use data smartly, to get independent data through comparisons and scope the exam, and ultimately that builds the good productive examination program and working relationship with our members.

MS. FLAHERTY: Eileen Flaherty. And that sounds really good and, Anne, what you're saying, you're there for five months, and your team is probably there for a good couple months, and there may be other groups that come in simultaneously, but not really, necessarily, working together. Is there a reason why the audits couldn't be coordinated? Wouldn't that create some efficiencies and focus?

MR. RAMTAHAL: We tried -- right now at FINRA we coordinate between the financial operational group, so internally we do coordinate -- so I wanted to make that clear -- and our colleagues at the district, sales practice. We do talk to our colleagues at the other regulators, whether it's the SEC, the CFTC, the NFA, when we are planning an exam. We coordinate in one respect, at least, in that we talk about the scope of our exams, and we ensure that no two regulators are duplicating efforts. We do that with the SEC, as well. Now, I don't think FINRA can dictate how another independent SRO or DSRO plan their program out in a given year to ensure that it's coordinated so that we're onsite at the same time. That would be outside of the scope of what we can do. Is it a good suggestion, good point? Perhaps. I think regulators, in that regard, would have to work together.

MS. BAGAN: Yeah, Eileen, we have tried doing that in the past so that we go in at the same time. We've actually gotten some negative feedback on that, that there's just too many auditors in the building at the same time. And there are scheduling issues between what FINRA's planning versus the time constraints that we're under, too. So, we would love to be able to do that, if possible. Unfortunately, a lot of times it's not.

MR. RAMTAHAL: We did listen to the industry in that regard and that in the past our sales practice reviews weren't coordinated with the financial operational reviews, and we recognized that that was becoming burdensome to our members, and so whenever there's a joint SB/FINOP review, it's always coordinated.

MR. RICHARDS: Yes, one other point before we leave the subject is no two -- the people you're regulating, no two firms are exactly the same, so the ability to try to segment that population to say where does the highest risk lie? Like, so in our world, there are a handful of firms that audit 98, 99 percent of the market cap in the United States. They're on a different inspection cycle than the rest, even though the rest represent several hundred thousand more firms. And so, I think the ability to both look and say well, how frequent when you're looking at the underlying risk and the nature of the engagement. I think those are two things to consider as you were thinking about and bifurcating, if you can bifurcate, the population of who you're regulating to really try to get at the highest risk relative to customer protection, or in our case, investor protection.

MR. BARNETT: Thank you.

MR. FLOWERS: Gary, and adding onto Steve's point, the reality is that when you go through your spot checks, so to speak, we're talking about spot checks as substantive type work. I'd recommend that certainly look at your internal control structure, and to the extent that you have specific controls, certain fundamental controls, that you're actually testing those ones on a spot-check basis because if they build up, they support the ability to control the firm. I think that that's more of an ongoing process that needs to be evaluated, as opposed to just doing some standard tests to ensure that the box is properly coordinated and nothing escapes. I think it's clearly important that they test those controls periodically, and I think a spot check is excellent for that.

MR. BARNETT: Great. Thank you. I want to go back to the CPA question again, one more time. Then we'll move into looking more at us, at the Commission. The question on the CPA is what internal control procedure should the external CPA perform and include as part of its internal control opinion? Sam, do you have a thought there? Oh, Rich, go ahead. All right. You had your hand up. I didn't see it.

MR. FLOWERS: That's all right.

MR. BARNETT: But I'm going to get you, Sam. Okay.

MR. FLOWERS: I think the assessment of the internal control environment is paramount that the, you know, at the beginning of the audit and then, throughout the audit, and up to the actual sign-off date. But the extent that you've assessed the control environment, you've broken down the types of controls, and that you've identified those which you're going to place more reliance upon. And if they satisfy the control objectives, I think those ones should be tested. To the extent that there's some specific controls, they might not be tested basis of materiality. In terms of time spent on that, it might not result in an actual benefit, but if you can see that certain fundamental controls or monitoring controls are overriding those specific controls, I think that it's now an acceptable process that's approved by the PCAOB to allow us to test it accordingly.

MR. BARNETT: Sam?

MR. TELZER: Sam Telzer. I want to build on what Rich said because I think it's actually very relevant. Internal controls assist at a point in time as part of the audit process. So, understanding what the controls are and how they affect whether or not the financial statements could be misstated is the way the external CPA looks at the audit of, whether it be a broker-dealer, an FCM, or indeed, any commercial enterprise. This is a very common issue. So, the issue of the CPA's responsibility internal control is to really understand what is the entity? What is its environment? Now we're dealing in this forum with a futures dealer, so futures dealer has a set of regulations to comply with. It has practices and procedures it should follow. It has an internal control structure that management is charged with establishing to ensure that there is not a material misstatement in the financial statements or the supplemental schedules.

But I want to go back to something someone on the panel said earlier is that this is a point in time once a year. And that does not mean that you can take that control environment and extend it to some future date. To the extent that there's an additional or incremental responsibility, that has to be evaluated against the existing auditing standards. That's where I see there's a very valuable role for an SRO or the Commission or the regulators to play because they actually help enhance the control environment by doing the spot checks, by doing the regular exams.

And then also, within a larger

enterprise, what role internal audit plays because that's not something that's been talked about, and how internal audit looks at the control environment and how they establish the liability of that control environment. So, I think there's a number of different factors that a CPA looks at when they're doing an audit. They all have to come together in order to determine whether or not there are controls and whether or not there are reliable controls that actually promote the ability to have financial statements that are not materially misstated.

MR. PICCOLI: Sam, you're talking about point-in- time testing, so I'll throw the question out there. Why not look at controls throughout the year? You know, similar to a SOx type review, it's got to be throughout the year. It's not just at that one point in time that they've got to make sure that they signed off on everything and they've dotted the I's and crossed the T's.

MR. YERES: Kevin, thank you. I think, though, there's two pieces to a SOx level environment, which is one, management in a SOx environment is usually putting their own view of the control structure on the table, and then the CPA opines on what management is saying. And so, if SOx is the right framework -- I'm not making a judgment if it is or is not -- but if SOx is the right framework, then there's some significant issues that are not in the rules right now that would need to be addressed. And certainly that gets to a question of do you impose a standard on FCMs that right now is not in the broker-dealer world that may not be in other regulated environment worlds?

So, I think, ultimately, if the question is do the customers know that their money is being safeguarded, I think that whether or not SOx accomplishes that is an open question that would need to be evaluated for the benefit of whether or not you get that objective met.

MR. BARNETT: Mark.

MR. HOLLOWAY: Just a couple of thoughts. I think you folks may know the SEC and you folks are working on a compliance certificate, and the process would require the broker-dealer and a few folks adopt a comparable program to FCM to make certifications at the end of the year, as of the end of the year, as to our compliance with the regulations. And at the same time, if the current plan holds true, we would be asked to make statements with respect to material weaknesses within our organization, and those statements, again, if the current plan were to hold true, would cover the entire year.

I think, Kevin, this is getting to your point. I'm not sure how this is going to develop from the auditor's standpoint, but as part of the certification package we would be asking our independent auditors to look at our controls throughout the course of the year. And I think that to address the kind of concern there that you were mentioning that the point in time review of controls doesn't mean that -- or at least appear to get you very far. Some of the internal control reports -- and I certainly don't want to speak for the public accountants, but some of the internal control reports currently available, the SSAE 16, do cover the entire year. And that's one of the reasons I was mentioning before that I think some of these internal control reviews, while not intended to capture fraud or whatever, but because of this time scope would certainly, perhaps, provide useful information about the controls themselves but make other things more difficult, as well.

MR. BARNETT: Let me ask a very broad question. And, you know, I mentioned at the beginning the way our oversight of the examination program works. You know, we go in, we sample the audit papers that were -- examination papers that were done by the SRO and then we do some amount of our own direct reviews, but not that many. So, I just want to strip it down, just ask a very open-ended question. What policies and procedures should we apply in examining an SRO's examination program? What would you advise? Bill.

MR. DE LEON: Gary, just to continue. I

would suggest to you that a top-down approach that really would guide that program for the DSROs, that not only does that allow consistency across the various types of exams, but it also allows for your own ability to rate their examination. So, it's not just looking at work papers and making sure they ticked and tied to right boxes and so on, but also did they do the right risk assessment of the firms? Did they look at the right areas? Is this a, you know -- let me pull out the standard audit report that I did over the last five years and just replicate that? So, it's that type of review that I think adds value from the Commission standpoint and also provides a much more integrated approach with the DSROs with their examinations.

And the same way I suggested about rating, there should be some of that feedback, as well, to make sure that, you know, that they stay on track, if you will, and that the exams are meaningful and relevant to, you know, what's going on in the industry, what we've seen as a shifting industry, the risk profiles, and so on and so forth. So, I would encourage that type of approach.

MS. BAGAN: Isn't that part of your exams when you come in and look at our audits? Aren't you doing that? Looking at our scope selection and risk assessment?

MR. BARNETT: Kevin can correct me, but I don't think we tend to second-guess judgment questions that were done. I think we more look and see that the steps were followed. That where discretion was involved or, you know, like a sampling size, or something like that, I think we don't re-test it. So, I mean, we don't question it, so --

MR. PICCOLI: I think we spend more time re- performing than we do stepping back and looking at it and saying but did they do the right things? Was the risk assessment the right risk assessment? Did they risk profile the firm properly? I'm not sure we do that as part --

MS. BAGAN: Because that's a huge part

of our audits. Before we even start is, you know, we put a huge memo together of how we came up --

MR. PICCOLI: Right. And taking that memo and saying how did that memo change the audit program, and that's, I think, one of the things we've got to focus on.

MR. BARNETT: We're looking at that, and I think, again, I don't want to -- and we've tried very hard not to say here's -- to the extent we can, here's what we do. Is it wrong? As much as what we're trying to say is let's start -- let's just, in this discussion, with the benefit of you experts, what should we do? So, we'll look back and see, you know, what we've been doing and so on, and we'll make changes, but that's -- so I don't want to get into too much of that dialogue, but just answer your question. Bill?

MR. DE LEON: Sort of taking the clean-slate approach here, and some of the things we think about a lot are asking the same set of questions of everybody and see how they stack up. Sort of going to Bill's point, we have certain things we care about, and I'm not sure they're necessarily the same things you care about or at the same level, however, I would argue that if you have a standard template that everyone is supposed to fill out and meet, from the SROs, and the SROs down to each FCM, and there's certain things that they have to do and meet a certain quality standard on.

And then there are other things that are bigger in scope and more complicated that don't fit into that box, I think that that would be very useful. It goes to Bill's point about sort of the -- did you get the right checked boxes or where did you score on certain things. So, do you do daily seg? How do you confirm it? What's electronic versus what's not?

MR. PICCOLI: Well, just to avoid confusion, I mean, we -- it's not that -- the question isn't that simple.

MR. DE LEON: I don't know why I really --

MR. PICCOLI: So, we go through the

audit module and we go through the steps. The questions is the -- there are some things that --

MR. DE LEON: We don't see it. We don't know what the score was for people. And there's certain information that I think if we knew was going to be reported -- and I think that if you were going to mandate that it be reported publicly, would raise the bar for a lot of people because the difference between reporting to somebody and then getting that audit going good or bad, and potentially get a fine is very different than the well, we're going to tell you how you did on your score, right? You know, how did you do today? Oh, I did okay, dad, is very different than well, it's on the web. Everyone can see how you did.

MR. PICCOLI: So, just so I understand, Bill. Are you suggesting that the exams of the firms, of the FCMs, so maybe when Anne goes out and does it -- an audit of, you know, Joe Blow, FCM, that that report, that rating, if you will, is public?

MR. DE LEON: Certain parts of it should be, I think. You know, how you scored on certain things, so there is a minimum standard of care which evolves over time, and where do people fall in that standard is important to know. So, it's just like, you know, who's your auditor and how did they score.

MR. PICCOLI: Let's put that out to the floor. Let's see what others think of that?

MS. DOWNS: I'm not in favor of displaying the full details of an audit in public, nor do we display the full details, even of a CPA. There are some core pieces that you look at, and that's relevant. I don't think it helps promote whether or not the overall findings of the firm are appropriate. I think it gets into the weeds and gets to be a competitive issue as opposed to whether or not we're protecting customers.

MR. BARNETT: Others? Mike?

MR. JAMROZ: I guess the concern I would have is kind of the chilling effect on the findings themselves, because already today we just

-- the findings without a rating that's public, there's enough fighting that goes on, because, you know, some folks get, actually, compensated based, you know -- the findings and exam finding are an element of their compensation in number and amount of findings. So, my primary concern would be that it would cause so much fighting about particular findings that -- I think what you really need is open communication between the exam -- those adjusted as to what should be done to improve practices, things that are intangible, what you could do better. And I think, making these findings and these ratings --

MR. DE LEON: I was not suggesting -- to be clear, I was not suggesting the entire report be made public. I'm suggesting there are certain aspects of the review that should be standard across all firms. That certain information should be -- you passed or didn't pass or what your score was. I agree, compensation should not be reported. I wasn't looking for information like that. I was thinking there's certain standards, though, do you meet and you achieve that would be useful to know on a regular basis as opposed to having to go and ask each FCM that you do business with, you know, when was the last time you were audited? Any material findings? You can go ask your FCMs that you do business with for a lot of this information, and they will -- some give it to you, some don't. Then as an end-user, I have to make a decision on whether or not it's material or not.

There are certain things, I think, that would be useful to have available just like there's certain information when a bank is signed off on, you know, is it good or not? And I go back to my current analogy, and maybe I'll use the Chevy Volt this time instead, right? It meets a certain standard, and it gets a crash rating, right? You don't get all the information about the car, but you get certain things, and you know where it stands relative to other people, and I think that's useful to have.

MS. BAGAN: Just to be clear. If we do

have a material finding where we take disciplinary action, that is public information on the NFA basic system, so firms can find -- or customers, can find out how their FCM is performing if it's a material finding, and if there's a fine involved.

MR. DE LEON: Right, there's, you know, but we're talking about the -- you're all the way down at the bad end of the spectrum, but you don't know where anyone falls here, and you have to do your own due diligence, you know. So, you get a two or a one. Okay, that's public. But are you a five, a seven, or a nine? And that matters a lot because where are they, and how do you get that information? So, I think a lot of firms like ours do a lot of due diligence to get information, but we can't get everything we'd like to get, and I'm not sure everyone has access to the same information given where they are in the market.

MR. BARNETT: Now, let me pull it back to, I mean, I want to pull it back to -- I'm sort of anxious to get the perspective of the experts, again, going back to what we should be doing. So, Bill's point was very appreciated. Others thoughts about things that we should consider doing? You guys kind of know what we do. Are there things in your mind that we should be adding, changing, doing differently? Dan?

MR. DRISCOLL: Dan Driscoll. I think from a perspective of an SRO, that I think we have some of the same, I don't want to say concerns, but some of the same wishes that the industry might have. I'm getting feedback from SROs, and I think that to the extent that the feedback, whatever you do, not saying so much what you should do, but that when you do it that we get feedback and we get it promptly. And that it not just be, if there are really ideas about things we could do differently, and they don't rise to a deficiency, that we hear about that so that there be -- you know, it not all be formal, would be informal and really have -- but it's important in our mind to get that feedback and get it as quickly as we can.

MR. BARNETT: Okay. Anyone else? Okay.

MR. FLOWERS: I think, Gary, that one of the points that assessing how well the CFTC may be doing in terms of transactions, we can use a real life example and was just discussed the other day at the FASB and that was the treatment of transfers. And that the clarification with respect to the de-recognition of repos to maturity and reverses to maturity may not be as indicated currently in GAAP. And that there's a desire to identify -- clear the actual risks associated with those types of transactions and that, in fact, they do have some exposure.

I think that the consideration of that particular accounting treatment relative to the purchase agreements is not just something that should be either at the SRO level or even at the CFTC level, but it should be an entire level for the entire firm, and that the GAAP is the universal measure and should be part of the daily assessment for looking at the individual firms that you're auditing or reviewing, and then see whether the SROs have kept the contact with the appropriate accounting standards. And there are a number of standards that are up in the air on many issues, and I think that the evaluation of those standards and the extent that they're important to the particular FCM, and whether FCM and the SRO see whether they're properly evaluated. And I think that that should be, you know, in your domain of review.

MR. BARNETT: Thank you. All right. Somebody sent me a question. I don't think it's an appropriate question, so if they want to come out and talk to me afterwards, that's fine. I want to -- final comments, I'm open to it, but then I'm going to end this session and let everybody go and take lunch, and we will come back for our next session at 1:30, I think. Yes. So, I want to thank you all so much. We really greatly appreciate your thoughts, your participation, your input, your advice. Really, thank you very much.

(Recess)

MR. BARNETT: Okay. Let's get started.

Welcome back to our roundtable, discussing customer protection requirements for futures commission merchants. We've completed our first panel. We're now moving to the second where we will focus on various questions that, actually, we want to ask you -- the Commission wants to ask you, or the staff wants to ask you, regarding customer protection proposals we've been working on. A quick reminder on housekeeping items. If you haven't already discovered it, the bathrooms are in the back down the stairs and, again, farther down and to then to the left. This is a two-hour session, from now until 3:30, and then we roll right into a third session. Somewhere along there we'll take a break, no later than 3:30, but it may be earlier depending on how the conversation's flowing.

Again, for those in the audience with questions, we have cards. You can submit your questions in writing, and then the cards can be brought up to us. We're creating a transcript of the discussion today. To make this work, when the panelist speaks, please first say your name so they can -- when we go and type it up, we can track who's talking. And then, as we said earlier, because of ongoing enforcement cases, we aren't going to talk about specific market events, whether it's MF Global, Peregrine, or otherwise.

Okay, so let's start the second panel. As we said, we want to use the time to get comments and reactions from you all about various proposals we've been working on. And before we start, since we have a lot of new faces at the table, a lot of people in the first, but new ones. Let's go around -- again, let's do the same thing we did before. My name is Gary Barnett, I'm director of DSIO.

MR. PICCOLI: I'm Kevin Piccoli, Deputy Director.

MR. COOPER: Charley Cooper from State Street.

MR. PARKE: Ross Parke, Barclays representing FIA.

MR. KEMP: Todd Kemp with the National

Grain and Feed Association.

MR. ROTHMAN: Howard Rothman with Vision.

MR. FOLEY: Kevin Foley, a partner at Katten Muchin Rosenman representing FIA.

MR. TIRRELL: Bill Tirrell representing SIFMA Capital Committee.

MR. LUKKEN: Walt Lukken, FIA.

MR. DAWLEY: Mike Dawley from Goldman Sachs and chairman of the FIA.

MR. DAVIS: Warren Davis, Sutherland Asbill & Brennan on behalf of the Federal Home Loan Banks.

MR. COCCO: Alessandro Cocco, JP Morgan.

MS. AYOTTE-BRENNAN: Christine Ayotte-Brennan, Fidelity Investments.

MR. THUM: I'm Bill Thum from Vanguard, also representing the Investment Company Institute.

MS. BREGASI: Nevis Bregasi, MFS, also representing ICI.

MS. FLAHERTY: Eileen Flaherty, Newedge.

MR. FILLER: Ron Filler, New York Law School.

MR. DRISCOLL: Dan Discoll, NFA.

MS. DOWNS: Yvonne Downs, Jefferies.

MS. BURKE: Maureen Burke, Bank of America, Merrill Lynch representing FIA.

MR. NUNERY: Cam Nunery, Office of the Chief Economist.

MR. BARNETT: Thank you. Kim, I see a spot. Your name's on there. Kim Taylor, CME.

MS. TAYLOR: Kim Taylor, CME. Thought I was on the third panel.

MR. BARNETT: Okay. All right. Okay, so let's start or just go through some of our proposals. We have not put out any of these specific provisions out there, so I know you'll be hearing this for the first time, but let's just get your reaction. So, let's start with Part 30 and, you know, as you know, first we're going to create as much of the industry -- FCMs have to hold sufficient funds in Part 30 secured accounts to meet their total obligation to customers that are trading on foreign markets, computed under the net liquidating equity method. No discussion there. Everybody seems to be in agreement. No longer allowed to use the alternative method which has allowed them to hold a lower amount of funds representing the margin on their foreign futures. Again, not very controversial. So, we want to make it clear that when funds are held in a jurisdiction that permits an opt-out from a seg requirement, we're going to prohibit such an election. We don't think that's very controversial. If there is, then react, please.

But here's one where we do need some help. Where FCMs are holding funds in Part 30 secured accounts to meet their total obligation, with respect to the funds that are in excess of the margin called on for the foreign futures, we want to require as much of the excess as possible to be held back in the U.S., subject to allowing some extra to remain in the foreign country to avoid real-time margin call issues and the like. It would just be practically impossible to not allow some amount of excess.

And our question is, one, does that makes sense? And some of you, I think, have proposed the same. I think FIA has. Then, assuming that people are in agreement, how should we size that excess? Some have suggested 50 percent. We think that is way too large. What are your thoughts and why?

MS. BURKE: Gary, I'll start. So, the FIA did recommend a similar recommendation for, obviously, moving to the full seg net value. No opt-out, I think, as we polled, going through the Financial Management Committee, all of our member firms as well as we have representation from the clearing houses and banks, everyone thought that we really didn't have the authority to opt out anyhow pursuant to the U.S. regs, so that's no issue.

On the third point of requiring FCMs to pull back, we see it as a material excess amount. We do think there should be an appropriate amount that could be left, but have daily policies and procedures for pulling back material excess amounts so they're not held in the foreign jurisdiction and subject to the foreign bankruptcy rules in the event of a default. The 50 percent, I think, pertains to an existing rule. Now if you have more than 50 percent of margin, you take a capital charge. So, at some point in time there was some thought process put into place for that through the CFTC and other regulatory authorities. Fifty percent seems as though it's a little more than a -- what you'd deem to be a proper material amount. I think it maybe should be a hard dollar amount and percentage -- combination of the two, lesser of. And, I think we can look at that and say what's an appropriate amount because margin numbers change every day, and there's the daily settlement, back and forth.

There's also, when you start trading on foreign boards of trade, there's a foreign currency settlements and things along that line. So, a combination -- 50 percent seems a little high, you know, southbound of that as maybe a combination of a hard dollar amount of percent. And then, that could be monitored versus, you know, that you're fully out of compliance. And I think the point should be that if you're over that amount, maybe just go to the capital component rather than putting you out of compliance because the numbers do fluctuate, so it doesn't create a compliance issue.

MR. BARNETT: Okay. That's helpful. Ron.

MR. FILLER: Just as you study that rule, I think the one thing you need to think about is the time it takes to convert the foreign currency back to and wire transfer it back to the states. Usually it's done in a 24 or 48-hour period, so if you had it as of the close of business on Monday, it could take one or two days before you got down below that certain amount. So, if you do go to a percentage or, as Maureen said, an acceptable level-type thing, just give it an extra day or two just in order to transfer the monies back.

MR. BARNETT: Eileen, did you have your hand up? No? Okay. Other thoughts? No. Okay.

MR. DAWLEY: Gary, I'd just add, I agree with Maureen and Ron. I think a time-date certain can be challenging, but I'd also just note that some of what you're requesting is already happening. There's a lot of clients that are actually requiring us to move back their excess, so as they get educated more about the process, they've adapted to it.

MR. BARNETT: They want it already. That's good. Okay. Now, the amount that's called, it's not just the clearing -- again, still on Part 30. So, not just what the foreign cleaning agency may have called, but also the foreign broker. And they have to do their own risk management. So, I mean, we kind of get that. But a question is is there a reason to be concerned about, sort of, affiliation and a need to track that what is being called by the affiliate broker is market? It is not being used as some way of holding up the amount that's leaving the country?

MS. BURKE: So, is your question that imposing that, similar to what you have here in the States, that you would have an exchange minimum requirement? Or clearinghouse minimum requirement flowing through from the affiliate so that the affiliates -- you wouldn't be funneling additional funds through to our affiliates through the affiliated cleaning broker relationship. That's the point.

MR. BARNETT: Yes. Quick example. So clearinghouse calls for four, the foreign broker calls for six, meaning two more, and then the US FCM calls for ten. You got four sitting in the States, you've got two sitting at the foreign broker, and you've got four, if I've got my numbers still in my head right, sitting at the foreign DCO. The question is, if it's all independent and not in market, I'm not worried about the two that the foreign brokers called for risk management purposes, being able to respond to margin calls, but if there's an affiliation or for some other reason, do I have to worry that that two starts creeping up to some larger number, and pretty soon we don't have four left in the States. We've got one and the other three is sitting with the foreign affiliate. Do I have to worry about any kind of evasion kind of question, trying to get around this?

MS. BURKE: I'm not aware of working through affiliates that there would be an add-on. Typically, when we look at our clients, we're looking at counter-party credit risk. And when we clear through an affiliated clearing broker, and the affiliate is issuing the call to the affiliate, the US FCM, the US FCM has the underlying clients and the counter-party credit risk of those clients. So, that's where the add-on of the margin would typically come into play. When you're looking at your US FCM, look at the counter-party credit risk of the underlying clients determining whether or not, based upon the credit parameters of that client, whether or not you have to add an additional add-on to the exchange minimum or clearinghouse minimum margin requirement.

So, when you're looking at an affiliated relationship, because it's an affiliate, and you have the credit due diligence being performed at the US FCM, that's typically where that excess -- and by implementing your proposal, and there was a similar proposal to what the FIA put out there as well, to return material excess, that will keep that excess for any add-on to the margin here in the U.S.

MR. BARNETT: All right. Let me turn to risk management then. And we know from FIA, NFA, the NFA rule, Section 16, there's a broad consensus that a policies and procedures approach be added, more of a control-based structure being advocated for at least disbursements from seg. And the proposals go to such things as setting the target residual, and we are all familiar with that. And included in a lot of that, among some of them anyway, separation of duties, selection of counter-parties and investments, training, and limiting the percentage of excess that can be withdrawn at any time without a sign-off by senior management.

And now we're getting to the questions. So, the scope of risk management is still much narrower, for instance, than what will be required of swap dealers, for instance, and of course, narrower than what's required of prudentially regulated entities. Is there anyone here who thinks we should not require risk management policies and procedures around all the risks of the business?

MR. COCCO: It seems to me appropriate to require risk management policies and procedures. I think it would make sense to look into the detail of that. In other words, I think that conducting an analysis of the practices that are currently employed, understanding whether those are sufficient or not, rather than designing a system in abstract from the current market practice and then requiring to comply by a certain date. That could create more risk rather than less. So, I think that if it does done in a way that looks at how things are being done and whether those are being done in a prudent manner now and what can be improved through consultation with the industry, it would seem to make sense.

MR. BARNETT: I mean, the reality is that aside from the CPA report that we get audited financials, I'm not really aware of any -- you know, and everybody in the last session talked about the control-based review as substantive examination plus a control-based review, but there's nothing in our rules, really, that requires, you know, risk-based, you know, policies and procedures around the risks of the business.

And we've got those rules that are coming and the internal business conduct rules for the swap dealers and MSPs, but we've got, you know, very little now. Now we've moved forward with risk management through FIA and NFA and CME efforts, but it's to date focused on disbursements from seg. And it doesn't go beyond that. And it seems it's hard to isolate one piece and where are the lines, and it seems like there ought to be a more general, beyond the specific one that people have proposed because of the issues we had and that we were reacting to that gave us that focus. It seems there should be more of a risk-based focus on how businesses are being managed. Yes?

MR. COCCO: I think that that makes sense to me. I think that just looking at the overall industry and the rules that prohibit the sharing of information between swap dealers and FCMs and drawing up comparison with that, I think that it would be helpful to recognize that in some complex financial groups the experience resides in a team that may not be the FCM team. And so, allowing for the transfer of information between those who have the actual knowledge and those who manage the risk on a day-to-day basis would be helpful, of course, making sure that appropriate safeguards are put in place so that customer information is not disclosed when it not appropriate.

MR. BARNETT: Okay. Other reactions?

MR. COOPER: Just a quick question as to how exactly this would work because I may not understand the proposal. Requiring the procedures, I think, absolutely, that makes perfect sense. What you do with them once they're required, I think, is the next question which is part of what was brought up. I don't know if there's a qualitative review. I don't know who that rests on. Is it the CFTC to make the determination as to whether or not those procedures work? Would it be FIA developing best practices? I guess, procedures are fine, but they can be crap, right? So, if there's not necessarily a qualitative measurement, the fact they exist does nothing to make the system safer unless they're useful.

So I guess I'm not understanding how the determination would be made as to whether or not the written procedures actually match up to what should be expected of those of us in the industry. So I'm asking.

MR. BARNETT: Yeah. No. That's a fair

point. I mean, we talked about risk-based examinations before, but it's like what are you examining, you know. So, there has to be more risk-management of the FCM, we believe, and the corresponding or correlative, you know, and the examinations have to match that.

MR. PICCOLI: Yeah, so I would expect that as these policies and procedures are developed that as part of the examination function by either CME, NFA, or the Commission, that go in and look at the policies and procedures, compare them to best practices or what the examiners have seen at other firms and make some type of qualitative decision as to are they good? Are they not? How can they be improved and enhanced? Because you're right, having just a book on the shelf doesn't really do much good unless you've got someone making sure that it's one, actually being followed, and two, it keeps up with best practices.

MR. DAWLEY: I would just add I think I agree with Charlie. It all starts with best practices, right. There's huge gaps between how FCMs manage risk, and I think starting with a clear set of best practices is something to work off of and compare to how different firms are managing risk. And I think that's something FIA could certainly help with, and some of that's already in the recommendations we put forth.

MR. BARNETT: Is there an industry group that's looking at that? You know, FCM best practice, risk management best practices?

MR. DAWLEY: We've talked about it. The FIA task force has put that into their scope, but I think it's really the FCMs are the ones who really can pull together what we feel are the best practices. And for your review, and if there's agreement on them being sound, you can use that as a tool in the audit process and begin to question FCMs who aren't potentially following some of those practices.

MS. TAYLOR: Depending on what kind of risk management practices we're talking about here, I think it may be appropriate that they be part of the kind of financial- compliance audit-process review, or it may be appropriate that they be part of a different, separate risk-management process review. We perform both types of reviews at CME, and the one thing -- I'm very much in favor of the idea of best practices and we'd be delighted to work with the industry on helping to develop those, but I think one thing to keep in mind is that FCMs manage their risk differently.

They also engage in risk differently, and not everyone engages in every type of activity. And so, I think we want to be careful to make sure that we're not requiring everyone to put in place risk-management activities that are not in line with the businesses that they perform. So, they risk manage, you know, in the areas where they do perform that business. But, you know, if we have best practices with respect to option activity, and we have FCMs who don't really engage in option activity, there needs to be a way for that to work so that we don't just require people to put practices in place that don't make sense.

MR. BARNETT: Just for the record, so that was Kim Taylor. I'm worried about the record. So, it's Kim Taylor, and before Kim was Mike Dawley. We should say who we are. And I'm not saying it, but I know that this could be a mess when we look at the transcript later and as we try to sort through people's advice. Dan?

MR. DRISCOLL: So, you set up this question by comparing the FCM environment to the requirements for swap dealers, and under the swap dealer rules, the procedures and policies will be reviewed as part of the registration process. And then, of course, there will be a follow-up examination process to look at the implementation. I would think for FCM risk practice requirements, to the extent that they're out there, are probably not best addressed in the registration process, but as part of the ongoing examination.

MR. BARNETT: That makes sense. And to speak to Kim's concern, I think referring back to the risk management rules for swap dealers, they don't -- and I don't envision rules that would lay out you must do this, you must do that. It asks for consideration of the risks of the business, and then addressing them in some way. Then that gets reported in, you know, an annual -- your policies and procedures and then a progress report and annual report. So, there's nothing, sort of, one size fits all, and no one telling you which risks that you consciously want to take on, whether or not you should take them on. So, it's more like knowing your own business, identifying the risks that you, in fact, want to take on, and then trying to create risk management around them. So, we shouldn't end up with the kinds of things that you're -- it wouldn't be intentional, I think. Okay.

A corresponding issue we've struggled with is -- so again, you've got risk management, you've got a change in the orientation of the examination process, and we're trying to figure out ways in which we could start to look ahead at risk and start to look ahead at problems, get ahead of things. So, we're talking about some additional reporting items, and some of the issues that we've raised, we considered; for instance, what about looking at what's going on at affiliates? What about issues at the securities business of joint BD FCMs? Should we be looking beyond capital seg and secured to things like leverage, liquidity, other business lines, major changes in the business? Those that might require consultation, for instance, with the SRO? Or is it the same kinds of events and affiliates? Is there really any way that we would avoid looking at those things if we are really going to take a risk, or add more of a risk orientation to the way we or the SRO looks at intermediary or FCMs? Reactions? Bill.

MR. TIRRELL: I think when you look back over time, it's fairly easy to see that a lot of the trends where firms have gone awry. You look at P&L, for instance, as one good measurement. So, it's a concentration of P&L in a particular product or a particular area of the firm, or envisioning that it is going to be a very big winner. So that, obviously, becomes a red flag, if you will, where you see a large concentration of P&L within a particular product or particular area. Concentration of a position, obviously, again, I think we've seen over time that that translates into some red flags that needs to be analyzed. Liquidity, obviously, I think is the -- would be probably number one on the hit parade as we've seen from past history. So, I think, collectively looking at different aspects of the business, and as well as a shifting of the business. Again, I think it's another red flag that would require additional, you know, review. So, growth through acquisitions, or just a push into certain market places. I think these are all things that would require some additional oversight to ensure that what is actually happening and being presented is real, and they have the right risk measurements around all that -- controls and so on.

MR. BARNETT: Okay. Thank you.

Charley.

MR. COOPER: Charley Cooper. As a general matter, I see the need and the desire to look at things -- big picture things that would tell you about the health of an institution. Leverage ratios, capital ratios, you go through the list. Where I get worried is in terms of how a place like the CFTC, with it's knowledge base, or the NFA, to the extent they're doing it for them, would be able to evaluate properly, and then, what to do about it once the evaluation's made. Different affiliates that are doing completely different things than what we're talking about. So, would, in JP's case, they have a private bank, international private bank. Does the CFTC envision looking at various different risk pieces or financial information from the private bank to make a determination as to whether or not that would affect the FCM? Or if they have a real estate firm, a real estate group? How does the CFTC evaluate the health of that real estate division to make the determination as to whether or not that poses a threat?

And then, assuming you even have the expertise to look across various different affiliates and make a reasoned determination as to whether there is or is not a problem, then what would the CFTC claim to be it's jurisdictional hook for acting? Or how would you force that affiliate to adopt a different method of business or risk management procedures, et cetera, so maybe you'd know there was an issue? I'm not even sure how you would know there might be an issue if it's the type of business you don't understand or that many of us wouldn't understand. But then even if you were able to understand it, well then, what do you do if it's something that you're not comfortable with? So, I don't know how you effectuate that kind of a system.

MR. BARNETT: I think -- should I answer or should -- okay. I don't think anyone's proposing that we would try to regulate people not within our jurisdiction, but we're thinking more about adding more to our reporting requirements.

So, something more like 8K type events, something major, significant, has happened that's affecting the registrant, the FCM, they tell us about it so we can take it into account in knowing that a problem may be brewing. So we have seen FCMs that bifurcate their financing into basically a shell-parent as a public entity, but it's not in the FCM. So, if you only look at the FCM, everything looks dandy. And to not look at that is kind of mad in a way, you know. It's not appropriate. I think you need to be able to take other things into account. So, I don't think you need to worry as much as you are suggesting, but I think it was fair. It's a question that we ask and that's good to hear your concern.

The one about liquidity is a significant issue, as well. Whoever was just -- Bill, talking about liquidity. I mean, we have our rule, 1.17(a)(4), deals with what happens to a business when it's under-capitalized. But it doesn't specifically address what happens when the -- it's essentially, you've got capital, but you're so illiquid that you're basically dead in your tracks. So, we need to take liquidity into account in some way, as well. What we should do -- I'd like to get your thoughts on that -- everybody's thoughts on that. Watching it, though, and being aware of it and being able to take that into account as we understand what pressures are on the FCM, that's the kind of thing that we're thinking about. But we're definitely not trying to regulate other people.

MR. COOPER: Okay.

MS. BURKE: So, Gary --

MR. BARNETT: Let Ron go, and then we'll come back to you, Maureen.

MR. FILLER: Ron Filler. Gary, I think you raise an excellent question, and, probably, in looking at it and trying to evaluate the answer, you almost have to look at it in today's world versus what it was two, three years ago because from an investment-risk perspective, and if you're focusing on the swaps OTC area, any swap dealer now has to have regulatory capital. Whereas in the past, they had very little capital because the parent company guaranteed the swap business at the respective firm. And that, with all the Basel 3 and everything else is a greater awareness and requirements for capital among, not just the registered entity, but now you have other firms that are affiliates that are becoming registrants which have a regulatory capital thing. I think the key part of it though is also how the -- if the investments or the concerns that you have -- the risky investments rest with the broker-dealer FCM entity, financials should pick that up.

Now, I know we're not supposed to talk about MF Global, but most of their investments took place within the BD FCM, and that's what caused that as opposed to a lot of other affiliates might have it through a parent company or another affiliate or whatever and not through the regulated entity. So, I don't think there's a right answer to your question, but I think it does, you know, require a lot more details to know exactly where you guys are going.

MR. BARNETT: Okay. Alessandro.

MR. COCCO: Gary, Alessandro. I had a couple of thoughts. The first one is -- maybe it's obvious to everyone, but would this be information that is disclosed to regulators as opposed to the public? Because, of course, to the extent that there's information that is confidential that has to do with the expansion of the group in one way or another, then it would not be suitable to disclose it in real time to the whole public.

And then, the other thought that I had was that I would also look into coordination between regulators, maybe within FSOC because, of course, you could have different regulators that are in charge of evaluating different aspects of the business, and coordination would go a long way.

MR. BARNETT: I think those are both excellent points. I think you're predicting one of our questions. The one about confidentiality, so we'll talk about it in a second because we think that we need more information for customers, but what are the data points they need and what should they not see? And so, we should talk about -- we should spend a good amount of time on that. So, let's come back to that, but we're definitely sensitive to that, but we do think customers need more, but we've got to be careful that it's not internal, confidential, you know, business stuff. And we'll talk about the lines.

In terms of coordination, we definitely agree that in this, you know, globalized world, and given the speed and all the complexity, that there has to be more coordination and trying to find that balance. We talked about it in the last session, and it's something that's become increasingly apparent and involving us all the time.

MS. BURKE: And, Gary, that was the same point that I just wanted to make, as well. You know, many of the larger firms, the SEC, the Fed, the OCC, come in and to have the point of coordination, maybe you could attend some of the meetings. And, you know, the new business items are brought up, new ventures, liquidity, and they're discussed in depth and, you know, having that open flow of information and if something comes up, then, you know, you can look at the FCM, go down to the FCM and decide do you need to go have an onsite visit. And, you know, just having that open flow of information at the outset.

MR. BARNETT: Right. Right. Okay.

MS. TAYLOR: This is Kim Taylor. I think I'm going to be reinforcing the point that some other folks have made about the need for regulatory coordination. I do agree with the general point that as an industry we need to be concerned holistically about the health of not just the regulated entity, but the health of the structure that supports the regulated entity. There, I think, are inherent limitations, and as Charley referred to, about the ability to actually enforce against the entity that is not the appropriately regulated entity. There are things that we can do from a risk management point of view. There are things that we can do from a regulatory audit point of view, but I think we also want to be cognizant of not increasing, unnecessarily, the burden on the FCM community of duplicative audit work. And where other regulators are already performing certain activities, it may be that there's an opportunity for enhanced information sharing.

I know there is good information sharing, and there certainly is an intention for there to be good information sharing, but it might be that there are some opportunities to find there, like the one that you mentioned, where kind of increased regulatory coordination helps everyone have a broader picture.

MR. BARNETT: Okay. Thank you. Thank you.

MR. DAWLEY: I would also encourage the Commission to potentially visit some of the FCMs and get a handle around how the structures are different. If you're going to request information, I think, you know, what a big bank who is in dozens of businesses globally does and how they fund themselves and how they deal with leverage versus a smaller FCM who's more future-centric is going to be, you know, very different. So, I think it would be very beneficial for you to just understand how the various FCMs are structured before you made a decision as to what type of information may be relevant for you to have a broader picture.

MR. BARNETT: Okay. Thank you. Can we go back to the liquidity point that Bill mentioned before. A big concern, again, for us that we have, you know, for instance, transfer the business and if you become undercapitalized subject to, you know, liquidating trades and some other things that the SRO or we might permit. But now we've seen several instances where a firm looks like it's, you know, it's got excess capital. It's got excess seg. And liquidity is so dire that it's problematic. Should we be seeking to do more with the liquidity issue, and if so, what should we be thinking about doing?

Bill?

MR. TIRRELL: Bill Tirrell. Just again, echo of what Maureen said before. A lot of these conversations are already taking place, at least at the bigger banks, and to the extent that you could tap into that, I think that would be very beneficial to start to frame what exactly -- we used the term liquidity. What does that mean, and what are those measurement standards and such? I mean, clearly having a diverse source of funding, you know, spread out over multiple durations and so on becomes a much more stable environment than having single-source short-term financing with long-term obligations.

So there are things, and there are measurement standards that can be used, but they have to be framed, as we heard before, to match the business, to match the different products with the business, and so on. But there is quite a bit of information, already, that's being disclosed to the various regulatory bodies. And I think that would be, as Mike said, very beneficial to start participating in that, or visiting the firms and understanding what the management is doing in order to measure all that, because again, I think all of us are well aware of the shortcomings now of having limited liquidity in the firms. And they've gone to great measures to review all that, put standards in place, to have internal committees to constantly review that.

So, I think there's a lot of information you could tap into that would make it worthwhile to you to create some sort of measurement standard for the different FCMs.

MR. BARNETT: Okay. Thank you. Other reactions? Other thoughts?

MS. AYOTTE-BRENNAN: Christine Ayotte-Brennan from Fidelity. I mean, I would venture to guess, definitely for Fidelity, and probably for the rest of the buy side, that you wouldn't get any argument about having increased, you know, transparency with liquidity. I mean, I think that coming up with standards that -- as people have pointed out, not all firms are the same, so coming up with standards may be tough, but I think if there was a, you know, industry standard that we could look at FCMs and say, oh, well, their capital's good, but, really, look at this liquidity, that it would be helpful for us.

MR. BARNETT: Okay. Okay. All right. So, let's then, maybe, let's turn then from reporting to us to more information for customers. And I know this is a little difficult to discuss in the abstract, but can we hear from -- I guess we're going to have a very different perspective from the buy side, the FCM community, but what kind of information does the buy side need to receive to have a level of trust and confidence in what's going on at the FCM. And then, let's triangulate on what kind of pressures the FCM or the concerns the FCMs have, if any, with that information.

MR. THUM: It's Bill Thum here, at Vanguard. I think this question gets at part of an issue that we encounter when we work with our FCMs, and certainly from Vanguard's perspective, you know, we have a lot of faith in the FCMs with which we trade with. However, we are aware that there's a broad range of FCMs, and certainly a broad range of clients, and all the clients don't either have the size or the business relationship or work with FCMs in a way that they can have full confidence in terms of transparency in a window into the FCMs health and performance.

So, I think that for the industry, Vanguard certainly, and ICI, would support a greater window into some of the reports that the FCM either currently provides or in accordance with the FIA and NFA recommendations will provide in the future. And I think that will enable the customers to be able to make a live assessment on a day-to-day basis and know if there is cause for them to port their trades to a new FCM. Absent that information, it really is very difficult to make that assessment other than what you read in the press. So, I think in terms of compliance with segregation requirements, compliance reporting of capital levels, net capital levels, these are areas where, certainly, the FCMs we trade with we feel perform extremely well.

And I think that the industry, overall, would benefit from a mandate that not only are the reports done that are being recommended, but they may be available on the CFTC's website on a live basis for customers to have a window in. And that will really give the customers that ability to perform the due diligence and to port their trades if they suspect things are at a risk level, and they're not comfortable to continue trading.

MR. BARNETT: Walt.

MR. LUKKEN: Walt Lukken. I think FIA supports getting more disclosure to customers and helping them to evaluate FCMs. Certainly, we recommend it coming out of the Peregrine situation, developing some sort of informational portal. NFA does a lot of this already and so, we're trying to compliment what they're currently doing with their systems, but we think there's more to be provided. Certainly our concerns are what Alessandro had mentioned already. Some of this is confidential information, so we want to make sure that we're not crossing any confidentiality issues.

And the other issue is we don't want to exasperate a run on the bank if there are information that could be misinterpreted by firms; that they may start to leave a firm because they don't understand the information that's being provided, so we're sensitive to that too. That if we're trying to stabilize an FCM in a crisis situation, we don't want to necessarily want disclosure to cause a run on that institution. So, those are the things, I think, we're certainly in favor of more disclosure, but we have to balance those issues as well.

MR. DAVIS: This is Warren Davis from Sutherland. On the question of run on the bank, I think it's interesting to step back and compare the situation with an FCM with that of a bank. The bank is using the customer money and going out and making longer term investments, and obviously, cannot afford to have all its customers immediately demand the return of their funds. So, that's where the run of the bank comes from.

In the case of a FCM, the money that the customer gives the FCM is not for the use of the FCM. It's solely to protect the customer, so it seems to me that the run on the bank analogy is not altogether appropriate here. But what is appropriate is to ensure that customer money is, in fact, used for the only purpose for which it's given which is to secure the customer's obligations to the FCM and the clearinghouse. And therefore, if information is released which causes a customer to move its account from one FCM to another, that shouldn't be viewed as a bad thing. That's sort of the way the futures world is supposed to work. The idea is that one of the big benefits of futures versus the OTC swap market is that you can move your money from one place to another readily and without consequence.

So, I think we think the emphasis ought to be on the disclosure and not on the concern about the potential adverse impact it may have on a particular FCM. I mean, it could cause them to lose business and to lose some profits, but that's not really what we're concerned about. We're concerned about whether the customers can do their trades with confidence that their money's going to be used properly.

MR. LUKKEN: Maybe run on the bank is not the right analogy. I understand your point, but oftentimes you're trying to wholesale, move that book to another FCM, and instead, if people are leaving and cause it to run into bankruptcy, it's a much more difficult situation for customers. It takes a lot more time to work through those situations than in a situation where you can sell and stabilize an FCM and move it to another FCM. And so, I think that's what we're trying to avoid, not necessarily a run on the bank. Perfect analogy but --

MR. BARNETT: Let me try to frame. I guess one risk of -- two sides of the coin -- two sides of the discussion. So, if one is if there's information that's material to the safety of my money, I want to know versus you give out information that causes a concern that isn't material to the safety of my money, but causes -- what are the risks of giving the wrong information? Could be a run on the bank, and if it didn't do what it was supposed to do, or -- I think that's what you're trying to say, so labeling it as run on the bank isn't what I'm hearing as much as that's one of the risks of giving the wrong information or too much or something like that.

And what Warren seems to be saying is, you know, I shouldn't bear the risk of not being told information that could be significant to the safety of my funds, and finding that place is difficult. And Warren's point is, who should bear that risk of getting it right or wrong? But when we're in a safe situation, we could try to be analytical about -- and try the best we can to talk about it. So, that's why we wanted to get views from people. Bill was talking before about second secured, but then you also said window into the health and performance of the institution. And I'm not sure that just second secured or maybe even just capital goes to all of that.

So then, how far do you go? And then, when you go too far you run into the burdens that Walt and Warren are talking about. So, what we were hoping to do, and as you can tell, we've been thinking a lot about, you know, what is it that people need, and what goes too far? We want to get help from folks on finding what data points are appropriate and, you know, not go too far in the sense of we're giving stuff that's not helpful, but it's burdensome, then, to the business versus we're giving stuff to customers that they ought to be able to see, and they're not currently seeing.

MR. DAVIS: Gary, as you know, we submitted a letter which had some very detailed comments on specific financial disclosures which either you presently require or which the FIA suggested ought to be required that FCMs give to the Commission and to their supervising auditors.

Our point was twofold: one, that information ought to be made as timely as possible; and two, that information ought to just sort of automatically go up onto a public website, so that the customers have visibility into it.

And we did suggest some ways in which, actually, the information that you're currently soliciting could be refined to make it more meaningful to customers; for example, excess funds in seg. You really want to know how much of that excess represents amounts which customers have voluntarily left with their FCM versus how much the FCM have put in there as a cushion, sort of residual interest. And seeing that on a daily basis would give customers, I think, a lot more information and confidence about how an FCM is dealing with segregation and what risks they may face by dealing with a particular FCM.

MS. TAYLOR: Gary --

MR. BARNETT: Let's get Howard, then I'll go to Bill.

MS. TAYLOR: Can we just make a

correction, though, first? Excess seg. I mean, I wonder if what you're getting at is you wanted to know how much margin was required from the customers? How much margin from the customers the FCM held, and then how much excess seg they had which actually is the firm's investment in seg. Is that what you're trying to get at?

MR. DAVIS: Right. So, there's an exchange level, and then there may be an FCM level, and then some customers leave excess amounts --

MS. TAYLOR: Some customers leave excess in addition to their requirement.

MR. DAVIS: To distinguish that from the amount the firm--

MS. TAYLOR: From the amount the firm invests. Okay.

MR. ROTHMAN: I think that we need to step back and after MF situation, we made a business decision to put on our public website not only the last current 1FR/Focus Report less the income statement, but for the last three months so that somebody could take a look at it and look at it on a trend basis, and including the last audited statement. And I can tell you, it's been now seven or eight or nine months, and what's happened is we've stopped receiving calls that you would receive from time to time -- would like to know more about financial structure, the FCM, could we speak to somebody? And at the last instance with PFG, we tracked the hits to that part of the site, and it shot up.

And we also tracked over the last month, monies received and monies gone out, and there's been very, very -- less than average amount of money gone out. So, I don't see -- and there's a lot of information, obviously, in a focus report and 1FR and maybe there's some changes to it that incorporates some ideas, but I don't see any downside. And I'd be more than happy if it has to go on a portal.

Also, that we at least start with that statement, because there are many times we as FCMs are also counterparties, and it would be nice information for me to see, or another FCM to see with someone else, about their counterparty, so they could evaluate it. If the customer sees it, they'd rather see it than not see it. I don't think we've had any negatives. I don't think we've lost any business. If anything, I think we've maybe gained business and trust. And I just think one should just think about it.

Obviously, the SROs, your banks, CFTC, and regulators are getting copies of that information. Why shouldn't the customer get it? Who's really -- that's where the money is coming that you're entrusting, so I just think it's one of those things where it sounds like it's a big deal, but once it would get implemented, people would say why didn't we do this a long time ago.

MR. BARNETT: Bill?

MR. TIRRELL: I mean, I think the FIA is in agreement that there's plenty of room for more disclosure, but just to comment on Warren's comment before, the reality is the world is not real time. So, an FCM that has daylight exposure, for instance, and is moving money through the course of the day by a facility from a bank. That bank goes, and you read in the paper -- decides that it's not going to renew its credit facility. Well, that may be information that would cause you to pull out. Maybe you didn't inquire enough to find out, well, yeah, that bank is not renewing your credit facility, but they've already enlisted two other banks that have doubled their credit facility.

So, the amount of information, the way it's dispersed, I think, is critical to be interpreted properly. It's not just how much is in seg during the course of the day and so on, or at close of day. I think that's information that we all agree should be out there, but there are other things that we need to take into consideration that can be very easily misinterpreted. And in today's world where everything's almost instantaneous, all you need is a little sniff of blood in the water, and you could have a very solid institution start having problems real quick, and I think that's where the balancing act comes into play. And quite frankly, I see that as a very important role of the Commission, because if you had full disclosure, I don't think we would need you guys.

MR. PICCOLI: Let's not go too far, Bill. (Laughter) Bill, I guess one of the things we've talked about internally, 8K- type disclosures, which is one of the things you were talking about. If a firm, their clearing bank, is no longer going to clear for them, but they have someone else. Well, is that a significant enough disclosure that should be made out there so people know, okay, well, JP Morgan is no longer going to clear? It's now going to be Harris Bank. Or things along that. I think the SEC already has, you know, well defined 8K-type disclosures for significant events. Is something like that important and helpful to people, to the public to see?

MR. TIRRELL: I think my response to that is that it depends. If you have an entity that has many relationships and losing one may not be that material. An entity that has one single relationship, maybe that's very material. But I think, as we talked about in an earlier session, that dialogue of where the firm is going, you know, the ongoing relationship with the firm, understanding the firm in many aspects will help guide you in that decision as to what needs to be publicly disclosed versus what can be disclosed to a regulator.

MR. BARNETT: Mike?

MR. DAWLEY: Hi, Mike Dawley. I'd just like to reiterate what Walt had said earlier and as one FCM, point out that we are totally supportive of getting as much transparency out there as possible, but I do think it's important to note a couple of risks that exist. First of all, you should know that as an FCM, we disclose to our clients pretty much whatever they want to know, and we have no problems supplying the regulators with a lot of information. What we're concerned about are the -- not our clients or you, it's everyone else who could misinterpret information. So, I think whatever we do there is going to require a lot of education, and I think, you know, the data itself really needs to be analyzed, and we need to be certain that, you know, somebody can't game the system or use that in an inappropriate way.

To Warren's point on excess, I think that's a prime example. I mean, right now, the excess numbers are being reported monthly, and I think those even are flawed and could even give a false sense of comfort. You know, there's big variances across firms there. Some firms have actually made a conscious decision to keep a consistent cushion in there, which is excess. Other firms just house their entire capital in the seg pool, which also appears as excess. Does it mean that a person who's got more in the latter bucket is safer than the other firm? Not really, because that's their capital. It's working capital. They could pull it out at any time, so I think some of the new rules and recommendations may prevent that going forward, but you know, it's really important to focus on what type of data we're going to put out there to the public.

MR. BARNETT: Warren, what's your reaction?

MR. DAVIS: I agree that it's really important to understand what the data is and what it isn't. And the education is very important. But I don't think the answer to that is not to put it out. I think the answer is the education, and get it out there, and get it out there regularly so that people don't do sort of end-of-the-month transactions to make their capital look better. It's valuable to have it on a daily basis where you can look at trends and see whether this money is for real. I agree that we need a lot more education about what that information means and what it doesn't mean.

MR. THUM: Bill Thum at Vanguard. Yeah, and I agree with that, I think that having a consistent agreed set of meaningful data points that can be reported in a consistent basis across the FCMs to be made available to all customers would really be a huge step forward. As I mentioned, you know, obviously, Vanguard has a strong credit team, a strong counter party risk team, and does a lot of in depth analysis and has strong relationships with its FCMs. Many, many customers, though, either don't have the wherewithal to perform that or don't have the business relationship. What you could end up having is those that can perform the due diligence supporting all their trades ahead of a problem, and having customers that don't have the window in or don't have the wherewithal to have the relationship remaining up until the end. So I think that having those data points, making them available publicly, you know, creates a level playing field for the customers, and also for the FCMs, because certainly, there are stand out FCMs certainly referenced in this room that have a very good story to tell. But we need to be able to differentiate that.

And it's interesting, the story you were telling about, that Howard was telling about the report made available on Merrill's site and it not being hit as frequently as you might expect. And I think, you know, that speaks a little bit to how well known is it that that information is available there among customers. And I wonder if the Commission did address this and require that the information be made available, then I think it would be hit on a regular basis by all customers in dealing with their FCMs.

MR. DAVIS: There's another point. I've had discussions with FCMs that said, well, you wouldn't know to look at that because you're representing large institutions like, you know, similar to Vanguard that have the capacity and resources to pay attention to this. But the real people who have lost in this market are the small investors. And the answer that I give is that, if you put this information out there, there will be third parties who will monitor that information and convey it, I think, to the small investor. So I don't think we have to be concerned that the small investor is not going to have access or wouldn't go to it, because I think there will be Wall Street Journal, Bloomberg, others who, if the information is meaningful in real time, we'll monitor it and provide the broader investment community with information about what's going on.

MR. BARNETT: Bill, can I ask you; are there data points that your diligence people tell you they routinely can't get when they look at FCMs and evaluate them?

MR. THUM: Well, no, I think that, you know, just the opposite. We've selected our FCMs for Swaps Clearing, you know, and that was based on discussions that we had with them and an understanding of the strength of their business model. So we do have that dialogue.

MR. BARNETT: Was it because you have access to them?

MR. THUM: Because we have access to them, there's a big potential for a lot of business to flow through them, and so there's an incentive to provide that data. And I think, you know -- so, in terms of Vanguard, I'm not suggesting that we have a problem in terms of how we make those assessments, but I think that, you know, we really should be aiming not to craft a situation where the large asset managers already have the information that they need, but that all customers have the information that they need.

MR. PICCOLI: So, Bill, is there any I guess I would love to, and maybe we could have it offline if you'd like, but just try to understand what are those data points that your folks are getting that may be very helpful for the public to get, as well?

MR. THUM: Sure, we can do that. And I think, as a starting point, certainly, the letter dated March 27, 2012, from the FHL banks that warrants mention has a really good summary of critical data that the buy side is looking for in a consistent basis from their FCMs.

MR. BARNETT: Yeah, Todd?

MR. KEMP: Todd Kemp with National Grain and Feed Association. I just wanted to follow up on Bill's point, I think it's a very good one. We represent agricultural hedgers, they're the purchasers and the end-users of grains and oil seeds, a lot of very small companies, and I'm sure they don't have the personnel or the access that some of the larger customers do. I don't have any particular data points to give you today, Gary, but I think more information is better than less, you know. We don't want to be in a situation where we're causing the run on the bank that we're talking about, but I think where our members really need the information is up front. As you said before, there's a crisis situation to do their due diligence to make the good decision up front to avoid a problem. So, you know, I was thinking back to the round table in this room -- when was it, back in February?

MR. BARNETT: Yeah, it was in February.

MR. KEMP: And there was a lot of talk about this same subject, about the type of information FCMs could provide. I think there was pretty much consensus around the room that, yeah, we ought to start doing this. Here we are, six months later, and it sounds like maybe there's been a little bit of progress. But I would sure encourage the Commission let's try to move more quickly instead of less. You know, we've seen a couple of more episodes since that time that have affected a lot of customers, so we'd sure like to see movement relatively quickly.

MR. LUKKEN: Just to add -- Walt Lukken -- to standardize and centralize this information, I think, is going to be tremendously helpful, as Bill was talking about, too, for the smaller customers, the small FCMs, as well as the larger ones. But I think the added benefit, just to add a fine point to this, is it's also going to create, while you put sunshine on all this, create benchmarks for the industry so that people with great risk management standards, like many of the people around this room, they may be shown to have those great risk management standards through disclosure. And it's going to shame the others who may not have those same risk management standards to want to get better and to pull up those benchmarks. So I think it has the added benefit of creating best practices within the industry as long as we can standardize it and make sure it's not misinterpreted. But if we get the right information out there, I think it's really going to be helpful.

MR. BARNETT: Okay, great. Dan?

MR. DRISCOLL: Dan Driscoll from NFA. I just wanted to point out that, recently, NFA adopted a new rule, Financial Requirement, Section 16, that requires a lot of information to be filed with the NFA and the SROs daily, semi monthly and monthly. And quite a bit of that information is going to be published on NFA's website in a way that puts it together with other information about each FCM, their registration history, their disciplinary history. And I did want to point out, because there was one, one concern is that a firm could do transactions at the, every two weeks or towards the end of the month, it would give them more flattering outlook than they are generally. And we issued an interpretive notice at the time we adopted that rule that says if we catch anyone doing that, that will be inconsistent with just and equitable principles in trade, and subject that firm to enforcement action.

Because we think it's very important that those numbers are not just window dressing as of one or two days a month, but are indicative of the standing of the firm throughout the month.

MS. BURKE: And, Gary, that was the intent, and you're referring to the SIDR report, and that's been a detailed report that the FCMs now need to file twice a month. And the intent on the recommendation was that, not only to just have it at month end for the purpose that there could be window dressing at month end, but twice a month, and also to detail out all of the investment types, as well as the counter parties and custodians and bank custodians. The FCMs are sending information in every day, the daily seg reports, and sequestered. So the intent there that it goes out to the regulators, the regulators can monitor our DSROs and can monitor where there's fluctuations, if there's fluctuations in the seg access, if there's big variations in the seg access that can bring up the FCMs and inquire if there's something going on within the FCM. There's also been enhancements made through, obviously, recommendations, and now NFA has taken them further, and the CME on documented policies and procedures on the targeted financial interest. And I think, Dan, the rule that has come out or is being finalized is that only the CFO or the CEO can sign off on the documented policies and procedures. And if there's a withdrawal of 25 percent from the prior day seg excess amount, that has to be authorized and signed off by a CFO, CEO, or a financial principle. And when you look at the financial principle, the intent there is to bring it down to someone who has the authority and knowledge of the seg computation, understands the ins and outs, the nuts and bolts, and, you know, is monitoring this on a daily basis. I can tell you from the work that's been done through the

Financial Management Committee, where we put this work group together after the round table back in February, there's been extensive work, and we support transparency, full transparency out to the client. We're looking at what should go out as consistent information, whether it goes out to every FCM's website, or if it comes through the NSA website, but, you know, there is the intent to have full transparency to aid the clients to review, you know, the various FCMs and have access to that information. And there's still work to be done. I think this is an ongoing process, we need to evaluate all the policies and procedures, and continue to make enhancements to customer protection.

MR. BARNETT: Okay.

MS. BURKE: I think the point of online access, where the DSRO or the NFA can get access to the FCM's bank accounts, which are under way right now, I think that will help enhance the protection. Because you're not just relying upon information that's stated, this is information that, you know, they would have to go in and do spot checks, a comparison. They'd have to go in, get the seg report, they'll have the seg report daily, go in and look at the balances on a spot check basis. And the industry supports that, the FIA supports it, and I can tell you every firm that's represented with broad representation to the Financial Management Committee supports this. We're looking for what can we do to improve customer protection and get rid of the black eye that's killed our industry. This is paramount.

MR. BARNETT: Okay. Christine?

MS. AYOTTE-BRENNAN: Christine Ayotte-Brennan from Fidelity. I mean, I think the point that Maureen made about consistency are extremely important, as well as Bill's points on leveling the playing field. What I would say about leveling the playing field, though, is that I equate this a lot of ways to reg FD in the securities world, right? You should get the same information to everybody at the same time. So even amongst the big money managers, you may have one credit team that calls an FCM one day and gets some information that somebody doesn't get for three more days. So I do equate it to that type of reg FD disclosure. And maybe something like that, and having all of those reports consistently on a daily basis, or on a regular basis would help not only the smaller guys, but everyone across the industry.

MR. BARNETT: That's an interesting point. Mike?

MR. DAWLEY: Mike Dawley. I think it's also important to just focus in on who is the target audience for this information. I think, you know, as I reflect back over the last couple of years, the vast majority of our clients are educated now. It's been a long process, and we've welcomed it, I've lost my voice some days having so many conversations with clients. But it's really a great feeling to know that your clients are fully informed as to how you're structured, how the business operates. And I do commend Bill for, as a large client whose got this information, representing the smaller type client, and I think that's really the audience that needs help and needs more information. And if we reflect back on some of the recent events that have occurred, they have mainly involved the smaller clients. So, as we look at ways to educate, we look at information disclosed, I think we have to keep in mind that that is an important constituency that needs help versus the larger institutional clients and the big bank firms. So I just wanted to make that point.

MS. TAYLOR: And I would agree with a lot of what Mike said, and think we also need to make sure that we consider the fact that, from a client's point of view that doesn't have a huge due diligence department, and I realize that Vanguard is in a different spot than -- many clients are in a different spot than smaller clients. I think we want to make sure that perhaps there's an educational piece or a framework that comes along with it on how they should interpret the information. Perhaps there needs to be information that lays out what some differences are naturally going to be between something that is a Broker Dealer FCM and something that is an FCM only. Those profiles, I think, will look very different, but the risks that those businesses face that could affect the customer can also be very different. And so I think there are, I think continuing to educate the customer how to use the disclosure is going to be important. Even if we come to an agreement on what kind of key standardized disclosure points might be. Because one of the worst outcomes that we could create is a false sense of security, because certain things about the FCM may or may not change in cases where there is a Broker Dealer FCM, or cases where the Broker Dealer business is outside the FCM and don't show up in the FCM's records. But the firm is still at risk in pretty much the same way they would be if there was a joint Broker Dealer FCM, but those risks would show up in the 1FR. So I think we have to be thoughtful in how we handle those things.

MS. BREGASI: Hi, Nevis Bregasi from MFS. So, going back to educating clients and helping the smaller client that doesn't have as much resources. I thought the FIA earlier this year put together a list of FAQs for clients which was very useful and gives the clients a lot of information that they weren't aware of before. I'm sure there are things that can be added to the FAQs, as well. Where do those stand, are they currently required to be given to clients, or not, yet?

MR. BARNETT: Yeah, on the FIA website, right?

MR. LUKKEN: No, we -- at they're best practices that we've put together, and we encourage our firms to use them with their clients, but, you're right, they're evolving, so we're in discussions with Gary and others in the industry about what else do we need to add, here. And I think we have also, FIA has an educational arm, an affiliated company called the Institute for Financial Markets, they're more about educating. And, really, this target audience that Mike referred to, we really need to -- sophisticated customers don't need an education, it's really the smaller ones on how to evaluate properly an FCM. We're talking about the types of information we're going to disclose, but what do you do with that information? And so I think the next step for us is to develop programs for outreach.

The Commodity Markets Council is trying to do this already, I think, with some help with law firms with certain ag clients. I think that's great. We're going to try to do some more with the IFM. And I think our FAQs, as you mentioned, are going to evolve over time so that we can, you know, improve those so that they're exactly what the customers need.

MS. BREGASI: But could some of those FAQs, though, go into some sort of risk disclosure to the client, which I know it's already being given by FCMs to clients when they sign up the agreements? And they probably should be given on a more regular basis so it's not done once. I mean, if the agreement is on for ten years, you've never read it again. So that's one point. I really did think those were very useful, and even larger clients that should know more, there's still a lot of gray areas that people are learning every day, so it would be really useful for clients. And, again, going with a smaller client, while a lot of smaller clients might not have the time or the resources to look at the NFA website or the CFTC website, one thing they most likely are looking at is their own statements.

So, currently, when you get a statement, there's no real detail of exactly where your collateral is, and breaking it down between, for example, U.S. futures and foreign futures, there's also no information on the foreign futures as to who your local FCM is that the U.S. FCM is using in that market. I totally understand that the client is taking the risk of dealing in a particular foreign market and understanding that there might be insolvency laws that are different there, but not having a regular daily report of who the local FCM is, where your collateral is sitting, and really informing your counter party risk at the client's side, there's sort of a hole in the system, there, where we're not seeing all the detail we should be seeing in order to evaluate our own counter party risk. And I don't know, just asking the FCMs, is there a particular reason why they can't be given, or is it possible to give that information daily to clients?

MR. DAWLEY: I'll take that -- it's Mike Dawley -- or at least one of the components, maybe Maureen can grab the other. First of all, we are required to disclose who we use in different jurisdictions, so that is information that's put out to all of our clients on their statement. So if we use a third party broker in Spain or somewhere else, we've got to disclose that sort of information. I'm sorry?

MS. BREGASI: I'm sorry, is that in the daily collateral call statement?

MR. DAWLEY: No, no, that's just the

brokers or the entities we're using. As far as your question to collateral, that gets a bit more complicated, maybe I'll have Maureen take that.

MS. BURKE: Yeah, I wouldn't, I'm not aware on daily statements out to clients that it breaks it down to who the counter party is. Where this is coming out into play, and we can look at this, and it's great to have this, this feedback, it's on the SIDR report, on the Seg Investment Detail report. On that report, it will show all of the counter parties, and if whether it's an affiliate or a third party broker, it will show who all the counter parties are. But I think, you know, I understand it's a wonderful to have the feedback, I think we've been operating in our business, and our daily statements go out to our clients, and I think we can look at that and say is there the potential, even just as a footnote to state, you know, the balances are held with, you know, XYZ counter parties.

Typically, I think we make an assumption that clients know all of our clearing relationships all around the globe, and many clients come in and they want to go through a large FCM, they know the counter party credit risk underneath, so they know the affiliates that we're clearing through. We give out all of our memberships around the globe and the affiliates that have the clearing memberships, and we also disclose if we have any third party relationships. But it's not bringing it down to the same detail that you're asking for.

MR. DAWLEY: I do think it does bring it down just via the initial margin required for the particular product that might be trading in another jurisdiction. So the IM's there, and part of the value proposition FCMs provide clients is the ability to consolidate reporting and potentially single currency margin, et cetera. So you can be assured that the value of that margin is sitting at the CCP or at the third party broker that relates to that product. I don't know, I'd like to hear if you'd like to get more granular than that, that's where I think it gets complicated.

MS. BREGASI: Well, could you have, in the local market, could you have money sitting at the DCO, the local DCO, and then money sitting in the local FCM, so that you have that division between the local clearinghouse and the local FCM? And the local FCM might be using another custodian, do we know who they're using? For example, I was very surprised recently to find that one of our larger FCMs that we're looking at for clearing swaps, when I looked at the questions that they were, we had asked a number of questions, and I was going through them, they use for their custodian for their futures and cleared swap segregation margin, an affiliated, pretty much their bank. Which is very surprising as a client to see, because you would think if there's an insolvency of the FCM, you don't want your initial margin sitting with their sister company. So just that type of information, which, even though it might be in separate reports, as an individual client that doesn't have as much resources or time, you're not going to put it all together, it's easier if it's in one place.

MR. BARNETT: Dan, are you able to speak at all to the, where it's located -- you know, this question about what NFA's thoughts are? Are you still in development of that?

MR. DRISCOLL: Well, one of the pieces of information that we will get when the rule becomes fully effective is whether the FCM has assets, seg assets or secured assets on deposit with one or more affiliates during that month, but we're not going to have it detailed down by which one and how much in each one. But that's what we were intending to make public is either a yes or no, we have money with affiliates or not.

MR. BARNETT: Well, my sense of it is that there's still a spread difference between, you know, knowing where the funds are located and where it's invested at that location. You can't get them all together yet. What I'm hearing is a desire to have more detail on that, and I think there's still some gap. I wonder whether, Bill and Warren, have you been following the developments, like the Section 16 information, and the, you know, the SIDR report and all that kind of stuff, and how much difference there is between that and what you guys have been asking for in terms of information?

MR. THUM: Well, I certainly have been taking notes, here, so I want to --

MR. BARNETT: Yeah, it's not a test, so that's okay. But I think there's still some -- I know your letters predate, I think, or -- and I think you've got to triangulate on them a little bit. I think there's movement, but I think there's still difference there, there's still a gap.

MR. COCCO: Gary, if I --

MR. BARNETT: Eileen, I overheard that.

MS. FLAHERTY: That's okay. Eileen Flaherty Newedge. If there's a better way to give clients access to more information, I think everybody around the table is saying the same thing, that that's a good thing, and that's necessary, and the purpose is to give clients comfort as to where their funds are, where they're being maintained. If there needs to be more transparency about use of affiliates, then so be it, then there needs to be more transparency, and there will be an effort to be more granular. But I think, to Maureen's point, there are really two issues here; disclosure, but also protection of the customer funds. Your disclosure goes to, do you want to do business with that FCM, but there also, hand in hand, goes with that, the protection of the customer funds. And the smaller investors really aren't going to be doing what you're doing, they're not going to be pinging the websites daily or monthly.

And so, to protect those customers, it really goes hand in hand with what Maureen said and with what NFA is doing to be able to verify, independently verify through electronic means and comparison those balances to know that those funds are there on a daily basis. And I think, really, that's the level of protection that the regulator has to provide to, not only protect you, but because you probably don't need the protection, but the smaller investors really do.

MR. BARNETT: Alessandro?

MR. COCCO: Thank you. I just wanted to mention that greater transparency will, of course, enable customers to make their own decisions, and also the educational efforts, I think, are very important. On the affiliate point, I wouldn't assume that holding a deposit with an affiliate is necessarily is bad thing, it depends on the affiliate, of course. Also, looking at the alternatives, if you force an entity not to hold deposits with an affiliate, then you force them to go outside. It may be a positive, it may be a negative. So I think the greater disclosure will enable everyone to make a decision based on the data available.

MS. BREGASI: Would it be possible to discuss it a little bit more? Because I just want to understand -- what --

MR. BARNETT: Can you speak up?

MS. BREGASI: Could we discuss that a little bit more, because I want to understand what the negative is. So, as a client, if you're using -- I'm just going to pick on you, Alessandro -- so if you're using JP Morgan as your FCM, and they're keeping all the initial margins sitting with JP Morgan, Chase Bank, NA, isn't it more likely is that if the FCM is insolvent that there might be some issue with the bank, as well? So now I have a double whammy where the initial margin that's supposed to be protected from the FCM's insolvency is sitting with a sister entity. So I don't think we have an issue with having a local FCM be affiliated, so you're using someone in your local market, but as the custodian who is actually holding the initial margin, what would be the negative in requiring that to be a different entity and not an affiliate?

MR. COCCO: Yeah, thanks for raising that. I think it is highly fact-specific. So, in other words, it depends on the custodian. The custodian may be a very strong capitalized bank that is not going to default. You're making an assumption that the two will default at the same time, and, of course, that may or may not be the case. So that was my only point. So, I'm thinking of other jurisdictions where there are, there's a requirement to not hold the collateral with the affiliate. You then essentially are forcing the FCM to go outside, and then they may not have an option that is as good as their own affiliate. So it really does depend on the affiliate, on the facts, and on the due diligence that you, as the customer, with the information available to you on the FCM and the custodian.

MS. TAYLOR: I just wanted to mention -- this is Kim from CME -- there are some emerging regulations in Europe that impose different capital treatment or different capital charges, I think, on the relationships between affiliates. I don't know if they extend to custodians, I think it's more related to holding margin requirements with different affiliates. But that might be something that we could talk about or look at, or maybe some of the firms with FSA regulated affiliates could comment on that.

MS. BURKE: Yeah, under FSA rules, there's a limitation that you can only deposit client money, which is equivalent to seg, up to 20 percent with an affiliate. There's a limitation there.

MR. BARNETT: Other thoughts?

MR. PARKE: Ross Parke. Just to go back to the disclosure of a number of pieces of information. Obviously, I think everybody in the room is for increased transparency. And going back to having it in a central repository, which is similar information, same information which is auditable by someone such as Dan with NFA or another group. I think that's the key in taking the information up, the brokers, the external brokers or affiliates having that information all in one location where you can see the information side by side, I think that's the key. If it's on websites that are controlled by the FCMs, I think there's more risk for manipulation of that information. I think, as you go down the rulemaking road, I would encourage you to look at how that information is stored, gathered, when it's distributed, is it same day, is there a delay similar to the financial data. When you get to information such as the SIDR report, that holds all of the custodians, it does have all of the bank locations.

So, going back to an analogy referenced earlier, the run on the bank; well, there are banks on there, and if Barclays decides to move its balances from one bank to another, that could be a purely commercial decision, it could be -- and it could be viewed incorrectly by clients if they see that movement on the bank balances. So I think that we just need to be careful how that information is displayed and distributed.

MR. BARNETT: Mike?

MR. DAWLEY: I have two quick examples of where information could be misused, maybe they're relevant or not, but, you know, for example, if -- one thing we've talked about is disclosing where margin sits throughout the world. And I may disclose that I have X amount of initial margin or client asset sitting at Eurex. And I happen to have some big clients who often will shift their investment strategy from Europe to the U.S., and suddenly, the public is seeing a huge drop in Eurex margin and a huge increase in CME margin. Is that something that we should be worried about? Maybe I don't care, but maybe the clients who are trying to shift their position would care. So that's a potential unintended consequence. Also, just public disclosure, and I don't know if you meant it to be public, Nevis, but even the brokers we might be using in a particular jurisdiction. Should a potential customer have access to that? Yes. Should the regulators have access? Yes. But should everybody in the world have access to that? I don't know. Same sort of deal, you know, if someone sees that Goldman Sachs uses X broker in a particular jurisdiction, and they see unusual activity or something, can they gain that sort of data? Just something to think about.

MS. TAYLOR: Or another example would be if Goldman Sachs used broker X in the jurisdiction, and for commercial reasons, just like you mentioned, you moved your bank balances to another bank for commercial reasons, you move to another carrying broker for commercial reasons, and the market misinterprets that as --

MR. DAWLEY: Good point.

MS. TAYLOR: A vote of no confidence in that carrying broker. I mean, those are the types of things I think we want to be sure that we think through all of the possible unintended consequences as we develop the disclosure. Which I'm in agreement with more disclosure being better, but we don't want it to have unfortunate unintended consequences.

MS. BREGASI: Sorry, can I jump in? So, Mike, I think my example was just information, too, on the statement to the client, so it wouldn't be anything that goes out to the public. And then two other points; just the point about generally not making something a requirement. Just for example, not using an affiliate as a custodian, because clients can just pick if they don't like that, they can go to another FCM. One concern is if you have five of the largest FCMs doing that, then where am I going? So is that making me not use those top five FCMs and moving down the list when I don't want to. So that's just one issue with leaving it up to disclosure and not making it a requirement.

And then, since we're talking about local FCMs and picking local FCMs and moving from one to the other, I don't know if this is the place for this, but another thing that's worth considering is, what duties does an FCM have when they're picking local FCMs for clients? Since, as I've said before, we're choosing to do business in that market, but we're not actually picking the local FCMs, so it would be good to understand what types of due diligence does the U.S. FCM do when picking local FCMs, how much of that can be given to the client and how much of that is ongoing?

MR. BARNETT: Christine?

MS. AYOTTE-BRENNAN: Christine Brennan from Fidelity. I'm getting back to the unintended consequences argument. I think we do have to be extremely thoughtful about how we present this information so we don't have unintended consequences. However, in a couple of the examples that I've heard of moving for commercial reasons, I think that's a good story for an FCM, right? So it gets back to disclosure, you're moving from one bank to another for a commercial reason, or from a clearinghouse to another for a commercial reason. Why not disclose that? Hey, we moved from X to Y because we think they can give us better service. I mean, I think that's a good story and can be disclosed in a way that doesn't create these unintended consequences.

MR. BARNETT: Warren?

MR. DAVIS: Just to make it a little more complicated. In our negotiations of clearing arrangements, talking about disclosure issues, one of the points that was made by a number of FCMs was we can't give you that information because we're not giving it to everybody else, and there's potential, you know, inappropriate disclosure to some people and not to others. So that's why we sort of urged a lot of this information to be made public, so we take that issue off the table.

MR. DAWLEY: Just to be clear, that point wasn't made here today, right?

MR. DAVIS: (Laughter) No, today, everyone's transparent, I don't recall that being made, no.

MR. BARNETT: So how do we close the gap? I hear a lot of buy side concerns about disclosure, and then concerns on the other side about, you know, excess disclosure. How do we find the right balance, what do we do?

MR. DAWLEY: I'll jump in. Look, I think the FIA has already kind of started a process, here, and we would welcome the buy side to also participate, along with the SROs and the exchanges. I think it's, there's a complete alignment and synchronization across the FCMs, the

CCPs, and the regulators that a more educated client is a better client. So I think we should work as an industry to just make sure we have the proper education out there, whether it's via some sort of informational portal or more disclosure docs, et cetera. I think there shouldn't be any disagreement around here as to that being an objective. And I think, during that process, we can delve into the detail around what type of information is easily presented to the public versus --

MR. BARNETT: Where does that process take place? I mean, what are you proposing? I'm just trying to understand, how is that communication and dialog and --

MR. DAWLEY: Where does the communication take place to form that --

MR. BARNETT: Getting together -- and --

MR. DAWLEY: Yeah. I don't know, I would recommend -- I don't know how Walt feels about this, but I think we could utilize the same FIA task force that was created to work on that.

That contains the SROs and the exchanges, and we could add buy side participation to that, and try and craft some sort of a plan and come back to you. Does that make sense?

MR. BARNETT: Yeah, that would be great.

MR. LUKKEN: And I don't think there's as big of an out trade as you might think. I mean, I just think everybody around this room, I think, is actually pretty close to sort of understanding where the tradeoffs have to occur and the disclosures that will have to happen, so we're happy to host a round table if that's necessary. Certainly, we don't have the force of law that we have with disclosures. We can encourage, we can try to get on the bully pulpit and encourage our firms to do these things, but I think it's going to ultimately be the SROs and the regulators that are going to have to --

MR. BARNETT: I mean, we could do another round table that focuses just on this one issue --

MR. LUKKEN: Yeah.

MR. BARNETT: And have, you know, the buy side with their list of issues. I don't know how else to do it, but it seems like you started, with the way Mike is suggesting, would narrow it somewhat and see where the real disagreements really are.

MR. LUKKEN: Absolutely, absolutely. And we're happy to host that, so.

MR. COCCO: I just had a suggestion -- this is Alessandro -- we've been working with the buy side, some of the people here today, on some other related issues, for instance, the implementation of pre trade limits for swaps. And that's been very fruitful. We've had the clearinghouses, the staff exchanges present, buy/sell side. So I think that having the opportunity -- and that was within FIA, as well, so having the opportunity to have one of those meetings, as well, like Mike was saying, would be helpful.

MR. THUM: It's Bill Thum with Vanguard -- I'll second that. I think the FIA has provided a really strong forum and has been very productive in terms of producing the execution agreement, in terms of producing the cleared swaps addendum, and I think that this will be another great area for us to work on in a partnership. And we, the buy side participated in meetings as late as yesterday, so we actively work with the FCMs and DCOs on these sorts of issues, so I think we could probably make some good progress on that.

MR. BARNETT: Sounds good. What I would propose is, if there's nothing anybody wants to immediately raise, we'll take a 15 minute break before we start the third session. Thank you all very much.

(Recess)

MR. BARNETT: So first an announcement. So FIA has a new FAQ, and it's on the side over there, on the table over there, and you can pick one up, and it's also on the website. Okay. Now, this last session of the day, it's sort of free form, free style, and we're talking about alternative models to seg, and what we really mean is any kind of substitute, add-on, variant. People have asked me, well, can we talk about insurance. The answer is yes.

And so, what we're trying to do is figure out, we've tried to invite people who are part of, or advocating, or whatever, just part of the industry discussion of different considerations. Again, these substitutes, add-on, variants and so on. So it would help us to understand what's going on in the market, how each of you know what's going on, help people connect to each other if you're not part of a conversation that's happening by itself, that sort of a thing. So what we're going to do is we're going to quickly -- you know, we'll actually introduce ourselves, go around, and then what we'll do is, and Cam's going to help me, every time we come to -- we'll go around the room, and everyone who's got a new one, we'll write it on the board, and we'll come up with a list. So just give it, like, a two minute, here's who, I'm working with this particular group, and we're pursuing such and such a thing, and don't go into a long thing about it because we will come back around.

We'll get a list created of what our discussion topics are, and then we'll go back through it again, okay? Bob?

MR. WASSERMAN: I would make one request, which is; help delineate, from your perspective, which of the things that we can do within our current regulatory structure, which are those things for which we can, by regulation, change and accomplish, and which are those things which, in order to accomplish, we would need Congressional action.

MR. BARNETT: And I think you can do that when we come back around to the topic discussion, let's get a list up there first, okay? But let's go around and introduce ourselves, and -- so Gary Barnett, I'm Director of DSIO.

MR. PICCOLI: Kevin Piccoli, Deputy Director.

MR. WASSERMAN: Bob Wasserman, Chief Counsel Clearing and Risk.

MR. COOPER: Charley Cooper, State Street.

MR. HURST: Steve Hurst, Merchants Data Repository.

MR. KEMP: Todd Kemp, National Grain and Feed Association.

MR. ROTHMAN: Howard Rothman, Vision Financial Markets.

MR. FOLEY: Kevin Foley, Katten Muchin Rosenman, and I'm half of FIA.

MR. LUKKEN: Walt Lukken, FIA.

MR. DAWLEY: Mike Dawley, Goldman Sachs.

MR. DAVIS: Warren Davis, Sutherland, on behalf of Federal Home Loan Banks.

MR. PERKINS: Chris Perkins, Citi.

MS. AYOTTE-BRENNAN: Christine Ayotte-Brennan from Fidelity.

MR. THUM: Bill Thum from Vanguard and the ICI.

MS. BREGASI: Nevis Bregasi, MFS and ICI.

MR. RICHARDSON: Bob Richardson from

Richardson Consulting.

MR. YERES: David Yeres from Clifford Chance.

MR. DRISCOLL: Dan Driscoll, NFA.

MR. ROE: John Roe with BTR Trading Group on behalf of the Commodity Customer Coalition.

MS. BURKE: Maureen Burke, Bank of America, Maryland, representing FIA.

MS. TAYLOR: Kim Taylor, CME Clearing.

MR. NUNERY: And Cam Nunery, Office of Chief Economist.

MR. BARNETT: Okay. So now we'll go back around, and Cam will help make this list. Again, if your product is already mentioned, just pass, if you don't have, if you're one of the other experts on the participants, that's okay. We'll just go around to find the first time for a product and get a list made up, okay? We'll start with Charley.

MR. COOPER: State Street is going to talk about, and you have a presentation in front of you for Tri-Party custody.

MR. BARNETT: Tri-Party custody, okay. Steve?

MR. HURST: MDR is going to present something very similar to Charley's, but where it's an industry owned and operated service bureau that facilitates the Tri-Party custody model for futures and cleared swaps.

MR. BARNETT: Okay. So service bureau, no problem. Todd?

MR. KEMP: National Grain and Feed Association has recommended a couple things, one is an optional full segregation structure, could involve something similar to what Charley's going to talk about, could be different. We've not suggested a particular model. Also, we believe that some form of insurance coverage needs to be layered in, in addition to that full seg structure for customers that opt not to go full seg.

MR. BARNETT: Okay. So let's put optional -- put insurance, yeah. And I know there's are others with insurance, okay, we'll just get a list up. Howard?

MR. ROTHMAN: I'll pass, insurance is on there.

MR. BARNETT: Okay. Kevin, pass. Warren?

MR. DAVIS: I won't pass. We've been thinking about the problems with LSOC, the gaps. LSOC goes a long way, but could they be partially, at least, addressed by having the clearinghouses guarantee the margin payments for the day before default until the trades get moved, so that customers would have claims not against a defaulting FCM, but against the clearinghouse?

MR. BARNETT: So we should call that, what, DCO guarantee, or -- we'll call that DCO guarantee, limited guarantee. Very limited.

MR. PERKINS: Pass.

MR. BARNETT: Pass, okay. Christine? Bill?

MR. THUM: So I have a list of, I'll call it LSOC gaps that perhaps could be plugged by through interpretive guidance or a possible additional rule making.

MR. BARNETT: Okay. We'll call it LSOC gaps.

MS. BREGASI: So, other than the LSOC gaps, excess being held at the DCO?

MR. BARNETT: No, okay. David?

MR. YERES: David Yeres. I'm not sure, and not having read the State Street presentation about third party custody agreements, I'm interested in talking about perhaps supplementing Interp 10, or alternatively setting up a direct relationship between certain customers and the clearing organization. This may overlap with what's already been discussed.

MR. BARNETT: Okay. What should we call that one?

MR. WASSERMAN: Guaranteed Clearing Participant, by chance?

MR. BARNETT: We could call it that.

(Laughter)

MR. DRISCOLL: I'll pass.

MR. BARNETT: Put down GCP.

MR. ROE: Insurance, but as well, bankruptcy reform.

MR. BARNETT: And bankruptcy reform?

MR. ROE: Insurance and bankruptcy reform, uhhuh.

MR. BARNETT: Okay. All right, let's see if we can group any of these. I think, to give the appropriate freedom to everybody, we'll just go back, we'll just start at the top and go on. Now, we've got some overlap, and the speaker will just take it into account, okay? You've got -- how many topics have we got there, Cam? Nine. And we have how much time? So we have about five or six minutes per type, I guess. So what I would suggest is maybe take two or three minutes to explain the idea, and then let's open it to the floor for questions or observations, okay? So, Charley, you've got, talk to us about the first one.

MR. COOPER: Yeah, I'd be happy to, thank you very much. All in front of you, you have a presentation from State Street entitled

Tri-Party Custody. I won't run through the entire presentation, in part to keep you all awake, but I think there are a couple of different things that I want to touch on, and the first one is to address Bob's initial question about current regulatory scheme, a future regulatory scheme, and what would require Congressional action. The proposal you have in front of you for Tri-Party could not be done in the current regulatory scheme, but the fix is actually, we believe, quite simple, and it would require a revocation of the amendment to Interp 10 that was issued in May of 2005, which prohibited Tri-Party custody arrangements in the futures markets. There is a second piece related to ratable distribution, which we can talk about, which would require a change to the bankruptcy code, but let's be clear, it is not necessary to allow for Tri-Party accounts. Tri-Party accounts can exist within the current bankruptcy code. However, the monies in those accounts would still be considered customer property under 766(h) under Subsection 766 of the

Bankruptcy Code. So, the overall review; Tri-Party custody accounts are already in place here in the U.S., they are an option for people trading uncleared swaps, they are allowed under LSOC when LSOC goes into effect in November for cleared swaps. They are mandated under the CFTC for 40 Act mutual funds that are clearing through affiliates in the futures markets, and they are used in Europe, they are allowed regulatorily in Europe for futures markets. So, in a sense, the U.S. futures market is a bit of an outlier in not allowing it, and the current regime that disallows it for futures is at odds with the LSOC regime, which would allow for it in cleared swaps. That's sort of a broad brush. A Tri-Party custody account is literally just that, it is a custody account that is agreed to between a custodian, the futures commission merchant and their client for use for initial margin and excess margin. The reason variation margin is not included is because variation margin is effectively a passthrough, moving back and forth as positions move one way or the other throughout a day. And at the end of the day, the variation movement is just that, it's a passthrough, it wouldn't require a custody account. I guess the easiest way to do this would be just to explain real quick how this works. If you go to the third slide, there's the only diagram in this otherwise word heavy PowerPoint presentation. In a Tri-Party account, when a position is put on by a customer and a margin call is made by the clearinghouse to that customer's FCM, when an FCM is willing to engage in a Tri-Party custody account, the FCM satisfies the margin call to the clearinghouse in the form of the accepted collateral by the clearinghouse. And the customer posts to a Tri-Party account the same amount or excess amounts of margin to be held within that custody account, which is opened in the name of the FCM on behalf of the client. The reason this is very important is because it's clear, within the confines of the agreement, that the FCM has unfettered access to those monies when those monies are needed. So the Tri-Party account would operate, again, as a custody account where the margin monies from the client are kept at the custodian. And what this would do is preclude the type of misuse, intentional or unintentional, that we saw at places like Peregrine or MF Global. This does not, as discussed earlier, change the Bankruptcy Code, the proposal, the first part of the proposal revoking Interp 10, and therefore, monies kept in this custody account, this Tri-Party account, would still be subject to the ratable distribution under the Bankruptcy Code. That would be the second piece. But the CFTC has the ability now to revoke Interp 10's amendment, and I think it's 10-1, from May of 2005. A couple of the benefits, though, I'll just run through, and then be happy to take questions. First of all, we've already discussed it, we're talking about a protected account at a custodian, so that that money, while it's there and the FCM can have access to it, it can only have access to it in whatever times it's necessary to meet margin calls, or if the client is in breach of the

Tri-Party custody agreement. Therefore, the kinds of excess monies we saw in MF Global that disappeared would not be there to disappear in the first place. Second piece is independent verification of customer cash and collateral. This is something that custody banks do all the time, and that's deliver a daily statement from the Tri-Party account, or from the custodian to the client. Under current rules in LSOC, customers can get statements from an FCM, but they cannot get independent verification from either the FCM's bank or the CCP's. So they have to be relying upon the FCM's statement, which I think we recently saw in Peregrine, it's not necessarily worth as much as it could be. Third thing, the FCM plays a critical role in substituting their own cash and collateral. This is important because, in this system, the clearinghouse remains fully funded, as it would in the current system. So the Tri-Party monies that are kept in that custody account are separate and apart from monies that the FCM are putting up, and the CCP is fully funded the entire time. And the final piece is that this creates less movement in terms of cash and collateral through the system every day, which decreases operational breakages and also mitigates operational risk. Margining works the same way as it does, bankruptcy works the same way as it does, the legal agreements, as I said, would be between those three parties. But the overall change, while different from the way things are going now, as I said, it's already in place in a number of other markets, and would require what is a small regulatory fix in terms of the revocation of Interp 10-1 from 2005.

MR. BARNETT: Okay.

MR. COOPER: That's the really truncated version.

MR. BARNETT: Okay, great, thank you --

MR. COOPER: We still --

MR. BARNETT: I wish we had more time.

MR. COOPER: No, understood.

MR. BARNETT: Okay. Questions? Luke, Walt?

MR. LUKKEN: No, Charley. The Tri-Party custody bank, is it a registrant or just a contractual arrangement? Would it fit in some registration category or would it just be contractual between the FCM and the CCP?

MR. COOPER: As it's currently structured, we're proposing it would not be a registrant, but to CFTC, if it so chose, could create a separate registrant category, which would be in addition to the Interp 10 revocation, if they so chose to do that. But as of right now, they would not be a registrant.

MR. LUKKEN: Thanks.

MR. BARNETT: Mike?

MR. DAWLEY: I had a question, Charley, on the FCM/CCP relationship. Who is posting collateral to the CCP?

MR. COOPER: The FCM.

MR. DAWLEY: And whose collateral is that?

MR. COOPER: It's the FCM's.

MR. DAWLEY: Okay. So there's a funding

requirement on the FCM?

MR. COOPER: Yes, correct.

MR. DAWLEY: Okay.

MR. COOPER: Actually, one other thing, if I could, which I just realized, and then questions. I should stress that this is optional, what we are proposing is optional in two different ways. First of all, the regulators wouldn't mandate that everyone use Tri-Party, but it would allow people to use Tri-Party, customers to use Tri-Party if they so chose. Second of all, we're also not asking the Commission to mandate FCMs to make it available, that would be on an FCM-by-FCM basis. So if an FCM made a determination that the Tri-Party model was not something they were comfortable with for risk management or whatever business reasons, they would not be forced into this regime, that would be a business decision. So there's two layers of optionality in this.

Sorry, Kim, I interpreted you.

MR. BARNETT: Kim?

MS. TAYLOR: Actually, I didn't kind of

add anything to the initial list because I thought things were covered that we're working on, but we're working on also a version of this optional Tri-Party custody type of arrangement --

MR. COOPER: Yeah.

MS. TAYLOR: That does two things that you didn't mention, here.

MR. COOPER: Okay.

MS. TAYLOR: One -- and they're not probably unlike GCP, although I think we can do it without, quote/unquote, GCP, that allows for there to be a fourth party so that clearinghouse can be a party, and that eliminates the funding problem that is part of the Tri-Party arrangement --

MR. COOPER: Right.

MS. TAYLOR: The FCM has to completely fund. And then the other thing is that, by structuring it in such a way that the first priority in the account is for the CCP versus the FCM. Our counsel has advised us that it becomes not a pro rata, a distributable property --

MR. COOPER: Right.

MS. TAYLOR: It's not customer property under the way the bankruptcy regs are written, so it might be able to provide both levels of protection, the malfeasance protection, and the pro rata distribution protection, but it's -- other than that, it sounds like just another flavor of what you're suggesting and what would be involving custodial would be Interp 10 to probably come off and all that.

MR. COOPER: Right. I addressed Tri-Party, but obviously, the quad party that you all have been discussing is something we're willing to discuss, too.

MR. BARNETT: Todd? Sorry, Warren?

MR. DAVIS: I just want to ask a question. If one out of ten customers elected this, and then the funds disappeared from the nine others who didn't, isn't the person elected still going to suffer, because he's going to share pro rata and the loss? So what is the real benefit to the client?

MR. COOPER: The benefit -- you're right

in the sense that, if the Bankruptcy -- well, I can't speak to Kim's quad party proposal, but in the Tri-Party proposal, in terms of the Bankruptcy Code, you're right, they would still suffer in their pro rata, a bit of a loss. Where this would have an effect is in a situation where the hole exists, or there's a misuse of funds at the FCM, MF Global, Peregrine, where the FCM wouldn't have the monies there to misallocate or lose, because it would be sitting in a custody account. So, yes, you're right in the event of a bankruptcy and there's a hole, without a change to the Bankruptcy Code, they would be sharing in that pro rata loss, that's correct. But, in terms of actually preventing fraud or misuse, not in the event of a bankruptcy, keeping monies at the custodian outside of the FCM is a layer of protection that the client could choose.

MR. DAVIS: But that only works if everybody elects to use it.

MR. COOPER: No, it only works for the clients who elect to use it.

MS. BREGASI: No, because if there is fraud in the rest of money, we're still pro rata sharing with everybody else's fraud. So if there's a short fall because the rest of the money that was fraud or misused there, doesn't the client that has a Tri-Party still share in that?

MR. COOPER: Are we talking about the case of a default? I mean, maybe I'm not understanding.

MS. BREGASI: If there's an insolvency and there's a short fall, and the short fall was caused because the FCM, there was either fraud or some sort of misuse of the customer funds that are not in the Tri-Party --

MR. COOPER: Right.

MS. BREGASI: Wouldn't the people who have the Tri-Party still pro rata share in that short fall?

MR. COOPER: Yes. Again, that's in the case of an insolvency, yes.

MS. TAYLOR: But that would be true with LSOC, too. I mean, there hasn't been a suggestion put forward yet that would fully product the clients from some malfeasance risk.

MR. ROE: With the exception of insurance.

MS. TAYLOR: Well, insurance, or the quad party type of arrangement that gets you outside of the pro rata distribution.

MR. THUM: I guess my question is, does the FCM benefit from the margin held at the custody bank? In other words, in terms of the investment of the margin, and then the upside in terms of investment, does the FCM direct the investments and reap the benefits of it, or is that severed?

MR. COOPER: No, as envisioned, they would not continue to reap the benefits as they currently do, which we understand certain FCMs would not be happy with. But we would imagine, although I don't have any specific numbers to put against it, that would be included in the pricing the FCM would charge for allowing Tri-Party and for satisfying the margin calls that were required by the CCP.

MR. BARNETT: Okay, Todd?

MR. KEMP: Yeah, I was just going to say, I think, conceptually, we very much like Charley's ideas, we like Kim's idea, you can probably combine No. 3 with No. 1 over there. But I think Kim's point is a really important one, which speaks to the concern over here; if this is really going to be of benefit to the customers who choose to use it, there's got to be a fix to the customer funds, the customer property definition, either by amending the Bankruptcy Code or by finding an appropriate account structure that doesn't define customer funds as customer funds.

MS. BREGASI: So, sorry, isn't the only benefit to this, then, the reporting piece? Which is, for the client that has the Tri-Party, the DCO can see exactly what collateral they have with the FCM instead of having to base their information on what the FCM reports to the DCO. Is that --

MR. COOPER: That's a definite benefit, yeah.

MS. TAYLOR: Actually, I'm going to challenge that, because the Tri-Party doesn't have the, the DCO sees nothing about the Tri-Party account. In the Tri-Party, the way I understand it, the way you laid it out, the assets that are in the Tri-Party account are in effect idle. They're margining the client's position, but the clearing member is forced to then doubly fund, because the client's margin can't be even appropriately passed through to the clearinghouse. So it actually will effectively double the amount of collateral that is needed in the system to support the activities of the business, which is certainly an option, but I think we need to consider that these types of frameworks have to work -- in order for them to work, they have to work for you, they have to work for the firms, and they have to work for the clearinghouses.

And, personally, I look at this one, and think it is a very large demand and additional collateral in a world where we already know the industry is going to be facing a very large demand for extra collateral, even at the end customer level. So that's just something to keep in mind.

MS. BREGASI: Thank you for clarifying that. But if that's the case, then it doesn't help on the reporting piece, as well, and I'm just taking what's being said at face value. Isn't the only way for this to actually offer any benefit is to make it mandatory? Meaning to make it mandatory so that each client of the FCM must use a Tri-Party? I mean, maybe what you can do is have the FCM choose to either offer this or not offer this, but that it must do so for all clients. So certain FCMs might choose to be in this business and other FCMs might choose not to be in this business, but if they give it for all clients, then at least we know we are getting the benefit of not having to share in the pro rata short fall, if there is one.

MR. PERKINS: I tend to -- this is Chris Perkins from Citi -- I tend to agree. I think, without a change to 766(h), this solution is expensive and it still exposes clients to loss.

As far as verification goes, we've initiated a transparency website of our own, and there's nothing on our site to prevent verification from a CCP to validate the numbers that we're putting out. Also, for our custodian banks, we don't see why they can't validate that the money that we've placed with them is actually there. So we think that the reporting aspect can be accomplished with the proper focus on transparency today.

MR. BARNETT: All right. Let's -- Steve.

MR. HURST: Thanks. I'm going to echo much of what Charley said, just at a high level. There's three components to this that are very, very important; there's the structural protection, there's the transparency side of it, and then there's the debate over whether or not a structure can be put together that is bankruptcy remote. Let's just say Charley's right and there's no way around that without an act of Congress. You're batting 600, folks, and from the other end of the spectrum -- and you need to think about this from where Todd's constituents are coming from -- not from the big institutional investor, but from the folks that got hurt in these last debacles, the folks that are required, by law, when they're buying crops forward, to hedge their positions, to be short in the market. They're the folks that got hurt by MF Global, and what they're asking for, and the NGFA has a very powerful letter that they've submitted to every member of the House Ag Committee, every member of the Senate Ag Committee, and all the Commissioners here, demanding some sort of optional program in which funds can be held in segregation tested in a pilot program. The only thing where you and I differ at all is, I think the question of whether or not the revenues from the investment of the proceeds are shared with the FCMs, that's a discussion between the client and the FCM. There's are some clients that might be just fine with that, they've been fine with that structure for years, it has resulted in lower execution costs. That's up to the market to decide. I don't think it should be something that has to be done by anybody, because some of the customers that Todd represents can't afford it. So what I'm advocating, and I'm number two there, is that the industry to come together and create a service bureau that exists to support the FCM community. Many of these firms are already operating individually segregated accounts, they are really expensive, they're operationally complex, they are not scaleable, and everybody has a platform that does it. These platforms do the same thing for every one of these firms, and they gain no competitive advantage in it, it's just the cost of doing business. So why doesn't the industry come together, find a way to build one platform, structure it inside a utility, share the costs so that it can be affordable, and make it available to the FCM -- and that's the important point. This is a service bureau that I'm proposing that supports the FCM. So the FCM for a client that, as far as the FCM is concerned, can qualify to hold the segregated account, they can offer them that choice, and let the client make a decision based on the client's own evaluation of the cost and the benefit. State Street has a platform that supports all of the Tri-Party custody arrangements that it holds in the market today. BNY Mellon has a platform that supports all the Tri-Party custody accounts that they hold in the market today. These are thousands and thousands of accounts. Northern Trust has a platform. Those platforms are all built on the same architecture, that technology is battle-tested, it has survived and worked very, very well through some major market meltdowns, and that platform is available in the market today. And this utility that I'm proposing be formed can leverage that technology. I'm proposing that we put it into use now. One of the things I'm asking and that Todd is asking for, as well, is a pilot program for the folks that have an interest in doing this. And some people may not. But for those that have an interest in doing it, we'd like to create a safe harbor where they can come in, we can bring some technology in, we can bring some customers in that have an interest in testing the model. We can bring some FCMs in that would like to facilitate their clients, and that's the important point. I mean, what I haven't heard a lot of here today is how do we take care of the needs of the lower end of the market that has a legitimate need for structural protection and transparency. And if they'd like to give this a go, why not, and why don't we do it today? And then my last point, let's -- just go with me for a second, here, and let's say that there were 10 or 15 futures commission merchants in this room that think that maybe there's something to this and they'd like to have a go at it. There's all this talk about insurance and how expensive insurance is going to be. I don't think so. First, monies that would be held in a Tri-Party custody account are fully insured to start with, so there's a layer of protection that comes from the fact that it's sitting in a federally insured depository. Secondly, we aren't the first industry that has ever had a crisis like this. Accountants were uninsurable after Enron, lawyers have been uninsurable for years, the medical profession has found ways to deal with their situation, and they did it by creating a risk pool, where they've provided some mutualized level of risk and they've purchased an excess of insurance policy on top of it. So if you have a utility, a service bureau that's holding funds in an account that is already insured under the existing regime, no act of Congress required, some layer of protection put on top of that by a risk pool by the participating FCMs, take that to the London reinsurance market, you will have that market competing vigorously to provide an excess layer of coverage on top of that. And at that point, you've delivered something that will be very, very useful to the people that got hurt at MF Global. So I'm open to questions about the service bureau model.

MR. BARNETT: David?

MR. YERES: Steve, do you anticipate that, in the service bureau model, the assets that are contributed by the customer will be held outside of the FCM, but rather by the service bureau, perhaps as agent for the DCO, and thereby outside the customer property definition?

MR. HURST: Right, that's the difference between the model that I'm proposing and the model that Kim's advancing, is that there would be a neutral, independent, third party that would operate the service bureau on behalf of the FCMs.

MR. YERES: But when you say on behalf of the FCMs, my question again is; will those assets be outside of the FCM's customer property estate and therefore not subject to pro rata distribution in the event of default by the FCM?

MR. HURST: And I can tell you that I've had not much luck trying to persuade CFTC staff on this. But let me give you a practical example that I've asked you to think about, about how there might be a way around the problem that David's referring to. A good deal of the money that was lost in the MF Global situation was from agricultural merchants that have lines of credit that they can draw on in order to meet their margin requirements. It's standard practice. So they open an account, they put a position into the market, the market moves, they're drawing on the line of credit, the funds are paid into the omnibus account, there's a default, the firm goes into bankruptcy. Those firms that are paid are customer property and are subject to the jurisdiction of the bankruptcy trustee. The undrawn portion on that line of credit are completely bankruptcy remote, they cannot be touched.

Believe me, if they could, they would have been. They can't. And that's to Todd's point about some things that might be done if you're willing to sit down around a table with some of the merchants, some of the banks that are loaning those merchants money, some lawyers that are of your par, Bob, that know a lot about this, and see if there aren't some alternative arrangements that could be made so that you could hit the trifecta and actually produce a bankruptcy protected custody account.

MR. WASSERMAN: So -- MR. Yeres: For clarification, Steve, I'm sorry, I wasn't questioning the efficacy of your proposal. Really, I support it. But I look at it from a different perspective. I'm looking at it from the perspective of the institutional participant that has had these protections in the swaps market up until now, and would, unless such an approach is taken, lose those protections upon the insistence of the statute to clear their trades and work through FCMs. So I think that there is a very valid structural solution. I tend to agree that if the FCM doesn't receive or require the assets, they're not part of the FCM's estate and should not be part of the customer property, and I think that's a very valid approach.

MR. WASSERMAN: So, Steve, you referred to some conversations we had, and I'm going to repeat here a question I asked you back when you were speaking; you mention here that this would really not require any statutory changes. And so the concern I have is that we're going to have some entity, and you mentioned it might be subject to regulation because it's subject to, it submits its rules to us. But, as I mentioned, we've had some experience with entities under one regulatory structure doing something that arguably that regulatory structure was never designed to do. Sentinel comes to mind. And so the question in my mind is; how do we have an enforceable regulatory structure to actually protect those customers who are electing to try this out?

So that, because, of course, you mention because there are banks, but banks are rather famous for following their instructions and operating in accordance with their agreements, as opposed to supervising whether those instructions are the right instructions. And so I'm at a loss to understand how we can have a -- what is going to be wearing the clothing of a regulated entity, but actually seems to me to be entirely outside of any actual regulatory power, and not benefit from -- you know, the customer protections aren't perfect, but --

MR. BARNETT: Okay, look, we've got to keep going. Who is the next person who's got something on the list? Very quickly, and that's it, we've got to go.

MR. HURST: Let's let form follow function, we've got lots of choices for organizational structures. It could be structured as a non depository trust bank in any number of states; it could be structured as a bank service bureau, I'll give you the citation for how that might work; and lastly, I think you guys have the power to create another form of registrant designation. Charley alluded to that. And if you need the power in order to implement this, we'd be happy to help you go get it.

MR. BARNETT: Okay. Who's next on the list? Optional full seg, where do we go for that?

MR. KEMP: That was me, Gary, but I think we can skip that, I think we've covered just about everything there.

MR. BARNETT: Okay.

MR. KEMP: The main thing we would say

is that there does need to be some solution to this Bankruptcy Code definition of customer property. That's a big point that we think would need to be resolved for customers to receive the full benefit. I think I might have mentioned insurance, too, and I won't dwell on that too long, but in our view, the full seg option would be optional to the customer, it would be an agreement between the FCM and the customer. And not all customers would be able or interested in taking on that additional cost, so we believe some form of insurance should be layered in on top of that. Maybe it's some SIPC-like insurance, maybe there is a private insurance alternative. We are very interested in exploring the various options there, but we think that's important for additional customer protection.

MR. BARNETT: Okay.

MS. BURKE: Gary, can I just ask a question before we move on?

MR. BARNETT: Yes.

MS. BURKE: It's for both Charley and

Steve. On your proposals, and even going to the four party, which seems as though the four party would not incur the cost of funding, which we know there's -- especially moving into OTC-cleared, what's the size, what's the number, how big will this be? But one of the issues that occurred when we had Tri-Party previously under Interp 10 is that there was unauthorized withdrawal of funds, whereby the custodians would release funds without the FCM's authority, and they were acting outside of the Tri-Party custodial arrangement. And the FCMs basically bore the brunt of that and had, you know, were cited for that, that they acted outside of the arrangement. So we would need automation, and there would have to be some oversight by the CFTC, and jurisdiction over the custodians or the service bureau that, in the event of unauthorized withdrawal, because that's imposing risk to the system. That's all about the fact that the FCM has the funds on hand, we're monitoring the counter party credit risk, and we're guaranteeing the obligation to the clearinghouse. So that would have to be factored in, as well.

MR. HURST: Yes, I agree, and you're the only one in the position to make credit decisions about the transactions that are implemented by your client. So our answer to that is, in the Tri-Party custody model that exists today over the counter, you have these, bespoke control agreements. In our model, it's a rule book. And it's a rule book that is worked through by the Commission, and it's in an entity that the, whether it's set up as a bank or set up as a bank service bureau, we want it to be subject to CFTC jurisdiction so the rule book will have the force of law.

MR. BARNETT: Walt, do you have a question?

MR. LUKKEN: I was just going to say, and it's not a theoretical proposition that Maureen's talking about. Bob mentioned Sentinel, it was a real life where we couldn't move the money potentially, and the downstream firms weren't able, and there was a systemic risk issue there. So this is something, but I'm glad to hear that registration is an option in submitting. So that, I think, would help to solve for that.

MR. BARNETT: Who's next on the list? You mentioned insurance first, right, but do we have other -- DCO limited guarantee?

MR. DAVIS: I may just defer to Bill. But our thought is that can we avoid at least some of the limitations of LSOC? And I'm thinking of this sort of the last day movement of margin by somehow making that the responsibility of the clearinghouse, basically mutualizing that obligation. And our understanding is that, at least one of the clearinghouses is coming up with a proposal to essentially do that, and that would move us forward. I don't think this deals with the malfeasance risk, but it would be a step forward. Otherwise, I think I'll just defer to Bill on gaps.

MR. THUM: Right. So Vanguard has been very supportive of clearing for swaps and has been very supportive of LSOC, because it starts to introduce many of the protections that are available in the non cleared swaps market. In the non cleared market and the over the counter market, we have daily margining, we post our margin, it's held by a custodian, we don't suffer any fellow customer risk. And LSOC, obviously, was meant to plug that gap that exists in the futures market currently. So, that being said, we have some concerns that the reading of the LSOC rule could conceivably lead to a divergence, in terms of the level of protection afforded to different buckets of collateral. So, in terms of the buckets, we see them, one bucket is the DCO required margin, initial margin; another bucket is excess margin, and excess comes up in many forms. It could be excess that is within the DCO required margin from day one to day two, the positions could change, DCOs holding more margin than it requires on day two. Also, the margin value itself could go up, so there could be excess margin at the DCO. The FCMs require a margin, which would be excess above the DCO required margin. There's also a ten percent up charge for speculative trades, that would be excess above the DCO required margin. There's margin put into the system by the FCMs, either put in specifically with respect to individual customer accounts or, indeed, an overall buffer. All these are areas of excess. And the final bucket, I would say, is the variation margin or the profit/loss that Warren was talking about. And the concern there, of course, which we don't experience in the over the counter market, is that our trades have value or they don't, and the chips fall where they may, based on our own investment decisions. And, of course, we're not really, while we can do a lot of due diligence on our FCMs, we can do no due diligence on our fellow customers. So having our margin either subject to fellow customer risk or, indeed, our investments themselves, and the profit and loss associated with them, subject to fellow customer risk is really unacceptable. So we're very gratified by the LSOC rule, not only that it provided some protection against fellow customer risk, but it built in a reporting requirement that we felt largely went to mitigate some of the operational and fraud risk that's presented in the system. That being said, as I pointed out in the beginning, the rules can be read in a couple of different ways. And while I know that the spirit of both the author of the rules, and the FCMs, and the DCOs that are in this room have been to do everything possible to protect a margin from fellow customer risk. Certainly, as we are now down to maybe 90 days until the go live for November 8th, let alone the later date for clearing for swaps to apply to swap dealers, or ultimately to us. We're seeing that there's tremendous level of practical challenges that are being applied to fully have LSOC protections apply to all margin levels. And in considering certain compromises that may be necessary, too, for the FCMs to move forward and achieve LSOC protection for the largest bucket of margin, or perhaps the most critical bucket of margin, that LSOC is being read, at this point, in terms of a phased approach where heightened protections are applied day one to DCO required margin, and then ultimately to excess margin. In looking at some of the rules, we think that it would help if the CFTC issued interpretive guidance to clarify the intention of the some of the rules, starting with 22.1, the definition of Cleared Swaps Customer Collateral. And while it presently reads collateral which secures a cleared swap, we think that should be clarified to make sure that it refers to all customer property received by an FCM or a DCO. Also in the rule, there are other references to lower case collateral, or lower case margin, and we think there should be clarified in the interpretive guidance whether those references to lower case collateral or margin are to the upper case defined term, or whether they are meant to relate to some different definition. In terms of 22.11-(c)(2), we also think interpretive guidance would help that the FCM's report of a customer's portfolio of rights and obligations arising from the cleared swaps includes all customer positions and cleared swaps customer collateral. The upper case defined term, as we just mentioned. We also think that it would be helpful if the CFTC issued a new rulemaking to require that such FCMs report be made as frequently as technologically feasible. The rule right now requires it be made at least once each business day. And the DCOs take all steps necessary to confirm that such FCM's compliance is accurate and complete. Obviously, there's are a lot of technical issues based on the reporting requirement which is causing some of the anguish in implementing LSOC rules before November 8th. We also feel that the Commission should consider, maybe sooner rather than later, if there is to be a phased approach of implementation of LSOC, should the Commission force the FCMs to implement LSOC on a limited basis in the near term, or work and devote all their energies to implementing LSOC, as we believe it should be applied to the required margin, all excess margin, and indeed, variation margin before the clearing requirement is mandated. So rather than have the target date be November 8th, have it be the date in February for this swap dealers, or the date in May for the rest of us. Personally, I think that the buy side will have a limited appetite to engage in voluntary swap clearing ahead of full LSOC protection applied to all margin. So I think it is something to think about, at least, as the FCMs are forced to, for the earlier deadline, to apply more limited LSOC protection.

22.13(c)(2), Additions to Cleared Swaps Customer Collateral; again, interpretive guidance would be helpful. The DCOs are required to provide a mechanism by which the FCM is required to identify each business day the amount of collateral posted in excess of the amount required by the DCO. Again, this, now, I think, is being viewed as a future state, looking at the protections and the requirements of the FCMs to provide the report, and the DCOs to require the report. But we think it should be clarified that the DCOs are definitely going to require this. And then, finally, 22.15, the Treatment of Cleared

Swaps Customer Collateral on an Individual Basis, confirm in that guidance that the requirement for the DCO to protect the value of collateral required, with respect to a portfolio of rights and obligations, actually includes all upper case defined term cleared swaps customer collateral. So rather than an alternative reading of this, which is that the protection is limited to the DCO required collateral, and not the excess.

MR. BARNETT: Thanks, Bill.

MS. TAYLOR: Before we have discussion of this, since we're on the topic of enhancements to LSOC, could I add a couple --

MR. BARNETT: Okay.

MS. TAYLOR: That I'm not sure that you mentioned, although one, I think, overlaps a little bit. One is, there seems to be confusion about the ability to continue to net the variation margin at or after the bankruptcy. And I think our concern is that netting the variation margin after a bankruptcy increases the risk that customers have to other customers. And we also think that allowing it to be determined differently by each DCO subjects customers to a variant of that kind of risk that they have no ability to control or protect themselves against, even if they chose not to do business at the clearinghouse that was going to continue netting and make the problem worse. So consistency around the netting of variation margin at a bankruptcy, and then the other concern that we have is that the industry is working very hard to try and nail down the solutions to many of the issues that Bill mentioned. And we haven't gotten to very much discussion yet of the netting of variation margin of bankruptcy, and we haven't gotten yet to the issue of passing along in a port of positions and collateral. I have a very large concern that the way the porting works, it seems that the clearinghouse is allowed to port over whatever margin was required for that customer's account at the DCO, let alone whatever excess might be determined to belong to the client. But there's no requirement that that margin actually be on deposit in the customer's account. And so if DCOs are allowed to port more money with a customer's position than that customer actually has in his account, that is creating a short fall right there. And I realize that the trustee will be able to technically call it back, but any time you have a trustee spending money, to try and call back payments that have gone out the door, I think what you're doing is, you're just depleting the estate and running the risk that the hole gets bigger, rather than trying to keep the hole as small as possible.

MR. PERKINS: I have another improvement for LSOC. What LSOC does is it removes customer money from the clearing water fall, and I think we all welcome that as an improvement to client protections. I think one of the challenges facing CCPs is they have to figure out where to make that collateral back, how do they stay efficient and make up that short fall. They have some options in their approach, they can increase initial margin, they can increase the guarantee funds, or they could increase their own contribution. I'd suggest that thought should be given to tying the CCP contribution to the ultimate guarantee fund contribution. That way, that have adequate skin in the game and don't end up ballooning, for example, the guarantee fund. If they were to do so, it would cause a breakdown potentially in portability, and I think sufficient controls around the relationship between CCP contribution and guarantee fund, as we move forward with LSOC, would help create a stronger system.

MR. BARNETT: Great, thank you. I want to get through the list, so that's LSOC gaps. Who had excess held at DCO?

MS. BREGASI: That was me. So I think that was in the middle between LSOC improvements and full segregation. So just getting back to excess -- to LSOC improvements, the only question I wanted to ask is how -- I'm still a little bit confused, now that we understand LSOC without excess, and excess is not required to be posted to the DCO. So as long as it's not required, let's just assume that it's not done.

If it's not done, it seems the rule is being read to only require position reporting to the DCO and not margin reporting. If that's the case, how does a DCO know which client defaulted on the day that the FCM defaults? Can anybody answer that question?

MR. WASSERMAN: I think the answer is that one would look at the positions, because essentially, the positions will imply a variation, and so one would apply that variation to the collateral associated with those positions.

MS. BREGASI: But, Bob, you're assuming that what the FCM reported yesterday was the client's position, was also what the client posted to the FCM for margin. If a client did not post them, they have up to three days before they really get hit, so if that client didn't post, then the DCO doesn't know that. I still don't get how the DCO is going to know who the defaulting client is.

MR. WASSERMAN: The question is, what

can the DCO use?

MS. BREGASI: Yes.

MR. WASSERMAN: What collateral is available to the DCO to use?

MS. BREGASI: Yes.

MR. WASSERMAN: And the answer to that is, any collateral that is the FCM's, and to the extent for each of those sets of positions, they can use the collateral associated with that, those positions.

MS. BREGASI: Right. But the problem is, they still need to know who the defaulting customer is. Because the whole point of LSOC is that they cannot use the collateral that the defaulting -- they cannot use the collateral the non defaulting customer for a defaulting customer. But how do you know who the defaulting customer is?

MS. TAYLOR: We agree with that problem.

MR. FOLEY: I thought the rules contemplated that the defaulting clearing member is obligated to tell the DCO.

MS. BREGASI: Well, that's the problem. So the FCM is defaulting, and we have to rely on them to tell the DCO who defaulted?

MR. FOLEY: Well, that was the point made some time ago, but --

MS. BREGASI: Right. But when we thought the requirement was to report margin, we knew that there might be an issue where they might not be reporting it correctly, but at least they had an obligation to report it. Now that they don't even have the obligation to report margin, we're even two steps back --

MR. FOLEY: It seems to me, if all that is asked of the DCO is 100 percent of their required margin --

MS. TAYLOR: But you don't know from the client --

MS. BREGASI: But you don't know that they posted it.

MR. FOLEY: No, but it's either from the clients or it's from the clearing member's excess.

MS. BREGASI: But that's a problem,

because the defaulting client, if what they have in there is some of the FCM's money, they're still a defaulting client, and the DCO doesn't know that.

MS. TAYLOR: And the -- this has been a complication that we identified with the way that LSOC works at the time of a default right from the very beginning. It is very difficult to know what client has defaulted, there's a process built into the rules for the FCM to pass more information, but the FCM is potentially in disarray, the FCM is, you know, going out of business. And what we have determined would end up being the likely default assumption for a clearinghouse would be that, if you were a client who, when we unwound the netting of the variation margin on that day and looked at all the clients who were making money, coincidentally making money that day, they would be absolutely not defaulting clients, because they had their margin on deposit, plus profits. The clients who had their margin on deposit from the prior cycle and had losses would all potentially be defaulting clients, even --

MS. BREGASI: Even though they might have excess to the --

MS. TAYLOR: Though they might have the excess -- at the FCM, and there's not a good way for the DCO to know it.

MR. WASSERMAN: To the extent of those losses. And so, in other words, you've got three clients, each of whom has 100, one gains ten, he's a gainer, one loses ten, he's entitled to 90, the other loses 375, I think we've found our default.

MS. BREGASI: So let me give you an example. You have a client --

MS. TAYLOR: You might have that money in an account with an FCM --

MS. BREGASI: That they're required well, their required initial margin is 100, so the FCM tells the DCO 100 is what their positions are. Well, they tell them positions, they know 100 is the requirement. But, in fact, that client has only posted 70 with the FCM. And then that client, let's say, has whether a loss or a gain, it doesn't matter, but the gain is smaller than the short fall that they had with the FCM, that should be a defaulting client. But the DCO isn't going to know that.

MR. BARNETT: Can we hold for a second? I want -- this LSOC is (laughter) everybody knows this exists, everybody's talking to each other, can we talk about the other alternatives, and you can all fight each other then?

MS. BREGASI: I can move to my other alternative.

MR. BARNETT: All right.

MS. BREGASI: So, moving on from LSOC; having all excess held at the DCO, so that's between LSOC improvements and full physical segregation, and the point would be that, if you have all of the client's money held at the DCO, then you reduce, if not take away, I think, even though some people might disagree, fraud risk and investment risk. And in terms of, well, it's understandable that you're taking some of the income away from the FCM, one solution, I think

CME came up with something like this a few weeks ago, one solution would be to have the DCO invest the money, maybe in agreement with the FCM as to what those investments would be, and then share the income or pass all the income to the FCM. So that's one thought. Moving on to the third thought, which is full physical segregation, if you can take the -- leaving aside Bankruptcy Code changes, which we all understand would be the best, but are very hard to do, going with something that the CFTC can do by rule. They could require, on top of LSOC as it is today, they could require that all FCMs keep customer money in a Tri-Party account or four party account even better, so that there is no issue with the FCM having to come up with initial margin to post to the DCO. I would think that, if you combine the four party account type with LSOC, LSOC is taking care of fellow customer risk, the four party account is taking care of investment risk and fraud risk, so that gets you pretty much, pretty close to full physical seg, without any changes to the Bankruptcy Code.

MR. BARNETT: Who's next on the list, David? No. John?

MR. RICHARDSON: This is Bob Richardson. I'd like to talk about insurance a little bit more.

MR. BARNETT: Okay.

MR. RICHARDSON: I mean, I hear all this, and I'm not, I don't have a commodities background, I have a SIPC background, and I've done it for 40 years, and somebody is going to steal the money some way. I mean, I hear all of these protections that are built in, all the segregation, all these other things, somebody's going to figure out how to steal the money, they've been doing it for forever. So I'm a proponent, and it's a long history of why commodities didn't get rolled into SIPC when it was legislated in 1970, but it seems to cry out now, with the two major cases that we've seen, for some type, and I'm going to bore down a little bit more on what those types are, of insurance program. And all of these efforts to protect have failed, and some customer loses the money typically because somebody steals it. Commissioner Chilton put out today a proposal, I don't know if it was just a little while ago, so I don't know how many people have seen it proposing an insurance fund, laying out some very general background. His proposal provides for an entity just very similar to a SIPC entity. People can debate the need for having something like that. But I do think that there needs to be some kind of protection for customers that would be beyond the scope of the regulatory changes and the other changes that have been discussed here. And it would be some form of insurance. There are a lot of variations there, either a fund like SIPC with assessments on the FCMs, or a combination of a relatively small fund, and private insurance to be layered on top of that. I appreciate the expense associated with, you know, setting up a program and funding a program, but it seems to me that there is some needed today, in light of MF

Global and Peregrine to have some type of protections in the event there's a failure, in the event there's a theft of funds. And so, I mean, I can talk about some ideas, just to touch on some in terms of the structure, you could have something rolled into SIPC. I don't want people sitting around waiting for a commodities broker to fail, there are not that many that have failed, but clearly, if that happens, you can have the stand alone, you can have some hybrid of that, you can have funding directly assessments against the FCMs, you can have after the fact. In some countries outside the U.S. And I will note that the U.S. is just about, if not the only system that provides insurance. It doesn't cover commodities, it only covers securities, so we're very much behind in terms of protections for the commodities industry. But you can have a very modest administration, you can have a very modest fund, and then you can supplement that with private insurance. So there are a lot of variations of it, but I did want to at least make a pitch for what happens if, you know, all of these protections don't work and we do see another failure. And I don't think this industry is really in a position right now to probably suffer through another one. And you never know, because I've been the trustee in SIPC cases, I've worked at SIPC, I've seen this. You don't know what's going to happen until 24 hours before you get that call and say we need a trustee.

So I'm just a proponent of it, I don't know if I can bore down any more details --

MR. ROE: If I can just.

MR. RICHARDSON: But I did want to tee that issue up a little bit.

MR. ROE: So when you mentioned you said you appreciate the expense, do you have any ideas, are there studies --

MR. RICHARDSON: Well, that depends. Commissioner Chilton suggested in this proposal that came out today something not to exceed the 30 or so employees at SIPC. I think an argument could be made that it could be a lot fewer employees. And I haven't run this by anybody at the CFTC, but the idea that maybe, if you're not going to roll it into SIPC and have two separate funds, you know, just have -- but you have all the administrative personnel already in place at SIPC. And it seems to me that an argument could be made that it doesn't justify creating a duplicate system. Maybe you could have a hybrid where you have very few commodities employees in this fund, and you could tap into the SIPC employees. They're not all that busy all the time. Now, granted, they have three big cases right now (laughter) that they're dealing with, but that is some way that you can kind of reduce the administrative expenses and still have a separate entity. So the answer to your question, no, I haven't done any study, I think having a full blown -- despite what Commissioner Chilton said in his proposal, and I know it was only a proposal -- I think having a full 30 to 40 employees running an insurance fund for the commodities industry is probably not justified.

MR. ROE: If I can just jump in there.

MR. BARNETT: John, go ahead.

MR. ROE: We've looked at this, we've studied this a little bit in our proposal to the Senate Committee on Agriculture, Nutrition and Forestry, and, first, I want to absolutely agree that, no matter what method of segregation that we use, and we certainly agree we should try a pilot program, we should give customers more options just in terms of segregation. But all we're really doing is shifting around where that insolvency risk goes, we're just kind of shuffling a little bit over to a different, maybe to a custodian, or shuffling a little bit over to a utility, maybe we're creating more concentration risk. Really, we haven't addressed what the real problem is here; at some point, these things do blow up, someone is going to either steal it or someone's going to use it to prop up their firm, there have been two very recent examples of that.

So insurance is the simplest form of addressing this. Congress wants this, it actually can be done very quickly through Congress. It will take an act of Congress, but surprisingly, this is going to be a fairly easy one. We can run that right up the middle, it will get support from both sides of the aisle. And in terms of a structure, we've looked at something that would be more like a liquidity facility. The problem in applying SIPC protections to commodity customers is they're fundamentally different than holders of securities. Holders of securities, for the most part, especially if you're talking about retail customers or investors, they want their securities back. Commodity customers are, it's a very broad term that can include all sorts of institutions, individuals that have different needs, but fundamentally, they're different, they require a lot speedier approach than SIPC. And we think that all sorts of terrible things happen in bankruptcy, and the best way to protect customers is to get them the heck out of bankruptcy. And that's by using a fund to port customers immediately to new brokerages, have that fund plug the short fall, and then have that fund remove the moral hazard that an insurance mechanism like SIPC could actually be inserting into the system by going after recoveries and stepping into the shoes of customers by taking their claims in bankruptcy. This way, you have the -- there's a punitive aspect to it, these companies have to pay back this fund for any recoveries that it's paid out. And that may be another way to keep the fund whole. So I think that, I totally agree that we've got to look at insurance, it's actually the quickest thing to do. It's fairly simple, straightforward, easy, you have it through your bank account, you have it for your stock account, why don't you have it for your commodity account?

And I think we can actually sit down in a room across a table and maybe it will be like LSOC and take us 16 months to do that, but we have to do that. We have the will in Congress to do it, people want it to happen, so I think it's time that we sit down as an industry and do it.

MR. RICHARDSON: If I can just comment

on one thing. I was a trustee in a case that was filed on November 19, 1999. Everybody remembers 2000, the world was going to melt down, we sold and moved every account before January 1, 2000. So there is a mechanism, I don't know if you were saying there wasn't, or are commenting on that, but you can -- SIPC advanced that money and got those accounts out the door to other brokers. I sold all those accounts, made a little bit of money from the estate, new brokers picked them up, and January 1, 2000, they were trading in their accounts.

MR. ROE: Right. No, there is, and certainly SIPC has that mechanism. But I think the commodities industry is a different animal, I think it's going to need its own fund. That fund doesn't have to have 100 employees, I looked at Commissioner Chilton's proposal, he's absolutely right about that. And he also mentioned capping the fund, absolutely. I think, if you can insure $4.3 trillion in the FDIC system with a reserve requirement -- what is it now, about.13 percent, severely underfunded -- we can probably do the same thing here; cap a fund. And, who knows, if everybody behaves, in ten years, we won't have to charge anybody anything. Just, if I could, I didn't mean to put insurance and bankruptcy reform in the same box, there, but moving on, I think we are going to have to roll up our sleeves and get deep into the Bankruptcy Code. All sorts of terrible things happen in bankruptcy, and we've got to address some of them, because some of that code is so old, it doesn't really work in the modern era. Specifically, one of the things that we have to look at, which could be very painful, perhaps even for some people sitting around this table, is ring fencing FCMs and Broker Dealers into separate corporate entities.

That is something that, if you look at Refco and you say, well, that was a good bankruptcy; well, one of the reasons why is because their Broker Dealer and FCM were in separate corporate entities underneath their holding company structure. And if we look at that and say, well, in that instance, the FCM was supported very easily, heck, even the stock owners got about $11, I think, or $12 back per share. When have you ever heard of that in bankruptcy? And that's only about a 50 or 60 percent loss from the IPO. I'll take that any day of the week and twice on Sunday for MF Global stock. So I think that we have to talk about that, I think we have to look at what that could look like. I think that you'll see a lot of Broker Dealers raise a huge cry and talk about how expensive that's going to be, when it's not really going to be all that expensive, and it's not going to create capital inefficiencies and all those terrible things. I think we have to talk about safe harbor and the automatic application of it -- excuse me, the application of it in instances of fraudulent conveyance, not actual fraud, and talk about how we can maybe remove some of that from the Code. I think we have to talk about fees. We have two trustees in the MF Global case, a Chapter 11 and a SIPC trustee, and through April -- I haven't gotten their fee applications yet for past April, but through April, charged $47 million, $300 per hour for paralegals, and $450 an hour for attorneys with a year of experience past bar. No client in the private sector would ever pay these fees, so there's got to be some kind of market mechanism in bankruptcy that says, hey, just because that's the way it is, and that's just what it is, go ahead and pay it, is the way bankruptcy court seems to work. That's not the way it should work. So, again, I think we've got to roll up our sleeves, we've got to get down deep into the Bankruptcy Code, it's going to go through a couple of committees on the Hill, it's going to raise the ire of a bunch of lobbyists, it's going to be a nasty fight that takes three years, but it's got to be done.

And circling back to the insurance point of this, the bankruptcy part will take a very long time, it's going to be very complicated, it's going to be like LSOC, they're going to be talking about it all day, all week, and all month and all year. Insurance, we can get done next week, we really can. If we can get a proposal that 80 percent of the industry agrees with, exchanges will come along. If the National Grain and Feed Association will come along, if a few other constituents will come along, we can get that into bill form and we can get it done in Congress quick. I'm talking by the lame duck session. So I really want to, must reiterate again, we're focused on insurance, but we have lots of other reforms we'd like to see done.

MR. WASSERMAN: If I could just make one observation on bankruptcy. My experience is that it's less of a structural issue and more of a money issue. If the money is there in seg, then frequently, you can almost certainly, universally in my experience, you can find a willing and able transferee, one or more, and it happens. If the money isn't there, things go a lot worse. In Refco it was all there, in Lehman, in Lehman, there's a whole lot of complicated proceeding, but as for the exchange traded commodity customers, they were transferred over the weekend. So --

MR. ROE: Except some of it wasn't there. JP Morgan held on to a bunch of it, he was fined $20 million for that.

MR. WASSERMAN: And the customers, though, ultimately, and, yes, there was some hiccups, but the fact of the matter is, they all got transferred over to Barclays, and I'm sure the MF Global customers would rather be in their shoes than otherwise. But it's a matter of "is the money there?". And, obviously, if you have an insurance scheme, it helps with the money is there. But, really, what it comes down to is, you're right, transfer is what we're trying to get at, and a lot of that depends upon where's the money.

MR. PERKINS: And, Bob, the reason why the money isn't there -- I mean, the biggest threat in my mind is malfeasance and fraud, and I think we get back to the earlier panel around transparency and accurate books and records, and validation and audit. We could come up with the best model in the world, but if people don't believe in it and violate rules, I think we get back to square one. So, again, our focus is on transparency at our shop.

MR. BARNETT: Any alternatives we haven't discussed?

MR. YERES: Yes.

MR. BARNETT: Go.

MR. YERES: David Yeres, as I said earlier, my focus has really been that of the swap market participant who, when clearing, becomes required, will forfeit the level of protection they now have utilizing a third party custodial arrangements and be put into a system which perhaps is enhanced significantly by LSOC, but is still not as secure as the third party custodial arrangements they now have, either from an operational point of view or from a bankruptcy point of view. As you know, they have bankruptcy protections, they have a safe harbor from the automatic stay with respect to their over the counter transactions. They don't get a safe harbor with respect to the automatic stay in respect to the relationship with the FCM, so they're at risk of being in a more perilous position. But, nevertheless, I think it's worth mentioning now that Commissioner Chilton has made a proposal for insurance which others have talked about here, and I think it's to be commended. It's a serious proposal, it does certainly require serious consideration. If it is adopted, I would suggest it should pick up swaps, as well as futures. But even if that were to occur, because of the caps, and the fact that the swaps market is a large institutional market, it should not be in lieu of protections that would otherwise be of assistance to swap market participants. In that regard, my focus has been on trying to identify ways in which customers can feel comfortable, that whatever they contribute as collateral for their swaps, will be applied as collateral for their swaps. And to do that, the simplest approach is to provide that the customer has some relationship with the DCO, rather than the funds passing necessarily through the FCM. It would be a possible choice. And I say just a choice, one option that a customer might take to, in one way or another, and I'll mention two of them; have a more direct relationship, i.e., its money is available only to support its positions, as opposed to support the positions of others, or make up for malfeasance or fraud. And, quite frankly, as we move to swaps, just to take a moment to digress, this Commission and the industry will take on some multiple, perhaps it's two times, perhaps it's 10 or 20 times, the amount of collateral that is has operated with before. It will take on a marketplace that has durations, according to your recent publication, out to 50 years. And I could only imagine the volatility if the interest rate curve should steepen. So, the amounts of money that will pass through the system are a great multiple of what they are now, especially, again, by the swap customers. With that in mind, my suggests are two to be considered. One we've talked about before, the guaranteed clearing participant. I know Bob's quite familiar with that approach. And the essence of that approach is that, rather than the customer's collateral, the swap customer's collateral passing through the FCM, that swap customer becomes a guaranteed clearing participant that has a direct relationship with the clearing organization. It has an account with the clearing organization called a settlement account that looks very much and operates very much the same way as any other clearing member's account does. The funds that pass through that account are never received or acquired by the FCM. Per the definition of the Bankruptcy Code, they cannot be customer property, and therefore, they are not in the estate, hence, they're only available to pay down the obligations of that customer for that customer's positions. They shouldn't very much imperil the FCM because, as I understand it, the only reason the FCM takes custody of these funds in the normal event is to satisfy the obligations through this customer's position. They don't take custody of them for investment purposes or to use them in their business, so the funds would serve the same purpose they're now serving, secure the customer's position through the marketplace of the DCO. The system would be simpler, it would be less prone to risk of any FCM default and shortfall, and for the DCO to make up the funds or for the market itself to suffer a loss. So that's one approach, and we've talked about that before, but there's a simpler approach potentially, and it's a variant of what Charley raised for State Street; that is, Interp 10. Interp 10, per your LSOC relief, is now available to swaps. But as Interp 10 is now written, it is an agreement between the customer and the FCM. And the protection the system gets is the FCM has unfettered drawing rights on that account. And people have expressed concerns that perhaps the custodians may not abide by their agreement. Interp 10 could be improved upon by having the DCO be the drawing agent on that account. The account could be set up much the same way, the custodians could conceivably be limited to those with whom the DCO has a relationship, or alternatively, is satisfied, has confidence in. And the DCO as drawing agent, then, would be able to draw down the funds in almost all instances. There could be instances in which, for example, the FCM has residual drawing rights.

But we would try to set up that account, structure that account in such a way that, A, if at all possible, and I think it is possible, the funds in that account never became customer property of the FCM unless and until the FCM drew on them. And, number two, harder question is trying to avoid the funds in that account being subject to the automatic stay in the event of an FCM bankruptcy, because if the FCM has a lien, a security interest on those funds, the likelihood would be that the funds would be subject to a stay. Unlike funds that are customer property, which are, by the Bankruptcy Code, excluded from the stay. We would have to deal with that issue, and I think that's an issue that could be dealt with most easily, although legislation is never easy, most cleanly usually through legislation so that the customer got the same protection in the cleared market that it now has in the over the counter market, where, as you know, there is an exception, a safe harbor from the automatic stay, or alternatively, through structural devices.

But either way, we're coming up to a date in the fall or the winter when financial institutions and others will be forced into a clearing environment which is, I think it can't be said to be quite as secure as the one they're presently in. And I think that should be avoided by the Commission wherever possible, especially in light of the fact as you're taking on a new marketplace, a marketplace as hard as you may have worked on this, is new to the Commission staff. The Commission is an organization with finite resources, as you well know, it has a very hard time in actually putting people on the ground doing auditing, monitoring behavior, so structural solutions, I think, should generally be favored in that environment. And that's what I'm proposing.

MR. BARNETT: Any other reactions to David's statement?

MR. LUKKEN: Just a quick question, David. The first option you talked about, becoming a direct clearing -- I don't know what you would call that, clearing members -- are they contributing to the guarantee fund, or would they be similarly situated as a clearing member itself, or --

MR. YERES: They would be a special class of clearing member.

MR. LUKKEN: But not --

MR. YERES: And they would not contribute to the guarantee fund. Rather, they would be guaranteed by a guaranteeing clearing broker, and there would have to be proper financial arrangements in place if, if clearing brokers offered the service. So there's a market issue, here.

MR. LUKKEN: Right.

MR. YERES: Will it be offered. But one

thing I would suggest in coming towards November or December, here, I think it's kind of imperative that the Commission make clear, at least, that it is not prohibiting or otherwise making unlawful these kinds of arrangements. Whether it be the guaranteed clearing participant or some variant of the modified Interp 10.

Because, right now, I think, if you talk to many clearing brokers, they would say those things are now unlawful under the present Commission structure, and they can't be offered. And we've heard that from some clearing firms who would say we would offer if it were lawful. But it isn't. And I think the Commission is in an awkward position if it is seen as stopping the offering of that kind of service.

MR. PERKINS: A quick question on the GCP model. I appreciate what you're doing, we all want the best segregation possible in accordance with the law. Upon the insolvency of a guaranteed clearing participant and the FCM essentially takes control over the collateral; does that defaulted entity and the collateral associated with it become part of the customer account, thus subject to 766(h)? Does it spring into -- for those who couldn't opt into the GCP, are they now subjected to share in any kind of losses upon the insolvency of the GCP?

MR. YERES: Well, in the first instance, the draw would be by the DCO. The purpose of the FCM taking control would only be, I assume, to satisfy obligations of the GCP in respect to the GCP's own positions at the DCO. Or, principally, let's start with that. Those funds would already be at the DCO, so there's no reason for the FCM to take control of those assets except to the extent there are other debts to the FCM, for example, fees, penalties, et cetera. That could be arranged through a separate account, apart and away from the GCP, so there would never be a need for the FCM to take control of that account in the main. Since, again, the purpose of those funds is to guarantee the obligation to the DCO, and the DCO has drawing agent rights, there's very limited situation in which the FCM should have any interest or right to take residual funds.

MR. BARNETT: Okay.

MS. TAYLOR: I actually think that Chris has a very good question there that we would have to make sure worked, because if the -- your assumption is that the client who had the GCP account defaulted.

MR. PERKINS: Yeah, that's right, exactly.

MS. TAYLOR: So, at that point in time, the clearinghouse would be looking to you to make good on that obligation --

MR. PERKINS: Yeah.

MS. TAYLOR: And I think the presumption would be that then, because you were making good on the short fall and you were responsible for liquidating the positions, and all of that, that you probably would need to have access to that collateral. So --

MR. YERES: If I can answer that for a moment. I think it's absolutely necessary for the clearing firm that is the guarantor to have control over the positions it will guarantee, and to have control over the positions in the event of default. That's separate from the funds. The funds are only going to be used to satisfy the DCO upon the FCM's liquidation in the first instance, right? Where's the money going first? It's going to satisfy you with the DCO.

MR. WASSERMAN: Actually, another way of looking at it is, if Chris, as the guarantor, has to make good on the guarantee, your rules, Kim, could then provide that upon his making good on the guarantee, he would then be entitled to reimbursement subordinate to you --

MR. YERES: Yeah.

MR. WASSERMAN: From those funds.

MR. YERES: Precisely.

MS. TAYLOR: I'm not saying there aren't ways to solve the problem, but I am, I am suggesting that Chris has a good point.

MR. YERES: And my point is, we'd never suggest, or I would never suggest that the FCM wouldn't have control, since it's the guarantor to liquidate the positions, would also have the benefit of the fact that if it had any obligation with respect to the DCO, with respect to those positions, the funds would already be available to the DCO. There would be no question of that. The DCO is the drawing agent, would have the funds available. To the extent there were excess funds, then there's the possibility, as Bob pointed out, DCO rules determining that it's the allocation of those funds is among its members.

MR. BARNETT: Okay.

MR. DAVIS: David, we've just gone through several months of negotiating the liquidation provision in the FIA addendum, and my understanding is one of the first things that the FCM might want to do is pay someone to put on a hedging transaction, assuming that required a lot of money. Are you saying, basically, to neutralize the risk in the portfolio, are you saying that the FCM would have access to the funds in that defaulting customer's account in order to put that hedging position on, or not?

MR. YERES: With the same DCO?

MR. DAVIS: It might be with the DCO, it might be over the counter with another firm.

MR. YERES: I think the answer to that is, the genius of segregating and isolating the funds is the customer is protected, the funds are only available to support its position at the relevant DCO. And the flip side of that is, they're not available to support positions outside that DCO. That is correct, they're dedicated to that purpose. That --

MR. BARNETT: All right. I think we're going to call it. So the conversation on all of these structures will continue, people will keep working it out, the transcript will be worth acquiring when it comes out. So it is valuable in that sense, that people know what's going on, and we hear the state of things, and people can reach out to each other. Thank you very much for your participation on this panel. Thanks very much.

(Whereupon, at 17:06 p.m., the

PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

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

(Signature and Seal on File)

Notary Public in and for the District of Columbia

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