

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

OPEN MEETING ON TWO FINAL RULE PROPOSALS
UNDER THE DODD-FRANK ACT

Washington, D.C.

Tuesday, October 18, 2011

1 PARTICIPANTS:

2 Commission Members:

3 GARY GENSLER, Chairman

4 BART CHILTON, Commissioner

5 MICHAEL V. DUNN, Commissioner

6 JILL SOMMERS, Commissioner

7 SCOTT D. O'MALIA, Commissioner

8 Staff:

9 DAVID STAWICK, Office of the Secretariat

10 Presentation No. 1: Consideration of Notice of
11 Proposed Amendment to Effective Date for Swap
12 Regulation

12 TERRY ARBIT, Office of General Counsel

13 MARK HIGGINS, Office of General Counsel

14 DAN BERKOVITZ, Office of General Counsel

15 Presentation No. 2: Consideration of Final Rule
16 on Derivatives Clearing Organization General
17 Provisions and Core Principles

17 JOHN LAWTON, Division of Clearing and Risk

18 ANNE POLASKI, Division of Swap Dealer and
19 Intermediary Oversight20 ANANDA RADHAKRISHNAN, Division of Clearing
21 and Intermediary Oversight

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1 PARTICIPANTS (CONT'D):

2 Presentation No. 3: Consideration of Final Final
3 Rule on Position Limits for Futures and Swaps

4 STEPHEN SHERROD, Division of Market
5 Oversight

6 CARLENE KIM, Office of General Counsel

7 NEAL KUMAR, Office of General Counsel

8 SALMAN BANAEI, Division of Market
9 Oversight

10 RICK SHILTS, Division of Market Oversight

11 ANDREI KIRILENKO, Office of Chief
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1 P R O C E E D I N G S

2 (9:41 a.m.)

3 COMMISSIONER DUNN: Ladies and
4 gentlemen, could you take a seat, please, and join
5 me in singing Happy Birthday to our Chairman. Now
6 I realize that I don't sound like either Marilyn
7 Monroe or Lady Gaga.

8 CHAIRMAN GENSLER: Do you want to vote
9 on that? Thank you very much, Mike, and I guess
10 good morning. This meeting will now come to
11 order, if that was any order, and I guess happy
12 birthday to my twin brother, Rob, as well.

13 This is a meeting of the Commodity
14 Futures Trading Commission to consider rules under
15 Dodd-Frank. And I'd like to welcome members of
16 the public, market participants, and members of
17 the media as well as those listening on our
18 Webcast and on the phone. I'd like to thank
19 Commissioner Dunn for that kind rendition of Happy
20 Birthday, but also thank him along with
21 Commissioners Sommers, Chilton, and O'Malia for
22 all of their significant contributions to the

1 rule-writing process and thank the hard-working
2 staff that have been working day and night and
3 weekends to complete these rules as we go along.

4 During today's meeting, first we will
5 consider staff recommendations providing further
6 exemptive relief consistent with what the CFTC had
7 done this past July and an exemptive order for
8 certain provisions of Dodd-Frank's Title VII that
9 would have gone effective at that point in time in
10 July. And as I think I said at that public
11 meeting, I think as we all deliberated, that as we
12 got later into the year we'd look at where we are
13 and consider further exemptive relief to give us
14 time and the market time as we -- or in this
15 significant effort of completing rules.

16 Next we will consider a final rule
17 relating to core principles for derivative
18 clearing organizations. And lastly today we will
19 consider a final rule that relates to position
20 limits. Position limit regime and the commodity
21 futures and swaps markets has been a critical
22 component of comprehensive regulatory reform on

1 the derivatives marketplace.

2 Today is our 20th meeting to implement
3 Dodd-Frank rules, and as we continue our work to
4 complete the rule writing, I think it's critical
5 to remember why we were here in the first place.
6 And though it's been three years since the
7 financial crisis, we cannot forget the weaknesses
8 that it exposed in both our financial system and
9 in our regulatory system. I think we cannot
10 forget the millions of Americans who really had no
11 connections to the derivatives marketplace or any
12 other exotic financial contracts, but still lost
13 their jobs due to a poorly regulated industry --
14 or more accurately maybe just parts of an industry
15 that were not regulated at all, and that's a
16 criticism of the regulatory environment that
17 failed for sure.

18 We cannot forget the millions who lost
19 their homes or their homes are worth less than
20 their mortgages. Somewhere in the vicinity of 20
21 to 22 percent of homes today are actually worth
22 less than their mortgages if you look at the home

1 mortgages outstanding in America. And though
2 there are many causes to this crisis, swaps
3 certainly played a role, the unregulated swaps
4 market. So the packages of reforms in Dodd-Frank
5 will help address some of the contributing factors
6 to the 2008 crisis. They are real concrete
7 measures that will bring transparency, openness,
8 and competitiveness to the swaps market while
9 lowering the risk they pose to the American
10 public.

11 Now there are some that would like to
12 roll back the reforms of Dodd-Frank, put us back
13 in the regulatory environment that preceded the
14 crisis three years ago, but that regulatory system
15 failed to protect the American public. And I
16 think what we must not forget is that people have
17 lost their jobs, the nation went through some very
18 critical times, and we're still bearing the cost
19 of that today.

20 Some have also raised significant
21 questions about costs in our rulemaking, and I
22 will say that we have greatly benefited from those

1 comments on costs. They've been very helpful as
2 we go through provision by provision to consider
3 how we finalize these rules, but it's also
4 important that we consider the costs of an
5 unregulated market and what that left us in 2008.
6 So I will say things about each of these rules
7 when we get to each of them, but before the staff
8 presents here today, I'll recognize the
9 Commissioners for their opening statements.
10 Commissioner Dunn.

11 COMMISSIONER DUNN: Thank you, Mr.
12 Chairman, and thank all of you for joining us
13 today for another meeting to consider final rules
14 promulgated pursuant to Dodd-Frank. Today we
15 consider rules in two areas, position limits and
16 derivative clearing organizations. And we also
17 consider a proposed amendment for the effective
18 date for regulations, swaps regulations.

19 When the Dodd-Frank Act was originally
20 conceived and then became the law, the fiscal
21 crisis of 2008 was fresh in everyone's mind. It
22 wasn't necessary to explain why Congress and the

1 President chose to overhaul the country's
2 financial regulatory system. Put simply, parts of
3 it were broken. Parts of our financial regulatory
4 structure did not work and because they did not
5 work, the people in this country suffered greatly.
6 Today, years after the crisis ended, I think
7 people have forgotten how it all started. For
8 these people, I'd like to remind them of why
9 Dodd-Frank is important by examining some facts
10 about what went on in 2008 -- and this amplifies a
11 bit, Mr. Chairman, on what you had started
12 saying.

13 Number one, the financial crisis cost
14 the U.S. an estimated \$648 billion due to slower
15 economic growth as measured by the difference
16 between the Congressional Budget Office's economic
17 forecast made in September 2008 and the actual
18 performance of the economy from September 2008
19 through the end of 2009. That equates to an
20 average of approximately \$5,800 in lost income for
21 each U.S. Household.

22 The U.S. lost \$3.4 trillion in real

1 estate wealth from July 2008 to March 2009
2 according to the Federal Reserve. This is roughly
3 \$30,300 per U.S. household. And further, 500,000
4 additional foreclosures began during the acute
5 phase of the financial crisis than were expected
6 based upon the September 2008 CBO forecast.

7 Number three, the U.S. lost \$7.4
8 trillion in stock wealth from July 2008 to March
9 of 2009 according to the Federal Reserve. This is
10 roughly \$66,200 on average per U.S. household.

11 Number four, 5.5 million more American
12 jobs were lost due to slower economic growth
13 during the financial crisis than what was
14 predicted by the September 2008 CBO forecast.

15 Let me make this point very, very clear.
16 None of this was a result of problems with
17 regulated futures and markets. I believe
18 implementing the final rules promulgated pursuant
19 to the Dodd-Frank Act will likely be the most
20 important thing that I have done during my tenure
21 at the CFTC. The financial crisis showed us that
22 many of our financial regulatory systems were ill

1 prepared to effectively prevent the catastrophic
2 loss of wealth this country suffered. For this
3 reason I believe that Dodd- Frank has correctly
4 taken center stage in our efforts to ensure that
5 events like this financial crisis of 2008 can be
6 averted in the future.

7 Unfortunately, there are times when a
8 sideshow takes center stage. Position limits are,
9 in my opinion, a sideshow that has unnecessarily
10 diverted human and fiscal resources away from
11 actions to prevent another financial crisis. To
12 be clear, no one has proven that the looming
13 specter of excessive speculation in the futures
14 market re- regulated even exist, let alone played
15 any role whatsoever in the financial crisis of
16 2008. Even so, Congress has tasked the CFTC with
17 preventing excessive speculation by imposing
18 position limits. This is the law. The law is
19 clear, and I will follow the law.

20 However, as a Commissioner at the CFTC,
21 I think it's important to let the public know what
22 may happen once we implement position limits.

1 After we implement position limits, in all
2 likelihood the prices of heating oil and gasoline
3 will not drop precipitously as some have strongly
4 suggested. Airline tickets will not be cheaper,
5 and the food you buy at the grocery store will be
6 the same price. Investments in precious metals
7 will continue to rise and fall unpredictably.
8 Things will remain relatively the same except for
9 those that use the markets we regulate to provide
10 the very resources we all need. For these
11 farmers, producers, and manufacturers, position
12 limits and the rules that go along with them may
13 make it actually more difficult to hedge the risks
14 that they take on in order to provide the public
15 with milk, bread, and gas.

16 The role of the futures market is price
17 discovery, not price setting. If we limit
18 participation in these markets through position
19 limits, producers may receive inaccurate market
20 signals when making production decisions. If this
21 occurs, the prices we all pay for our groceries
22 and to heat our homes may become more volatile.

1 Position limits may actually lead to higher prices
2 for commodities that we consume on a daily basis.
3 Despite the fact that we have received 15,000
4 comment letters on position limits and had
5 hundreds of meetings concerning the pros and cons
6 of position limits and whether or not excessive
7 speculation even exists, my opinion has not
8 changed. I am still left with the conclusion that
9 no one has presented this agency any reliable
10 economic analysis to support either the contention
11 that excessive speculation is affecting the market
12 we regulate or that position limits will prevent
13 the excessive speculation.

14 Just in the last couple of weeks, Mr.
15 Chairman, the Dallas Federal Reserve issued two
16 papers in which they claim speculation did not
17 have any impact on WTI. While at the same time,
18 the St. Louis fed issued a paper saying they did
19 think -- although it wasn't the most significant
20 -- it was a factor in the prices. I guess we're
21 still in search for a one-armed economist, but we
22 are seeing things on both sides, and there is

1 legitimate debate on this particular issue. Maybe
2 we ought to ask the Kansas City fed to issue a
3 paper, which would be the tiebreaker.

4 As I said when we voted on the proposed
5 rule, my fear is that position limits, at best a
6 cure for a disease that does not exist, are a
7 placebo for one that does. At worst, position
8 limits may harm the very markets we're intending
9 to protect. I commend the staff for drafting a
10 rule that will hopefully do as little harm to the
11 market as possible. I know that the time and
12 effort put into this rule may be greater than any
13 other rule that comes before the Commission. It
14 is unfortunate because it has taken the
15 Commission's limited resources away from the
16 issues that should be center stage, the important
17 work of improving our financial regulatory
18 structure to prevent another financial crisis.
19 Among the rules that should take center stage for
20 us is our rulemaking regarding derivatives
21 clearing organizations that we will take up today.
22 I take pride and the industry should take pride in

1 noting that the regulatory system that we have in
2 place for the futures industry works, and it
3 worked during the 2008 financial crisis and its
4 aftermath.

5 The DCO rules we vote on today hopefully
6 will bring a similar level of transparency and
7 oversight to the swaps industry. In considering
8 these rules, I am mindful of the excellent job
9 that our clearinghouses have done in regards to
10 the futures industry. In fashioning these rules,
11 we should not be taking actions that place new
12 restrictions on how they have always done their
13 futures business. However, there are instances
14 when our existing budget situation forces us to be
15 prescriptive rather than principles-based in these
16 rules. Unfortunately, the Commission simply does
17 not have the resources to oversee everything that
18 it would need to do to be a more principles-based
19 regime. As a result, this rule is much more
20 restricted than it should be in my opinion if we
21 had the necessary resources for oversight.

22 Again, Mr. Chairman, I want to thank the

1 staff for the hard work they've put into all three
2 of these measures. I appreciate their effort in
3 drafting the rules that should take the center
4 stage in our effort to avoid or prepare for
5 another financial crisis. But I especially
6 appreciate their time and effort of meeting with
7 me, my staff, in working out compromises that we
8 have within these rules. Thank you.

9 CHAIRMAN GENSLER: Thank you,
10 Commissioner Dunn, for those excellent remarks and
11 the singing of Happy Birthday. Commissioner
12 Sommers.

13 COMMISSIONER SOMMERS: Good morning.
14 Thank you, Mr. Chairman, and thank you also to the
15 teams that have worked so hard on the final rules
16 before us today and also the amendment to the
17 Commission's July 14th order relating to the
18 effective date of swap regulation. The current
19 order expires on December 31st of this year, and
20 I'm glad we're addressing the necessary amendment
21 to that order now instead of waiting until the
22 last minute to provide the needed certainty to

1 market participants.

2 Today we will be voting on final rules
3 for DCOs, and in my opinion the rules are
4 needlessly prescriptive and go beyond what it is
5 required by the statute. Our registered DCOs have
6 a fantastic track record of protecting their own
7 financial safety and soundness, and have proven
8 themselves even during the financial crisis to be
9 excellent at managing margin and risk. We should
10 allow them to continue to do so without imposing
11 unnecessary and inflexible rules, regulations, and
12 restrictions upon them.

13 It appears that these rules and many
14 others we have proposed and finalized are largely
15 colored by the perception that swaps are
16 inherently riskier than futures and options, and
17 that as a result require a more prescriptive
18 regulatory oversight regime. To that I say
19 futures and options are and always have been
20 risky. Swaps that are exchange traded and cleared
21 will likely have a similar risk profile as
22 exchange traded futures and options. We should

1 not be creating a separate regulatory regime for
2 economically equivalent products. I believe this
3 approach will not stand the test of time and will
4 have to be rethought as the market evolves.

5 The fact that we are allowing letters of
6 credit to be used as initial margin for futures
7 and not for swaps is an example of this thinking
8 and is a distinction that is not legally or
9 factually justifiable. We should treat them the
10 same way unless there is a compelling reason not
11 to. This is especially the case given the fact
12 that today there are end-users that voluntarily
13 clear swaps using letters of credit as initial
14 margin. Once we ban that practice, voluntary
15 clearing will become more expensive for these
16 end-users and, therefore, less attractive to them.
17 If we want to encourage clearing -- which I think
18 was one of our goals -- we should not be taking
19 steps to make clearing less attractive to those
20 who are not required to do it.

21 It has been nearly two years since the
22 Commission issued its January 2010 proposal to

1 argued for position limits with such fervor and
2 zeal, believing them to be a panacea for
3 everything. Just this past week, the Commission
4 has been bombarded by a letter-writing campaign
5 suggesting that the five of us have the power to
6 end world hunger by imposing position limits on
7 agricultural commodities. This latest campaign
8 exemplifies my ongoing concern and may result in
9 damaging the credibility of this agency. I do not
10 believe position limits will control prices or
11 market volatility, and I fear that this Commission
12 will be blamed when this final rule does not lower
13 food or energy costs. I am disappointed at this
14 unfortunate circumstance because while the
15 Commission's mission is to protect market users
16 and the public from fraud, manipulation, abusive
17 practices, and systemic risk related to
18 derivatives that are subject to the Commodity
19 Exchange Act and to foster open, competitive, and
20 financially sound markets, nowhere in our mission
21 is it our responsibility or mandate to control
22 prices.

1 When analyzing the potential impact this
2 rule will have on market participants, I am most
3 concerned about the effect on bona fide hedgers --
4 that is the producers, processors, manufacturers,
5 handlers, and users of physical commodities. This
6 rule will make hedging more difficult, more
7 costly, and less efficient, all of which
8 ironically can result in increased costs for
9 consumers. Currently, the Commission sets and
10 administers position limits and exemptions for
11 nine agricultural commodities. Pursuant to this
12 final rule, the Commission will set and administer
13 position limits and exemptions for 28 referenced
14 contracts. Along with the 19 new referenced
15 contracts comes the new responsibility to
16 administer bona fide hedging exemptions for the
17 transactions of massive, global, corporate
18 conglomerates that on a daily basis produce,
19 process, handle, store, transport, and use
20 physical commodities in their extremely complex
21 logistical operations. Their hedging strategies
22 are no doubt equally complex.

1 At the very time the Commission is
2 taking on this new responsibility, the Commission
3 is eliminating a valuable source of flexibility
4 that has been a part of regulation 1.3(z) for
5 decades -- that is the ability to recognize
6 non-enumerated hedge transactions and positions.
7 This final rule abandons important and
8 longstanding Commission precedent without
9 justification or reasoned explanation by merely
10 stating the Commission has expanded the list of
11 enumerated hedges. The Commission also seems to
12 be saying that we no longer need the flexibility
13 to allow for non-enumerated hedge transactions and
14 positions because one can seek interpretive
15 guidance pursuant to Commission regulation 140.99
16 on whether a transaction or a class of
17 transactions qualifies as a bona fide hedge. Or
18 they can petition the Commission to amend the list
19 of enumerated transactions. These processes are
20 cold comfort. There is no way to tell how long
21 interpretive guidance will take. Moreover, a
22 market participant can petition the Commission to

1 amend the list of enumerated transactions. If the
2 Commission chooses to do so, it must formally
3 propose the amendment pursuant to APA notice and
4 comment. As we all know too well, that is a
5 time-consuming process fraught with delay and
6 uncertainty. In the end neither of these
7 processes is flexible or useful to the needs of
8 hedgers in a complex global marketplace.

9 When the Commission first recognized the
10 need to allow for non-enumerated hedges in 1977,
11 the Commission stated, "The purpose of the
12 proposed provision was to provide flexibility in
13 application of the general definition and to avoid
14 an extensive, specialized listing of enumerated
15 bona fide hedging transactions and positions."
16 Today the global marketplace is much more complex
17 than it was in 1977, as are complex hedging
18 strategies. I'm not comfortable with the notion
19 that a list of eight bona fide hedging
20 transactions in this rule is sufficiently
21 extensive and specialized enough to cover the
22 complex needs of today's bona fide hedgers.

1 Repealing the ability to recognize non-enumerated
2 hedge transactions and positions is a mistake, and
3 the statute does not require it.

4 For decades the Act has allowed the
5 Commission to define bona fide hedging
6 transactions and positions to permit producers,
7 purchasers, sellers, middlemen, and users of a
8 commodity or product derived there from to hedge
9 their legitimate, anticipated business needs.
10 This provision is in Section 4a(c)1. In addition,
11 Section 4a(c)2 clearly recognizes the need for
12 anticipatory hedging by using the word
13 "anticipates" in three different places.
14 Nonetheless, without defining what constitutes
15 merchandizing, the Commission has limited
16 anticipated merchandizing hedging to transactions
17 not larger than current or anticipated unfilled
18 storage capacity. It appears then that
19 merchandizing does not include the varying
20 activities of producers, purchasers, sellers,
21 middlemen, and users of a commodity as
22 contemplated by 4a(c)1, but merely consists of

1 storing a commodity. This limited approach is
2 needlessly at odds with the statute and with the
3 legitimate needs of hedgers.

4 I have always believed that there was a
5 right way and a wrong way for us to move forward
6 on position limits. Unfortunately, I believe we
7 have chosen to go way beyond what is in the
8 statute, and we have created a very complicated
9 regulation that has the potential to irreparably
10 harm these markets.

11 I want to thank the teams again today
12 for all your hard work on both the DCO final rules
13 and on the position limit rules, and I look
14 forward to the questions.

15 CHAIRMAN GENSLER: Thank you,
16 Commissioner Sommers. Commissioner Chilton.

17 COMMISSIONER CHILTON: Thanks, Mr.
18 Chairman. I'm going to date myself yet again.
19 Remember the old television show, "Starsky and
20 Hutch?" There was the informant, the narc, Huggy
21 Bear. And he used to say, "I'm going to lay it
22 out so you can play it out." And that's sort of

1 like what Congress has done with the law. They
2 lay it out and the regulators put the serious and
3 deliberate meat on the bones, and they play it
4 out. And we've been doing that since July of
5 2010. It's a process we go through.

6 I believe that we are within the four
7 corners of the law, that we are precisely in the
8 middle, and we are doing what Congress instructed
9 us to do. It's an uncommon rule. It's not going
10 to please everybody. I'm not pleased with all of
11 it. I have many of the same concerns that
12 Commissioner Sommers was just talking about with
13 regard to anticipatory hedging, and we'll talk
14 about that when we get to the position limit rule.
15 But overall, I think this is a really needed,
16 important, piece of regulation that's going to
17 make the markets more effective and more efficient
18 and devoid of fraud, abuse, and importantly,
19 manipulation.

20 There are three takeaways for me in the
21 position limit rule. One is that for the first
22 time in metals and in energy we're going to have

1 mandatory, hard cap limits, federally established
2 limits. Now you can argue about the studies, and
3 we can talk about that for a long time, but here's
4 what I know. We've seen 30, 35, 40 percent of a
5 market controlled by one entity -- upwards of 40
6 percent at times. It's not theoretical in my view
7 whether or not that can manipulate markets. I've
8 seen it. It can happen. With this rule that will
9 end.

10 The second thing is we're going to get
11 rid of sort of the "Wild Wild West" of exemptions.
12 We gave that responsibility years ago to the
13 exchanges, and instead we're going to take on that
14 responsibility. The Commission will approve
15 exemptions, but only under very strict guidelines.
16 There's an old Bruce Springsteen song, you've got
17 to "Prove It All Night." So traders will have to
18 prove that they are bona fide hedgers, that they
19 have a legitimate business risk every day. The
20 requirement will be that they tell us every month,
21 but they will have to prove it all night and all
22 day that they need this for legitimate business

1 purposes, that they're not involved in excessive
2 speculation. We all know we need speculation in
3 the market; but not excessive speculation.

4 And the third thing -- and this is
5 really the historic part of this -- is that we
6 finally cover what the Chairman and what
7 Commissioner Dunn talked about and that is the
8 swaps market, the dark over-the-counter markets
9 that in fact were part and parcel to the economic
10 meltdown that my colleagues discussed.

11 One final area and that is the limit
12 levels. If any one of us were writing this, we
13 would write it differently. I would write the
14 limit levels more strict in certain cases,
15 definitely with regard to precious metals.
16 However, what we are doing -- and people I hope
17 don't underestimate the importance of this -- is
18 that we are setting up a position limit regime.
19 It will be systematic. It will be part of what we
20 do. Those limit levels will be identical across
21 the board at first -- that's the 10 percent in
22 contracts up to \$25,000 and then there's an added

1 multiplier for the larger contracts. But the rule
2 also requires that the Commission reassess and
3 recalibrate as we deem appropriate. In my view we
4 should be doing that very often. These markets
5 are changing rapidly. And I hope that at the very
6 least -- and I'll say it today -- that next year
7 when we look at the swaps limits that we also
8 reassess the limits on the regulated exchanges.

9 So I thank my colleagues for their help
10 on this even though I think some have concerns --
11 Commissioner Sommers -- I know Commissioner
12 O'Malia has some concerns. But what may not go
13 noticed a lot is that they still have had a big
14 impact. I know Commissioner O'Malia had some
15 early-on changes. Commissioner Sommers and I were
16 working over the last several days and even though
17 she still has concerns, she's made some
18 improvements to this. The Chairman and
19 Commissioner Dunn and I have worked tirelessly on
20 this over the weekend, and I thank you all. I
21 also thank my staff, in particular Elizabeth
22 Ritter, who this rule wouldn't be anywhere close

1 to that -- Steve Sherrod and Dan Berkovitz. And
2 finally I want to thank the people who did
3 comment, the 13,000 people who commented. When
4 you comment, it's not a vote. We don't just do
5 whatever the most votes say. But having those
6 comments has been particularly helpful on this
7 rule. And even in the last week, the 823 emails
8 that we received -- no, we don't control prices.
9 We're not a price-controlling agency. But we do
10 want to make sure these markets are fair and
11 there's a level playing field. And these folks
12 have told us to make the markets fair. They've
13 told us how they want us to play it out. Thank
14 you.

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

17 COMMISSIONER O'MALIA: Thank you, Mr.
18 Chairman. Happy birthday.

19 CHAIRMAN GENSLER: Thank you.

20 COMMISSIONER O'MALIA: Thank you to the
21 staff for their hard work. The Commission is
22 voting on final rulemakings on position limits and

1 derivative clearing organization core principles.
2 Further, the Commission will be voting on the
3 exemptive relief during the pendency of the
4 Commission rulemaking.

5 Before we begin, I'd like to join my
6 colleagues in thanking the three teams. I know
7 they've worked tirelessly. The position limit
8 rule has been here in the works since I arrived at
9 this Commission nearly two years ago. So I
10 believe that they are probably very relieved to
11 have this behind them. Their work has resulted in
12 comprehensive documents totaling nearly 800 pages.
13 Their perseverance over the past two years, nearly
14 two years, has been truly inspiring.

15 The position limit rulemaking will form
16 the foundation of the Commission's surveillance of
17 physical commodity markets. The DCO core
18 principle rulemaking will form the foundation of
19 the Commission's oversight of the financial
20 integrity of market transactions. However, I'm
21 disappointed with both rulemakings because they
22 rely on fundamentally flawed assumptions, namely

1 that the government knows best and has substituted
2 its judgment for that of the exchanges and DCOs
3 despite the complexities of the futures and now
4 swaps markets. In my opinion such assumptions
5 will lead to regulations with substantial costs
6 and uncertain benefits.

7 These assumptions are very difficult to
8 justify on an evidentiary and statutory
9 perspective. First, both rulemakings have a
10 substantial economic impact on the market
11 participants who rely on these commercial and
12 legitimate reasons to use swaps and futures
13 markets for their hedging purposes. Both
14 rulemakings have been confirmed by the Office of
15 Management and Budget to be major rules. Under
16 the Congressional Review Act, this means that OMB
17 has determined that each rule will have an annual
18 impact of no less than \$100 million. This
19 determination is not surprising given the position
20 rulemaking alone will force commercial hedgers to
21 invest multiple millions of dollars in developing
22 compliance systems just to account for their

1 legitimate hedging strategies.

2 Neither the position limit rulemaking
3 nor the DCO rulemaking will fully describe its
4 costs even qualitatively in its cost benefit
5 analysis. Further, neither rulemaking attempts
6 meaningful quantification of its costs. Both
7 rulemakings deprive the public of transparency
8 into their impact in direct contradiction to two
9 Executive Orders and make themselves vulnerable to
10 legal challenge. The two quotes that best capture
11 my views on cost benefit analysis are from the
12 President himself. He said in his Executive Order
13 affecting this agency, "Wise regulation decisions
14 depend on public participation and on careful
15 analysis of the likely consequences of regulation.
16 Such decisions are informed and improved by
17 allowing interested members of the public to have
18 a meaningful opportunity to participate in the
19 rulemaking and to the extent permitted by law such
20 decisions should be made only after consideration
21 of their cost and benefit, both quantitative and
22 qualitative." The second quote is from his recent

1 decision on the ambient air quality and it's, "I
2 have continued to underscore the importance of
3 reducing regulatory burdens and regulatory
4 uncertainty particularly as our economy recovers."
5 I notice he didn't say "minimizing." He said
6 "reducing" regulatory burdens, and I think both of
7 these rules go in the opposite direction.

8 Obviously, it is a challenge to balance
9 the regulatory objectives of the Dodd-Frank Act
10 with economic growth, but the Commission has an
11 obligation not to lose sight of the economic
12 impacts to our economy. By not providing
13 meaningful quantification, especially when we can
14 easily do so, our cost benefit analyses are
15 inadequate by the President's own standards.

16 Second, in addition to failing to detail
17 costs, the two final rulemakings fail to
18 articulate a convincing rationale for eliminating
19 the current regime of a principles-based
20 regulation and substituting a prescriptive
21 government-knows-best regime.

22 I recently celebrated my second

1 anniversary serving as a Commissioner of the
2 Commodity Futures Trading Commission. Like my
3 colleagues, I take this responsibility very
4 seriously and am honored to serve. I recognize
5 there are passionate views on both sides,
6 especially with regard to position limits. But
7 our role is to make decisions on policy in a
8 dispassionate manner rooted in the facts. I hope
9 that we will continue to examine the facts and ask
10 tough questions as to the implications of each and
11 every rulemaking.

12 I've had several concerns with both the
13 position limit and the DCO rulemaking. I have
14 articulated my concerns in a separate,
15 comprehensive dissent, which will be available on
16 my Commission Website after the vote, and I will
17 ask that be published in the Federal Register.

18 Let me briefly address my concerns with
19 each of the rules today. Today's position limit
20 rule represents the Commission's desire to check
21 the box on position limits. Unfortunately, in its
22 exuberance and attempt to justify doing so, the

1 Commission has overreached its interpretation and
2 its statutory mandate to set position limits.
3 While I do not disagree that the Commission has
4 been directed to impose limits as appropriate, the
5 Commission does not provide a legally sound,
6 comprehensibly rational basis on empirical
7 evidence for a final rule that we will likely pass
8 today. If the commercial entities who use futures
9 and swaps for hedging feel like we are waging war
10 on them, I don't blame them. According to the
11 Commission's cost benefit analysis, legitimate
12 hedgers will pay close to a third of the annual
13 cost of \$100 million just for reporting alone.
14 These are market participants for which Congress
15 extended specific protection for their commercial
16 hedging purposes, yet the rulemaking will increase
17 the cost of hedging and managing their risk.

18 For some, the new regulatory regime may
19 be challenging, but I have no doubt that index
20 investors and other passive long investors will
21 continue to be able to secure their commodity
22 exposure through new regulatory loopholes that

1 we've yet to conceive of in our government-
2 knows-best mandates, including possibly expanding
3 their investments into physical stocks. This is
4 not what Congress intended. And as I have said
5 before, the data backing up the effectiveness of
6 position limits on agriculture products over the
7 last several years just doesn't hold water. These
8 commodities have experienced volatile markets and
9 high prices. And obviously, as all of my
10 colleagues have said, we're not a price-setting
11 agency and nor will these position limits affect
12 those.

13 The DCO core principle final rulemaking
14 is among the most important of the Dodd-Frank
15 rulemakings in my opinion that the Commission is
16 undertaking. I've been a strong proponent of
17 clearing, and I am certain that clearing will
18 benefit the swaps market and in particular,
19 benefit the buy-side firms that will have access
20 to the same beneficial opportunities enjoyed by
21 dealer firms. However, I disagree with the
22 prescriptive approach of this final rulemaking

1 because it leaves DCOs with insufficient
2 discretion to take legitimate action to manage the
3 risk they confront. Two provisions in particular
4 best highlight these concerns: In the final
5 rulemaking it prohibits a DCO from requiring more
6 than \$50 million in capital from any entity
7 seeking to become a swaps dealer. The number
8 makes a great headline; unfortunately, it appears
9 to lack evidentiary basis. Moreover, where the
10 \$50 million threshold may prevent a DCO from
11 engaging in anti- competitive behavior, it may
12 also prohibit a DCO from taking a range of
13 legitimate risk-reducing actions -- for example,
14 increasing capital requirements proportionate to
15 risk. This final rulemaking provides little to no
16 insight in the manner in which the Commission
17 intends to distinguish its priorities in setting
18 legitimate risk rules, including default fund
19 management, guarantee fund levels, and margin
20 requirements.

21 Let me be clear. I am against
22 anti-competitive behavior; however, an entity with

1 \$50 million in capitalization may not be the
2 appropriate clearing member for every DCO. The
3 Commission should have provided principles-based
4 guidance to DCOs on their components of fair and
5 open access such as the standard for less
6 restrictive participation requirements. This
7 would have also put the Commission in greater
8 accord with its international colleagues and
9 regulators.

10 The other concern I have is the
11 rulemaking also requires a DCO to calculate margin
12 using different minimum liquidation times for
13 different products. Specifically, a DCO must
14 calculate margin for futures based at a minimum of
15 one-day margin liquidation; agricultural, energy,
16 and metals swaps based on a one-day margin
17 liquidation time; and all other swaps based on a
18 five-day liquidation timeframe. As a preliminary
19 matter, such minimum liquidation times appear to
20 lack any evidentiary basis. More importantly,
21 when these requirements are juxtaposed against our
22 proposal interpreting Core Principle 9 for

1 designated contract markets, it becomes clear that
2 the requirements have the potential to severely
3 disrupt established futures markets. According to
4 the proposal, a DCM may convert delisted futures
5 contracts into swaps contracts. However, if the
6 futures contracts reference financial commodities,
7 then this rulemaking would require a DCO to margin
8 such swap contracts using a minimum liquidation
9 time of five days instead of one day for futures.
10 If nothing substantive about the contract changes
11 other than the characterization, then how can the
12 Commission justify such a substantial increase in
13 minimum liquidation time and margin?

14 Again, the Commission should have
15 retained the principles-based regime and should
16 have permitted each DCO to determine the
17 appropriate liquidation time for its products
18 based on a risk-based analysis. Determining an
19 appropriate margin requirement involves
20 quantitative and qualitative expertise. Such
21 expertise resides at the DCO and not at the
22 Commission. It is a cost benefit analysis and the

1 final rulemaking admits as much. Returning to a
2 principles-based regime would have better aligned
3 us with international regulators on this matter as
4 well.

5 Finally, let me mention a brief comment
6 about the effective order as Yogi Berra famously
7 proclaimed, "It's déjà vu all over again," and
8 that encapsulates my feelings today. I support
9 the proposal as I did the last time because it's
10 important that the Commission provide market
11 participants and the public with the form of
12 relief the exemptive order is contemplating. But
13 I would have preferred this rule like its
14 predecessor to not have selected an arbitrary end
15 date.

16 Mr. Chairman, I again renew my call for
17 a comprehensive implementation plan that provides
18 greater insight into the reporting requirements on
19 swap data repositories as well as separate
20 rulemakings on real-time and block rules. The
21 Commission must also provide some certainty on the
22 clearing and trading mandates, including

1 clarification of "made available for trading" and
2 guidance on swap clearing.

3 And Mr. Chairman, I'm mindful that today
4 is your birthday, and you're probably old enough
5 to know that you don't get everything you want on
6 your birthday. And I will be voting against both
7 the position limits and the DCO core principles.
8 Thank you.

9 CHAIRMAN GENSLER: I am mindful, and I
10 still want to chat with Macie about what you did
11 give her on Christmas, but --

12 COMMISSIONER O'MALIA: She didn't get a
13 towel rack.

14 CHAIRMAN GENSLER: I know she didn't get
15 a towel rack. And we've been working pretty well
16 together, Commissioner O'Malia, even though we
17 have some fun in public about sometimes when we
18 don't see eye to eye. And I think there's a lot
19 in these rules that have benefited from your
20 advocacy and your input as well as Commissioner
21 Sommers. But I'm addressing you as much as
22 anything because you've really been into engaging

1 in these rules even though you're not supporting
2 them today. So I thank you.

3 With that I think that the staff will
4 make presentations concerning the recommendations
5 on final rule implementation. As we mentioned
6 we're going to start with some of the members from
7 our General Counsel's Office: General Counsel
8 Berkovitz, Mark Higgins, Terry Arbit. It's good
9 to see you again. I suspect we'll see you many
10 more times, but to take up further relief under an
11 exemptive order, which would be if we vote it out
12 today, proposed and we'd seek public comment and
13 seek to finalize it before the end of the year.
14 But I think Mr. Berkovitz --

15 Oh, I'm supposed to -- I'm sorry. I'm
16 supposed to ask for Unanimous Consent that all
17 final votes conducted at the meeting will be
18 recorded votes and the results published in the
19 Federal Register. It's so being done. Now, Mr.
20 Berkovitz.

21 MR. BERKOVITZ: Thank you, Mr. Chairman.
22 For the presentation this morning, I'll turn it

1 over to Mark Higgins in our office.

2 MR. HIGGINS: Happy birthday, Mr.
3 Chairman, and good morning Commissioners. On July
4 14, 2011, pursuant to the authority provided for
5 in the Dodd-Frank Act, Section 712(f), and Section
6 4(c) of the CEA, the Commission issued an order
7 granting in two parts temporary exemptive relief
8 from certain provisions of Title VII of the
9 Dodd-Frank Act.

10 First, the Commission provided relief
11 from certain provisions of the CEA added or
12 amended by the Dodd-Frank Act that do not require
13 a rulemaking, but that do reference one or more of
14 the terms regarding swap entities or instruments
15 that the Dodd-Frank Act requires be further
16 defined. Such terms include swaps, swap dealer,
17 major swap participant, and eligible contract
18 participant. The Commission jointly with the SEC
19 has issued two Notices of Proposed Rulemaking to
20 further define these terms. But because these
21 final rulemakings were not expected to be in place
22 as of July 16, 2011, the Commission temporarily

1 exempted entities from complying with these
2 provisions until the earlier of the effective date
3 of the definition of rulemakings for such terms or
4 December 31, 2011.

5 The second part of the relief is the
6 Commission provided relief from certain provisions
7 of the CEA that may apply to certain agreements,
8 contracts, and transactions in exempt or excluded
9 commodities -- generally financial, energy, and
10 metal commodities -- as a result of the repeal of
11 various CEA exemptions and exclusions by the
12 Dodd-Frank Act as of July 16, 2011. This
13 exemption was based on the Commission's existing
14 Part 35 exemption for swap agreements, but was
15 made available for certain agreements, contracts,
16 and transactions that may not have otherwise
17 qualified under those rules -- for example, if
18 they're cleared. The Commission stated that this
19 exemption was also temporary, expiring upon the
20 earlier of the Commission's repeal or withdrawal
21 of Part 35 or December 31, 2011.

22 The Notice of Proposed Amendment before

1 you today would modify this relief in two ways.
2 First, it would extend the outermost date of the
3 relief from December 31, 2011, to July 16, 2012.
4 Second, the proposed amendments would account for
5 the repeal and replacement as of December 31,
6 2011, of Part 35 of the Commission's regulations.
7 In all other respects, the proposed amendments
8 would maintain the status quo. As such, the
9 Notice seeks comment only on the proposed
10 amendments.

11 Before concluding, I would like to thank
12 our Division and Market Oversight and Division of
13 Clearing and Risk colleagues for their assistance,
14 particularly DMO's David Van Wagner, Don Heitman,
15 and Ryan Miller, as well as the Division of
16 Clearing and Risk's Jody Partridge. They'll be
17 happy to take your questions.

18 CHAIRMAN GENSLER: Thank you, Mr.
19 Higgins, and Dan and Terry. I think I'll
20 entertain a motion to accept the staff
21 recommendation on this amended order.

22 COMMISSIONER DUNN: So moved.

1 COMMISSIONER SOMMERS: Second.

2 CHAIRMAN GENSLER: I support the
3 proposed amendment to the July 14th exemptive
4 order. The order as was just described, of
5 course, provided relief until the end of this
6 calendar year or when the definitional rulemakings
7 were effective. These are further definitions on
8 entities or what the public would think of as the
9 swap dealers and then on products or what many
10 people of the public -- it's swaps. And though
11 Congress has been pretty explicit and detailed on
12 those definitions, along with the SEC the CFTC was
13 to give further meaning to these words.

14 I thought I would just mention that the
15 Commission staff is working very closely with the
16 Securities and Exchange Commission on these rules
17 and that staff is making great progress. We
18 anticipate taking off the further definition on
19 the entities or swap dealers in the very near
20 term, product definition following behind it. I
21 think two of my fellow Commissioners were probably
22 with -- and I don't know where Mr. Karpoff is and

1 the lawyers. Mr. Higgins, you're working on that
2 one, too. But somewhere in the next couple of
3 weeks to get a document to you on the entity
4 definition, and then we'll start to get more
5 feedback. You, of course, will have comment
6 summaries. So to the extent you have feedback

7 based on those comment summaries that would be
8 enormously helpful to staff, particularly as
9 they're negotiating across the two agencies. That
10 would be very helpful. I think the comment
11 summaries on products will come shortly
12 thereafter, maybe in the next two weeks you'll get
13 the product summary comments, which will then help
14 us move along each of those.

15 As these definitional rulemakings have
16 to be finalized and become effective, today's
17 proposed amendment would provide relief through
18 July 16 or when the definitional rulemakings would
19 become effective. But I do think that that gives
20 us sufficient time given that we'll have a
21 document, a pens-down version, on the entity
22 shortly and the comment summary on products pretty

1 shortly as well and then move after that. In
2 addition, today's amendment clarifies by kicking
3 it out to July 16. It also tailors the July 14th
4 amendment in light of the Commission's actions on
5 agricultural swaps. I understand that we revoked
6 Part 35, and so we have to have a reference at
7 least till July 16th.

8 So unless I've said something you find
9 inaccurate, I support the proposal. I look
10 forward to public comment as well, but I turn it
11 over to Commissioner Dunn for any questions.

12 COMMISSIONER DUNN: Thank you, Mr.
13 Chairman. This action today to me is a painful
14 and embarrassing reminder that we still do not
15 have definitions. And I know that you have worked
16 hard to try to get those out, but here we are
17 expanding the timeline simply because we don't
18 know what we talk about. And this has probably
19 been the greatest concern that I've heard from
20 industry as a whole that tell us what we are, tell
21 us what the products are. And I'm hopeful that
22 there doesn't have to be another extension on

1 this.

2 Mark, just a couple of questions. How
3 does the proposed order change the nature or scope
4 of the existing relief provided on July 14th?

5 MR. HIGGINS: It does not.

6 COMMISSIONER DUNN: That's what I was
7 hoping to hear. Does the order provide an
8 assurance of finality in regard to when the
9 Commission's final rule establishing a new swaps
10 regulatory regime will be finished and how?

11 MR. HIGGINS: It does not.

12 COMMISSIONER DUNN: Thank you.

13 CHAIRMAN GENSLER: Thank you,
14 Commissioner Dunn. If I might mention, Congress
15 was pretty specific on what is a swap dealer and
16 what is a swap. And I don't think there's much
17 debate about what a five-year interest rate swap
18 is, for instance. But what we benefited by in
19 this definitional process is we did as you recall
20 an ANPR. That's where we ask the public for
21 comments before we even do rulemaking. We did
22 some public roundtables with the SEC, particularly

1 on the swap dealer definition. And then we did
2 two proposals and got very detailed comments.
3 And, of course, everybody wants their very
4 specific and unique question answered, but most of
5 the questions on products relates to the forward
6 exclusion, which we've had for decades. And I
7 think all of us, while there's some differences on
8 the substance, have taken to heart Congress'
9 intent, that futures and forwards are not swaps
10 and then it just gets around that. Some really
11 excellent comments that have come in to insure the
12 public and the agricultural markets and in the
13 energy and metals markets, producers, and
14 merchants, and so forth if they're entering into
15 forwards, that's not going to get caught up in
16 this thing. So it's taken some time just to make
17 sure that we react responsibly to all of the
18 comments as well as on the swap dealer definition,
19 which is similar. The swap dealer side is also a
20 lot about commercial parties not getting caught up
21 in this thing.

22 COMMISSIONER DUNN: Mr. Chairman, I

1 don't take issue with the benefit we're getting
2 from getting public comments on this. What I take
3 issue with is drawing this out in the timeline and
4 trying to get some certainty out there so that
5 people know what they're talking about. I grant
6 you that a lot of them know who they are and what
7 they deal, but until they see it in rule, hope
8 springs eternal.

9 CHAIRMAN GENSLER: Nothing would please
10 me more than to bring it to you at the next
11 meeting. I think we're pretty close on the entity
12 definition.

13 Commissioner Sommers?

14 COMMISSIONER SOMMERS: I just have one
15 question with regard to the end date. So what
16 needs to be accomplished between now and then to
17 make sure that we don't have to extend this again?

18 MR. HIGGINS: Right. So for Part 1, it
19 would be the further definition and rulemakings
20 that reference that. And then for Part 2, it's
21 coterminous with the expiration provided for in
22 Dodd-Frank for the grandfather relief provisions,

1 2(h) and 5(d).

2 CHAIRMAN GENSLER: Thank you,
3 Commissioner Sommers. Commissioner Chilton.

4 COMMISSIONER CHILTON: I just wanted to
5 briefly try to explain this in lay person's terms,
6 and the lawyers can tell me if I've got it wrong.
7 Because last time we did this, I received some
8 criticism from people who thought we were sort of
9 cutting out the responsibility from market
10 participants to comply with the Dodd-Frank law.
11 Until we do what I termed earlier -- putting the
12 meat on the bones of the law -- until we do that,
13 there's really nothing for folks to comply with.
14 They don't know if they fit into the definitions.
15 They don't know what exactly they're supposed to
16 do. They just have the general skeleton of the
17 law as Congress laid it out for us. So we have to
18 do the rules in order to give them something to
19 comply with.

20 I agree with Commissioner Dunn. I wish
21 we'd done a lot of this before. On the other
22 hand, we want to be thoughtful. We want to make

1 sure that we're getting it right. So that's why
2 we have to do this again. I'm disappointed on one
3 hand. On the other hand, I think people should
4 take some comfort in the fact that we're trying to
5 be deliberate.

6 So have I misstated anything, Mr.
7 Berkovitz?

8 MR. BERKOVITZ: No, Commissioner
9 Chilton. I think you've correctly stated it. I
10 would add just an expansion of the point that
11 you've made, that the order also provides that
12 with respect to any rulemaking that the Commission
13 shall issue during this period, if the Commission
14 in that rulemaking makes that provision effective,
15 then that provision will become effective prior to
16 the expiration. So as the Commission -- it
17 anticipates that as the Commission does
18 rulemakings during this period, the Commission may
19 make those rulemakings effective.

20 COMMISSIONER CHILTON: So if we pass
21 position limits today, then it gets implemented in
22 accordance with that rule and the same with other

1 rules?

2 MR. BERKOVITZ: It would be in the
3 individual rulemaking. The position limits, as
4 we'll explain later, does have its own effective
5 date.

6 COMMISSIONER CHILTON: That's a very
7 helpful clarification. I thank you for it. Thank
8 you, Mr. Chairman.

9 CHAIRMAN GENSLER: Yeah, I think it is a
10 helpful clarification because the 11 rules we
11 finalized this summer in public meetings -- and we
12 finalized another by seriatim so I'll call it the
13 12 -- have their individual effective dates. And
14 to like swap data repositories is -- they can
15 register already for instance. Large trader
16 reporting has some dependency on the further
17 definitions, but where it doesn't, where it's a
18 clearinghouse or futures commission merchant, they
19 could already be providing information. Is that
20 correct?

21 MR. BERKOVITZ: That is correct, Mr.
22 Chairman.

1 CHAIRMAN GENSLER: Or the FOREX, of
2 course, which we finalized in 2010 earlier. Is
3 that right?

4 MR. BERKOVITZ: Yes, that is correct.

5 CHAIRMAN GENSLER: Commissioner O'Malia?

6 COMMISSIONER O'MALIA: I don't have a
7 question. I've asked that we have some certainty
8 I think like Commissioner Dunn, and we just
9 eliminate the artificial date and just go with
10 when the rules are effective. And it sounds like
11 there's consensus on that. So maybe I should
12 quickly draft up an amendment here to swap that
13 out.

14 COMMISSIONER CHILTON: There's not
15 consensus on that.

16 COMMISSIONER O'MALIA: Hope springs
17 eternal. So I have no comment, but I just hope
18 that we won't have to revisit this yet again.

19 CHAIRMAN GENSLER: I know what we have
20 consensus on. It's to finalize the further
21 definition of swap dealer and further definition
22 of swap. That is a lot of consensus here. I

1 mean, we'll get into the details, and I think
2 you'll be very pleased with the staff work. It's
3 consistent with the comment summary that you have
4 on the entity definition as I've seen it.

5 COMMISSIONER O'MALIA: Well, that will
6 be an interesting debate and a very good debate.
7 We might even fill the room again because that is
8 for all the marbles. And we have different
9 rulemakings out there. The Volcker Rule has
10 different entity definitions, and we're debating
11 different definitions. So this will be a great
12 one to have. I can't wait for it.

13 CHAIRMAN GENSLER: Great. I think, Mr.
14 Stawick, if you want to call the roll?

15 MR. STAWICK: Commissioner O'Malia?

16 COMMISSIONER O'MALIA: Aye.

17 MR. STAWICK: Commissioner O'Malia, aye.
18 Commissioner Chilton?

19 COMMISSIONER CHILTON: Aye.

20 MR. STAWICK: Commissioner Chilton, aye.
21 Commissioner Sommers?

22 COMMISSIONER SOMMERS: Aye.

1 MR. STAWICK: Commissioner Sommers, aye.

2 Commissioner Dunn?

3 COMMISSIONER DUNN: Aye.

4 MR. STAWICK: Commissioner Dunn, aye.

5 Mr. Chairman?

6 CHAIRMAN GENSLER: Aye.

7 MR. STAWICK: Mr. Chairman, aye. Mr.

8 Chairman, on this matter the yeas are five; the

9 nays are zero.

10 CHAIRMAN GENSLER: I guess the yeas have

11 it, and the staff recommendation is accepted. And

12 we'll be sending it out to the Federal Register

13 for comment. Thank you very much, Ananda, and

14 others on the team. It's a big team. John Lawton

15 and -- I gather Phyllis is on -- she's not

16 physically here, is that right? But we'll give

17 members of the public -- we're going to give a

18 minute to just allow the next group to get up to

19 the stage.

20 We're going to welcome John Lawton, Anne

21 Polaski, and Ananda Radhakrishnan, all of the

22 Division of Clearing and Risk, to present the

1 staff recommendations regarding the final rule on
2 derivative clearing organization, general
3 provisions of core principles. These are
4 primarily related to the financial risk management
5 and risk oversight of the clearing organizations,
6 but take up other critical matters as well.

7 Ananda?

8 MR. RADHAKRISHNAN: Thank you. Do you
9 want me to wait for Commissioner Dunn?

10 CHAIRMAN GENSLER: Yeah, why don't you
11 wait. It might just be a minute. That'd be fine.
12 Thank you.

13 Ananda, I think we're going to --

14 MR. RADHAKRISHNAN: Okay. Good morning,
15 and we're going to present the final rules to
16 implement --

17 CHAIRMAN GENSLER: Do you want to just
18 move the mic a little closer to you?

19 MR. RADHAKRISHNAN: Oh, sure -- to
20 present the final rules to implement a significant
21 portion of the DCO core principles. Before I do
22 that, I'd like to recognize the dedicated members

1 of the team from DCR who worked on this: John
2 Lawton, Deputy Director; Phyllis Dietz is away on
3 vacation in Japan, but she has promised to try and
4 get into the Webcast. It's like close to 12:00 in
5 the morning in Japan, but being the tireless and
6 dedicated civil servant that she is, instead of
7 enjoying herself in Japan, she is watching this by
8 Webcast. Anne Polaski, the Special Counsel from
9 the Chicago office; and I'll mention other people,
10 Eileen Donovan, Jake Preiserowicz, Jonathan Lave,
11 Julie Moore, Tom Zabroske, Susan Rios, Steve
12 Greska, Kenji Takaki, Halle Rawl. So I thank my
13 team, and I'm going to hand it over to John -- I'm
14 sorry, Anne's going to go first.

15 MS. POLASKI: Good morning, Mr.
16 Chairman, Commissioners. My comments will provide
17 a brief general overview of this rulemaking, and
18 then John Lawton will discuss the major issues.

19 The rules would implement 15 DCO core
20 principles: Compliance, financial resources,
21 participant and product eligibility, risk
22 management, settlement procedures, treatment of

1 funds, default rules and procedures, rule
2 enforcement, system safeguards, reporting,
3 recordkeeping, public information, information
4 sharing, anti-trust considerations, and legal
5 risk. In addition, the rules would update and add
6 related definitions, address DCO Chief Compliance
7 Officers, and revise procedures for DCO
8 applications, including the required use of a new
9 Form DCO.

10 The rules were proposed in five separate
11 Notices of Proposed Rulemaking. The Commission
12 received a total of approximately 119 comment
13 letters addressing these proposed rules. The
14 Chairman and Commissioners as well as staff
15 participated in numerous meetings with
16 representatives of DCOs, FCMs, trade associations,
17 public interest groups, traders, and other
18 interested parties. In addition, staff has
19 consulted with other U.S. financial regulators,
20 including the Federal Reserve Board and the SEC,
21 as well as foreign regulators.

22 Many of the rules would be adopted as

1 proposed, although there are a number of
2 provisions that have been revised or eliminated
3 upon further consideration in light of the
4 comments received. The rules are designed to
5 strike an appropriate balance between establishing
6 general prudential standards and specific
7 requirements. The rules also reflect a careful
8 consideration of the costs and benefits associated
9 with each rule.

10 Now I'll turn it over to John.

11 MR. LAWTON: Good morning. I won't go
12 through all core principles addressed in this
13 rulemaking, but instead highlight about a half
14 dozen of the more prominent provisions.

15 First, financial resources: The final
16 rule would require each DCO to maintain sufficient
17 financial resources to enable the DCO to meet its
18 financial obligations to its clearing members
19 notwithstanding the default by the clearing member
20 creating the largest financial exposure in
21 extreme, but plausible, market conditions. This
22 is the so-called Cover 1 Standard. It is the

1 standard set forth in Section 5(b)(c) of the Act.

2 You will recall that in addition to
3 proposing the Cover 1 Standard as a baseline for
4 all DCOs, the Commission had also proposed a Cover
5 2 Standard for those DCOs designated as
6 systemically important by the Financial Stability
7 Oversight Council or FSOC. Because the FSOC has
8 not yet designated any DCOs as systemically
9 important and because international standards in
10 this area have not yet been finalized, staff
11 believes that it would be premature to finalize
12 this or any of the other rules relating to SITCOs
13 at this time. So that's not in this particular
14 package.

15 The next prominent issue is participant
16 eligibility. The final rule would state that a
17 DCO may not set a minimum capital requirement of
18 more than \$50 million for clearing members. This
19 provision is intended to permit more firms to be
20 eligible to become clearing members in furtherance
21 of the Congressional mandate of fair and open
22 access. The rule should increase competition for

1 clearing services thereby reducing costs, and it
2 should reduce concentration thereby reducing
3 systemic risk.

4 As a risk management tool, the rule also
5 would require DCOs to set scalable limits for
6 their clearing members in accordance with the
7 financial resources of each clearing firm.

8 Moving now to margin, an important issue
9 is the liquidation time horizon to be used in
10 setting margin requirements. The final rule would
11 provide that DCOs should set a liquidation time
12 that is at least one day for futures; at least one
13 day for swaps on agricultural products, energy
14 products, and metals; and at least five days for
15 swaps on financial products. The rule also
16 provides a safety valve permitting the Commission
17 by order to establish either a longer or a shorter
18 time for particular products. The times set forth
19 in the rule reflect current practices at DCOs.
20 The rule provides legal certainty for the evolving
21 marketplace as well as a practical means for
22 assuring that thousands of swaps subject to the

1 Commission's oversight will have prudent, minimum,
2 margin liquidation time horizons.

3 In addition, it will prevent a potential
4 race to the bottom by DCOs that might be tempted
5 to compete by lowering margin requirements.

6 Also in the area of margin, the rule
7 would require DCOs to collect margin from their
8 clearing members for customer accounts on a gross
9 basis. For those DCOs that do not already collect
10 on a gross basis, this will increase the amount of
11 margin at the clearing level thereby reducing the
12 risk that a clearing member will default to the
13 DCO. In order to reduce potential operational and
14 technology development costs that commenters
15 mentioned in the comment period, the final rule
16 would permit DCOs to collect the sum of a clearing
17 member's gross customer positions without
18 necessarily breaking it down by individual
19 account.

20 The last prominent margin-related issue
21 is the use of letters of credit as initial margin.
22 The rule would permit their use for futures, but

1 not for swaps. Unlike other margin assets,
2 letters of credit are a promise to pay, not an
3 asset that can be sold, thus they pose different
4 risks than the other types of margin assets
5 currently collected. A number of commenters
6 stated that letters of credit, however, have been
7 used for some time in the futures markets without
8 incident. In order to avoid disrupting current
9 practice, the rule would in a sense grandfather
10 letters of credit for futures while establishing a
11 more cautious standard for the potentially larger
12 swap market.

13 Finally I should mention that the rules
14 would provide for staggered effective dates. I
15 won't go through all the provisions, but note that
16 most of the rules would be subject to a 60-day
17 effective date, but some would be subject to a
18 six-month or one-year timeframe. For example, the
19 letter of credit provision would be effective in
20 six months while the gross margin provision would
21 be effective in one year.

22 And that concludes the presentation.

1 Thank you.

2 CHAIRMAN GENSLER: Thank you, Mr.
3 Lawton. I look for a motion on this staff
4 recommendation on core principle final rules --
5 clearinghouse core principle rules.

6 COMMISSIONER DUNN: So moved.

7 COMMISSIONER SOMMERS: Second.

8 CHAIRMAN GENSLER: Thank you. I support
9 the final rulemaking. I think this is one of the
10 most significant rulemakings to help lower risk in
11 the financial system. Clearinghouses that have
12 existed since the late 19th century have
13 functioned both in clear skies and during stormy
14 times. They've, of course, functioned in the
15 futures marketplace, and this agency I think has a
16 proud history of regulating those clearinghouses
17 through the Great Depression and numerous bank
18 failures. I guess we weren't regulating it during
19 the Great Depression, but through numerous bank
20 failures, a world war, and, of course, the 2008
21 financial crisis to help lower risks to the
22 economy.

1 And importantly, centralized clearing
2 protects the dealers -- usually the banks -- and
3 their customers from the risk of either party
4 failing. So when one customer doesn't clear their
5 transactions, they actually take on the dealer's
6 credit risk. So uncleared transactions take on a
7 credit risk; cleared transactions then have the
8 risk- reduction side in a clearinghouse. And we
9 have seen over the decades that banks and dealers
10 do fail. Centralized clearing protects all market
11 participants requiring the daily mark-to-market
12 valuations and requiring collateral to be posted.
13 These two fundamental features, value the
14 transactions daily and putting up the daily
15 valuations, which have worked so well in the
16 futures industry these many decades. But it does
17 protect the counterparties or customers -- the
18 corporate end-user, the farmer, the merchant -- in
19 case a bank fails. And, of course, it protects
20 banks in case other banks fail or dealers fail.
21 It lowers the interconnectedness between financial
22 entities that helped spread risk throughout the

1 economy in 2008. Any wonder about this just think
2 about AIG and how many uncollateralized swaps they
3 had between them and other parties.

4 So then that turns me to today's
5 rulemaking and why I support it. I think it
6 establishes certain regulatory requirements for
7 the clearinghouses to implement their core
8 principles. And we recognize the need for very
9 robust risk management standards, particularly as
10 more swaps come in. Dodd-Frank says there's a
11 mandate, and that mandate might cover much of a
12 \$300 trillion marketplace moved into
13 clearinghouses. And throughout this great debate
14 over these last two years, there's been many an
15 editorial and many a news story about are we just

16 moving systemic risk from the banks to the
17 clearinghouses? That's why this rule that we look
18 to today is so important. And yes, that's why,
19 Commissioner O'Malia, that I think it's important
20 that we are prescriptive because safety and
21 soundness cannot be a race to the bottom between
22 clearinghouses picking and choosing their risk

1 management standards. I think they should compete
2 on service and price. And there are many, many
3 things to compete on, but there is a risk if they
4 compete on lowering standards in a competitive
5 environment.

6 So what did we look to? We looked to
7 international standards. They're called the IOSCO
8 and CPSS standards. These are just acronyms for
9 international organizations that have come
10 together. And what we've put in the final rule,
11 based on much public comment, is that the
12 financial resources and risk management
13 requirements will strengthen the integrity and
14 also enhance legal certainty of these
15 clearinghouses.

16 We've adopted a requirement that the
17 clearinghouse collect initial margin on a gross
18 basis for its clearing members' customer accounts.
19 And we have, as Commissioner O'Malia pointed out
20 and the staff pointed out, differentiated that for
21 interest rate and financial index swaps -- credit
22 default swaps in essence, the index swaps -- we

1 are maintaining as proposed a minimum liquidation
2 period of five days. That means if somebody
3 defaults, you have to have some margin to cover
4 five-day liquidation. This happens to be
5 consistent with current market practice. And, in
6 fact, we got many comment letters to say "keep
7 this in place" from industry associations as well
8 as large banks and as well as the largest interest
9 rate clearinghouse itself today. We also got
10 comments from the central banks themselves, from
11 the U.S. Federal Reserve directly to me in the
12 most senior way they can -- "do not, please, lower
13 this five-day" -- and from the Bank of England as
14 recently as meetings last Thursday that I had.
15 They are very focused on that interest rate swaps
16 are at the center of the swap market, some 80
17 percent of the market, and it's where bank-
18 to-bank risk is most fundamental.

19 We have taken the view on the physical
20 commodity swaps such as energy, metals, and
21 agricultural swaps, which is a far smaller part of
22 the market -- and by the way, has a market

1 practice here in the U.S. of one-day margining in
2 swaps at two large clearinghouses and had one-day
3 margining based on commission orders and practice.
4 And there are many commenters that said we should
5 lower the cost of our initial rule and go to
6 one-day liquidation.

7 As a safety valve and as flexibility,
8 we've included that the clearinghouses can
9 petition overtime. And I accept Commissioner
10 Sommers' point of view that this may change
11 overtime. It may be that swaps become as liquid
12 as futures. They're not there yet, but they may
13 become as liquid as futures. And I think it is
14 appropriate from time to time to have the
15 Commission take a look at it either by petition or
16 by actually adjusting this rule through Notice and
17 Comment. But for now I think as we have this
18 great paradigm shift, it's critical that we listen
19 to the central banks around the globe, listen to
20 the largest industry associations, and keep the
21 interest rate swap liquidation period at five-day
22 periods.

1 In 2008, I do want to note for the
2 public, it took five days to actually move the
3 position of Lehman Brothers at LCH, which is in
4 London and is the largest interest rate swap
5 clearinghouse. That is relevant, at least from my
6 thinking, as I looked at this and actually debated
7 often with fellow Commissioners this one-day or
8 five-day margining. I think that our agency is a
9 market regulator, but it's also a safety and
10 soundness regulator; and critical that, as we look
11 at the risk on the horizon whether they're from
12 Europe today or in the U.S. or elsewhere, we go
13 with the best practices that exist today.

14 Second, the rulemaking implements
15 Dodd-Frank's requirement on open access.
16 Participant eligibility requirements promote fair
17 and open access to clearing and help democratize
18 the marketplace. Importantly, the rule only
19 addresses how a futures commission merchant can
20 become a member of a clearinghouse. And the rule
21 promotes more inclusiveness while allowing a
22 clearinghouse to scale members' participation.

1 And I think this is quite critical. The
2 clearinghouse will be able to scale participation
3 by the amount of capital. So when this rule says
4 a minimum of \$50 million capital, somebody that
5 has a billion dollars of capital can be scaled to
6 have a lot more risk in the clearinghouse. And we
7 think that that is appropriate and prudent, but
8 that clearinghouses have less risk if they're more
9 inclusive. And that's certainly the model on the
10 futures industry -- I see John Damgard here who
11 heads the Futures Industry Association -- but I do
12 think that it's worked well in the futures
13 industry to have a more inclusive model, and
14 that's what this embodies, Congress' will.

15 There's reporting requirements as well
16 that will help the Commission and the public with
17 regard to clearinghouses, and the rule finalizes
18 application procedures to have greater uniformity.
19 I think overall the rules help lower risk to the
20 system, particularly moving the swaps market into
21 central clearing. But I don't know -- Ananda and
22 John and Anne, if you have anything to say on my

1 little monologue there as to why I'm supporting
2 this rule.

3 MR. RADHAKRISHNAN: Just one more point.
4 LCH in addition to five days, it consumed 30
5 percent of the margin.

6 CHAIRMAN GENSLER: You're saying on the
7 Lehman Brothers situation?

8 MR. RADHAKRISHNAN: On Lehman Brothers.

9 CHAIRMAN GENSLER: But it's correct,
10 Ananda, because you lived it -- I know Bob
11 Wasserman and others and some of the Commissioners
12 were here at the time, three of my fellow
13 Commissioners -- that it took till that Friday for
14 them to actually move or deal with the Lehman
15 Brothers interest rate swap --

16 MR. RADHAKRISHNAN: That's what they
17 told us.

18 CHAIRMAN GENSLER: Thank you.
19 Commissioner Dunn.

20 COMMISSIONER DUNN: Thank you, Mr.
21 Chairman. As I said in my opening statement, I
22 really feel like we're moving into the center

1 stage here, that opening up the clearinghouses for
2 the swaps certainly does get us into the area of
3 providing a greater amount of openness,
4 transparency, and safety in our financial
5 regulatory programs. When we first started doing
6 proposed rules, and I think it was probably at the
7 first meeting, I had directed folks to what I
8 called the boilerplate section in the back of the
9 regulations and pointed out the cost benefit
10 analysis. And I didn't know what type of Pandora
11 box I was opening at that time, but that certainly
12 has become a big issue on this rule, and the next
13 rule that we're going to take up, and will be a
14 concern as we continue to go. And I really do
15 appreciate those who have sent in comments and
16 have pointed out their concerns about what the
17 costs and benefits will be of these various rules.

18 I know some of my colleagues are going
19 to drill down on this so I'm not going to spend
20 much time there. Ananda, under Section 39.11, it
21 "permits any other financial resources deemed
22 accessible by the Commission." The preamble to

1 this rule states that, "The Commission could
2 evaluate letters of credit on a case-by-case
3 basis." Under what circumstances would the
4 Commission make such an evaluation and what
5 criteria would be used in making such an
6 evaluation?

7 MR. RADHAKRISHNAN: I imagine that -- I
8 mean, I'm just thinking out loud because I don't
9 know what the DCOs will tell us. But if the DCOs
10 can show that there has been a call on a letter of
11 credit and the bank paid, that would give me a lot
12 of assurance. The concern I have about letters of
13 credit is that it's a promise to pay by a third
14 party. It's not possession by the DCO of
15 collateral that it could use unfettered. So the
16 proposal before the Commission seeks not to
17 disturb the current practice in the futures
18 industry, and that's why it says it's fine for
19 futures and not for swaps. But that is the
20 concern. Perhaps if they showed that banks that
21 are issuing the letters of credit have a history
22 of paying, maybe not in the futures context but in

1 other contexts. The question is what assurance
2 can they provide the staff and then eventually the
3 Commission that if called upon, the bank will
4 actually pay? I'm not talking about the
5 contractual obligation. The letter of credit can
6 be completely airtight and the letter of credit
7 could say "I will pay and I'll pay within an
8 hour." But promising to pay and actually paying
9 are two different things.

10 COMMISSIONER DUNN: Ananda, throughout
11 the period the Chairman did step out, but for him
12 and his staff I greatly appreciate their working
13 with me, my staff, and my fellow Commissioners on
14 accepting changes to the rule from the initial
15 proposal. There were some, and it has been
16 greatly approved. So I appreciate the hard work
17 the staff did and the time and patience, Ananda,
18 that you've spent in my office explaining to me.

19 MR. RADHAKRISHNAN: No, it's my
20 pleasure, Commissioner.

21 COMMISSIONER DUNN: It didn't appear to
22 be at the time.

1 MR. RADHAKRISHNAN: I'm just a sourpuss
2 guy.

3 COMMISSIONER DUNN: One of the things, a
4 phrase that you've used to me over and over and
5 the Chairman has repeated this morning, is a "race
6 to the bottom." And it occurs to me that working
7 with a DCO is greatly different than looking at
8 over-the-counter swaps for credit default swaps,
9 for instance, because you have another entity that
10 is at risk and a risk committee that are looking
11 at things in there. Overall -- and I said early
12 on that I thought we should be less prescriptive
13 -- this rule is much more prescriptive than I
14 would like to see. I would hope during future
15 periods that we're able to get back to principles-
16 based regulations in this arena. But is there a
17 distrust that we have with the DCOs that the
18 monies they've got at risk and all the members
19 have at risk that they're not going to be prudent
20 and conscientious as they look at products and
21 clearing members?

22 MR. RADHAKRISHNAN: I wouldn't say that

1 there is distrust. So far no DCO has done
2 anything that has caused me or any members of my
3 staff to distrust them. But I think if I could
4 direct you to page 4 and 5 where the document
5 seeks to explain why we've chosen regulations in a
6 way. We talk about increasing legal certainty for
7 DCOs, clearing members, and market participants.
8 And in case anybody's inclined to lower risk, it
9 prevents them from lowering risk for competitive
10 reasons or for taking on more risk than is
11 prudent. "The imposition of legally enforceable
12 standards provides assurance to market
13 participants and the public that DCOs are meeting
14 minimum risk management standards. And this can
15 serve to increase market confidence, which in turn
16 can increase open interest and free up resources
17 that market participants might otherwise hold in
18 order to compensate for weaker DCO risk
19 management." So I think the DCO rules are not
20 just meant for the DCOs, but also meant for public
21 consumption because we may see a tremendous shift
22 of activity from the current uncleared bilateral

1 market move to the cleared regulated markets, and
2 we just want to make sure that the history that
3 you've pointed out, Commissioner Dunn, about the
4 record of the futures industry thus far of having
5 no blemishes continues to do so.

6 MR. LAWTON: I would also add that in a
7 couple of instances DCOs commented in favor of
8 some of these prescriptive rules. So I think some
9 DCOs at least have some concern that some of their
10 competitors might, in fact, move in a different
11 direction without them.

12 MR. RADHAKRISHNAN: Because we have 16
13 DCOs now, and we might have more in the near
14 future. And also to John's point, a lot of these
15 rules sort of codify current DCO practice and,
16 therefore, we believe that most if not all DCOs
17 should not have difficulty in complying.

18 COMMISSIONER DUNN: In our conversations
19 the concept of codifying some of the current
20 practices are, in fact, moving from a
21 principles-based regime to a more prescriptive
22 base.

1 MR. RADHAKRISHNAN: Right.

2 COMMISSIONER DUNN: And you and I have
3 had numerous comments on this. And your final
4 appeal to me always appeared to be well, this is
5 what we can do with the staff we have and for us
6 in an overabundance of caution, we feel like we
7 have to have the final oversight on this since we
8 don't have the FTEs available as full-time
9 employees available to go out and conduct audits
10 on compliance with the regulation. Could you
11 amplify on that concern a bit?

12 MR. RADHAKRISHNAN: Prior to having
13 rules, you had principles which are a fairly broad
14 brush and there's also the Core Principle A that
15 says the DCO essentially has discretion on how it
16 complies with the core principle, which if you're
17 a DCO is really nice because you can say I can
18 pretty much do whatever I want. And so the
19 question is, how does a regulator respond to that?
20 And I think that in an environment where you don't
21 have resources, you could potentially have a lot
22 of time spent going back and forth between the

1 CFTC staff and a DCO as to whether a DCO is in
2 compliance with a core principle.

3 A regulation is much more clear-cut.
4 You're either in compliance or you're not. We
5 have 13 examination staff. That's woefully
6 inadequate for 16 DCOs. You know, we try and do
7 the best job that we can, but if somebody asks me
8 whether we can examine all DCOs once a year, the
9 answer is no. So we hope that having regulations
10 would make it easier for us. And the other issue
11 is, how serious do we want to be taken as a
12 regulator? I'd say very seriously. When things
13 are going fine, everybody says back off, get away,
14 don't interfere in my business. But when things
15 go wrong, people suddenly start looking at us and
16 saying where were you?

17 COMMISSIONER DUNN: You've made the
18 comparison to me of some existing DCOs and what
19 you see as new ones coming on. Do you contemplate
20 deferential supervision in the future?

21 MR. RADHAKRISHNAN: By deferential do
22 you mean would we spend more time? Yes,

1 absolutely, because it's going to be a function of
2 the amount of activity that a particular DCO
3 undertakes. So, for example -- not to pick on
4 names, but -- when we examine the CME Group or LCH
5 or ICE Clear Credit, we would probably spend more
6 time because of the sheer volume of activity that
7 they undertake to make sure that we have a
8 comprehensive understanding of their operations
9 than we would with say a DCO that has not begun
10 clearing where the open interest is fairly small.
11 So it's differential, it's risk based, but that's
12 how we operate.

13 COMMISSIONER DUNN: I often tell people
14 that there's no such thing as a final rule because
15 this is a dynamic process, and we're going to be
16 learning as we go along. In addition, folks that
17 completely disagree with it can petition us to
18 rewrite the regulation if we're landing the
19 airplane upside down. Certainly the staff is
20 going to say wait a minute, we need a change here.
21 There is a possibility for folks to go to Congress
22 and get the legislation changed at all times. But

1 also, do you contemplate that as we begin to
2 understand what we're doing here and the industry
3 as a whole, do you anticipate that we'll be going
4 to some guidance in lieu of some of the stricter
5 prescriptive positions that we've taken?

6 MR. RADHAKRISHNAN: I can't answer that
7 because I don't know what our staffing will be.
8 We might find that regulations work just fine
9 because everybody likes the bright line of a
10 regulation. If you look --

11 COMMISSIONER DUNN: But they haven't
12 contacted me yet.

13 MR. RADHAKRISHNAN: Not surprising. But
14 if you look at FCMs, for example, FCMs are not
15 subject to principles. FCMs have been subject to
16 the Commission's regulatory scheme since the time
17 the Commission was set up. And FCMs will come and
18 complain from time to time, but it's very clear
19 what an FCM has to do. So is it possible? I
20 guess a future Commission may direct staff to say
21 I want you to go back to a more guidance approach,
22 and the staff will do what the Commission tells it

1 to do. But I like regulations. I like a bright
2 line because then I can tell somebody you're in
3 compliance or you're not.

4 COMMISSIONER DUNN: Thank you very much,
5 and thanks to the entire team.

6 MR. RADHAKRISHNAN: Thank you.

7 CHAIRMAN GENSLER: Thank you,
8 Commissioner Dunn. Commissioner Sommers.

9 COMMISSIONER SOMMERS: Thank you, Mr.
10 Chairman, and I have said already how much I
11 appreciated all of your help and assistance on
12 these rules. They're very complex and
13 complicated. It's a huge amount of work that's
14 gone into all of the proposals. And thank you to
15 Phyllis who's listening for all of her help as
16 well. She's put in a lot of long hours on these
17 rules. So certainly thank you to Phyllis as well.

18 I have a number of different areas where
19 I'd like to ask a few questions, and the first one
20 is on the Chief Compliance Officer. When we did
21 the final rule on swap data repositories, we
22 prohibited an SDR from having the General Counsel

1 or a member of the legal department from serving
2 as a Chief Compliance Officer due to the possible
3 conflicts of interest. But the DCO rules allow
4 members of the legal staff to serve as a CCO,
5 which I by the way agree with. But can you
6 explain what kind of thought process goes into
7 this kind of discrepancy in our rulemaking? I
8 mean, how is it okay for a DCO, but it's not okay
9 for an SDR? I think, again, you did the right
10 thing, but was there any sort of back and forth on
11 this?

12 MR. LAWTON: One thing was that there
13 were some comments from some of the smaller DCOs
14 that said it would be a staffing problem for them
15 and that they didn't really have a big enough
16 staff. And so I think the potential distinction
17 was that there may be potentially fewer SDRs and
18 they may, in fact, have larger staffs to start
19 with. So again, I'm not familiar with the
20 comments that were received in that case, but I do
21 know on the DCO side there were people that said
22 we simply -- we'd have to go out and hire yet

1 another person. We think that we can do this --
2 that the same individual could carry out more than
3 one responsibility in a small operation such as
4 ours.

5 COMMISSIONER SOMMERS: Thank you. On
6 financial resources, the 39.11(b)1 and (b)2 list
7 the types of financial resources that are
8 acceptable for purposes of enabling a DCO to meet
9 its obligations notwithstanding a default by its
10 largest clearing member and to enable a DCO to
11 cover its operating costs for a period of at least
12 one year. In addition to the financial resources
13 that are listed, the rule allows a DCO to use any
14 other financial resource deemed acceptable by the
15 Commission. Can you describe how we will make a
16 decision about other financial resources and will
17 we have to do a Commission order in order to
18 expand that list?

19 MR. RADHAKRISHNAN: I think the -- I'll
20 answer your second question first. It either
21 could be a Commission order or it could be an
22 amendment to a Commission regulation, but I think

1 staff's thinking of Commission action.

2 As far as the type of resource, I guess
3 it's an identification of the resource that people
4 want to use, why they want to use it, and why it
5 makes sense for them to use it. And, you know,
6 there are two issues. One is a resource that they
7 want to use to meet their Cover 1 obligation as
8 opposed to a resource that they want to use in
9 order to pay their electricity bill. So I guess
10 the question is, why you want to use it and what
11 it is you want to use. I bring it up because I
12 know one of you is going to bring it up anyway.
13 The CME's been talking about using projected
14 revenue as a resource, and we've said that we
15 could, the Commission could, look at projected
16 revenue.

17 The one issue that I do want to mention
18 is the Core Principle B talks about each DCO shall
19 possess financial resources. So the one thing
20 that we need to get over is you don't possess
21 projected revenue. It's something that's
22 projected. So the Commission will have to -- if

1 the Commission wants to use projected revenue, I
2 think the Commission will have to potentially
3 exempt the DCO, pass some sort of exemptive relief
4 from the term "possess." So that's the issue.

5 COMMISSIONER SOMMERS: I do find myself
6 agreeing with this bright line -- make it black or
7 white -- in this area. I think that this is one
8 particular area where prescriptive rules make it
9 more clear for market participants or for DCOs.
10 And this is an area where for letters of credit
11 you allow them to be counted as a financial
12 resource, but not for initial margin.

13 MR. RADHAKRISHNAN: Right.

14 COMMISSIONER SOMMERS: And if there's a
15 problem with a letter of credit and you have a
16 problem with whether or not the bank is going to
17 fulfill its contractual obligation, why don't you
18 have the same concern with regard to financial
19 resources you do as initial margin? I feel like
20 there needs to be this bright line, and operating
21 revenue I feel the same way. We say in the
22 preamble that the Commission --

1 CHAIRMAN GENSLER: Jill, what page is it
2 in the preamble because I keep trying --

3 COMMISSIONER SOMMERS: Well, I'm on the
4 September 27th version, so it's 49 and 50. In the
5 preamble it says that "we've received inquiries as
6 to whether we would deem projected revenue as an
7 acceptable financial resource."

8 MR. RADHAKRISHNAN: Page 50.

9 COMMISSIONER SOMMERS: Right, okay.
10 "And the Commission expects that projected revenue
11 generally would be deemed acceptable for
12 established DCOs that can demonstrate a historical
13 record of revenue, but not for DCO applicants or
14 relatively new DCOs with no such record." So I
15 think it would be helpful -- I mean I'm quite
16 frankly not as concerned about established DCOs
17 who very easily can demonstrate their record.
18 What I'm worried about is how we make a
19 determination of whether operating revenue would
20 be an acceptable use of funds for everybody else.
21 I mean, we have a handful of DCOs that have been
22 registered with this Commission for a very long

1 time that have that record.

2 MR. RADHAKRISHNAN: Correct.

3 COMMISSIONER SOMMERS: And I've had a
4 conversation with you about this before. You're
5 not worried about those DCOs.

6 MR. RADHAKRISHNAN: That's right.

7 COMMISSIONER SOMMERS: But for everybody
8 else, where's -- how do they know? And what does
9 this do for them if they're not going to be able
10 to know?

11 MR. RADHAKRISHNAN: If we were going to
12 do this, I think the consideration would be -- and
13 again, I'm just -- some thoughts for the
14 Commission's consideration -- how long their
15 record has to be. Five years? Ten years? And
16 whether we do any sort of haircut because let's
17 say that the record is that the quarter-by-quarter
18 revenues are not smooth. It goes up and down and
19 so on. Then the question is, do we have a haircut
20 because somebody says I make \$100 million every
21 quarter. Well, that's not true because sometimes
22 you make \$50 million. So those are some of the

1 considerations.

2 COMMISSIONER SOMMERS: I trust your
3 judgment in some sort of criteria that we could
4 use to put that out as some sort of guidance.

5 MR. RADHAKRISHNAN: Okay.

6 CHAIRMAN GENSLER: Can I ask
7 Commissioner Sommers, did we -- on this one, did
8 we delegate to the head of DCR to make these
9 judgments or where does that stand? I mean, I
10 think Commissioner Sommers just said she trusted
11 your judgment.

12 COMMISSIONER SOMMERS: I do.

13 CHAIRMAN GENSLER: But I just don't
14 remember what we did because I remember the
15 preamble language, but frankly I couldn't
16 remember, do we delegate to you or your successors
17 to do this?

18 MR. RADHAKRISHNAN: No. This is
19 Commission action. It's not delegated because the
20 rule says "such other resources as the Commission
21 deems acceptable."

22 CHAIRMAN GENSLER: But could the

1 Commission not in this narrow case just for this
2 provision alone -- I don't know if we trust your
3 judgment on everything, Ananda --

4 COMMISSIONER SOMMERS: I do, Ananda. I
5 just think it would have been --

6 CHAIRMAN GENSLER: I do. Now we're
7 going to give you a delegation of -- I think
8 Commissioner Sommers might give you delegation on
9 a lot of things.

10 COMMISSIONER SOMMERS: I think it would
11 have been appropriate to put some sort of
12 bright-line test in the rule text.

13 MR. RADHAKRISHNAN: Yes. I'm sorry,
14 Anne tells me it is delegated.

15 CHAIRMAN GENSLER: So we have -- oh,
16 good. This wasn't -- I was really -- so do we --
17 this paragraph that's on page 50 about financial
18 resources and everything, Anne you're saying we
19 have delegated that to the head of DCR?

20 MS. POLASKI: Yes.

21 CHAIRMAN GENSLER: Because I think we --
22 I haven't polled the other Commissioners, but I

1 think we have agreement. It'd be terrific if that
2 is like a DCR judgment and if you can accept some
3 of these financial resources and operating, it
4 doesn't have to -- that doesn't get you all the
5 way there, but part way there.

6 COMMISSIONER SOMMERS: My point is that
7 taking this on a case-by-case basis is not a fair
8 way of doing it. So my point is not that we need
9 to delegate it or not delegate it, but that it
10 needs to be some sort of bright line.

11 MR. RADHAKRISHNAN: So I see your point.
12 The issue is two things: One, not all DCOs are
13 created equal so we've got to figure out how far
14 back we look. And then the trouble is if we have
15 a haircut, some of them will say that's too much
16 and some of them will say fine. That's why
17 sometimes I think a case-by-case is more targeted
18 because we can look at the particular DCO and look
19 at their revenues.

20 MR. LAWTON: May I add one additional
21 point? I think that one of the reasons for
22 putting the delegation in was that we're going to

1 get periodic financial reports from DCOs and just
2 in reviewing them people may come across a
3 financial resource they haven't seen before and
4 there has to be some semi-quick judgment. Are we
5 troubled by this one or not? And at some point it
6 would be elevated to the Commission, but I think
7 in other cases it might be that the staff might be
8 able to make a judgment.

9 COMMISSIONER SOMMERS: And I guess
10 that's in the next part of the preamble with
11 regard to "the DCO is left up to contacting
12 Commission staff prior to submitting the quarterly
13 financial resources report" in order to know
14 whether something counts.

15 MR. RADHAKRISHNAN: That's right.
16 That's right.

17 COMMISSIONER SOMMERS: Well, I think any
18 sort of clarity in this area for the future I
19 believe could be helpful.

20 MR. RADHAKRISHNAN: I can imagine that
21 we'll get something from the CME tomorrow, so --

22 COMMISSIONER SOMMERS: On letters of

1 credit, back to letters of credit with regard to
2 the differing treatment between whether they're
3 accepted for futures or for swaps. I do think
4 that there's potential for people that are
5 clearing swaps now using letters of credit as
6 initial margin to have the disincentive to clear
7 in the future if they're end-users and are not
8 required to clear because we're not allowing them
9 to use letters of credit. So in that case, is
10 that something that we would consider on a
11 case-by-case basis?

12 MR. RADHAKRISHNAN: Yes.

13 COMMISSIONER SOMMERS: Okay, thank you.

14 And one last --

15 MR. LAWTON: I'm sorry, can I add one
16 additional point that the rule prohibits a DCO
17 from accepting it from an FCM. It doesn't
18 prohibit an FCM from accepting it from its
19 end-user. Now they might not want to accept it if
20 they can't pass it through, but it might make a
21 judgment. We will accept the letter of credit
22 from the customer even if we can't pass it through

1 to the DCO.

2 COMMISSIONER SOMMERS: I think that that
3 -- correct me if I'm wrong here -- but that does
4 not work for NGX, right?

5 MR. LAWTON: That's right. At least at
6 the moment, NGX does not have an FCM model.
7 They're self-clearing, so that's right.

8 COMMISSIONER SOMMERS: So for NGX, you
9 have to post those letters of credit directly to
10 the DCO. And so in that particular case, would we
11 consider the fact that they've done that, it has
12 not been a problem for them?

13 MR. RADHAKRISHNAN: NGX is a very
14 unusual example because even though they're a DCO,
15 to my knowledge most of their business is
16 forwards, cash, and that's the way the business
17 has grown up in Alberta. But in conversations
18 with them, they have told us that they want to
19 expand into the swaps area. And I've told them
20 that that's something we can discuss because we
21 didn't feel comfortable accommodating them because
22 then, you know, it's like going to the bottom.

1 COMMISSIONER SOMMERS: I have one last
2 question, and this is on the contracting and
3 sizes. Rule 39.12(b) (5) requires "that a DCO
4 select contract unit sizes for clearing purposes
5 that may be smaller than the contract units in
6 which the trade submitted for clearing were
7 executed." And I have questions about how exactly
8 this is going to work in practice, and will it
9 lead to a basis risk for hedge positions?

10 MR. LAWTON: It shouldn't lead to a
11 basis risk, I don't think, because essentially if
12 you do a contract that's a \$10 million contract
13 and then the DCO says they're going to be \$1
14 million-unit sizes, so long as you keep the ten
15 positions on, you're going to be fully hedged. It
16 might actually give more flexibility to the
17 end-user at some point if they decide they want to
18 adjust it somehow. It's easier to adjust by
19 getting rid of one \$1 million unit than
20 liquidating your \$10 million and then re-executing
21 with a \$9 million.

22 COMMISSIONER SOMMERS: If the contract

1 units add equally up to the notional value, but
2 what if they don't?

3 MR. LAWTON: I don't think they could.
4 I think they'd have to. I think that's the way it
5 would have to work.

6 COMMISSIONER SOMMERS: Okay, thank you.

7 CHAIRMAN GENSLER: Thank you,
8 Commissioner Sommers. Commissioner Chilton.

9 COMMISSIONER CHILTON: Thanks, Mr.
10 Chairman. I spent a lot of my time talking about
11 position limits at first, so I don't want to give
12 short shrift to the important work that you all
13 have done -- Anne, and John, and Phyllis in Japan,
14 Arigato, for all the work that she's done -- but
15 in particular Ananda who I think we all respect.
16 And he's a straight shooter which I very much
17 appreciate and one of the stars of the agency.

18 I just have one question, Ananda, and it
19 has to deal with bundling. In the SDR rule, we
20 prohibited that. We said that you can't bundle
21 services. And I like it, and I'm curious why we
22 don't have that in this rule. Should we have it

1 in this rule?

2 MR. RADHAKRISHNAN: Commissioner
3 Chilton, we didn't have that in this rule. We
4 didn't propose it. And so we had notice issue for
5 us to impose a requirement now because we didn't
6 propose it. And also at that stage, you know,
7 this issue of bundling I guess between an SDR and
8 a DCO?

9 COMMISSIONER CHILTON: Yeah.

10 MR. RADHAKRISHNAN: You know, it was not
11 brought to the team's attention. It has been
12 brought to the Commission's attention if I'm not
13 mistaken --

14 COMMISSIONER CHILTON: Yes.

15 MR. RADHAKRISHNAN: -- in a letter the
16 DTCC submitted. And I think that Commission rule
17 49.27, the SDR rule that the Commission
18 promulgated, should take care of it because if I
19 could read it, it's 49.27(a)(2). It says that "a
20 registered SDR, consistent with the principles of
21 open access, shall not tie or bundle the offering
22 of mandated regulatory services with other

1 ancillary services that an SDR may provide to
2 market participants." So a DCO that wants to be
3 an SDR has to register as an SDR.

4 COMMISSIONER CHILTON: They still have
5 to register as an SDR; therefore, they would --

6 MR. RADHAKRISHNAN: So they'll be caught
7 under the SDR rule.

8 COMMISSIONER CHILTON: Okay. It would
9 be anti-competitive if it was allowed. So thank
10 you very much, and again, thank you for all your
11 work.

12 MR. RADHAKRISHNAN: Thank you very much.

13 CHAIRMAN GENSLER: Thank you to
14 Commissioner Chilton. Commissioner O'Malia.

15 COMMISSIONER O'MALIA: Thank you. My
16 thanks to the team. This is as complicated as it
17 gets, and I appreciate the hard work and patience
18 that you've had with me to explain it to me and
19 walk us through these things. Nonetheless, I
20 still have a bunch of questions.

21 Let me kind of clarify two questions --
22 go back to two questions that Commissioner Sommers

1 raised. Ananda, you said the statute on the
2 financial resources issue is pretty restrictive.
3 It says we must -- something about possessing
4 these resources, yet the statute says that for
5 existing -- or the rule says that "the Commission
6 would deem projected revenue an accepted financial
7 resource to satisfy the requirement of 39.11(a)(2)
8 if they can demonstrate a historical record of
9 revenue, but not the new ones." So how did we get
10 to this point if the statute is so limiting? And
11 I just want to make sure we're clear so that we
12 can continue to use it because I do believe that
13 these financial resources and these projected
14 revenues are a legitimate resource.

15 MR. RADHAKRISHNAN: I think this is
16 something that cannot be delegated to me because
17 -- and you raise a good issue. This is going to
18 be my preliminary opinion, but it may change
19 depending on consultations with OGC and so on.
20 But it may be that in order to allow us to do
21 this, we may have to issue an exemptive order
22 precisely because of what the statute says, which

1 is fine. And that will be a Commission action.

2 COMMISSIONER O'MALIA: Okay. But you're
3 standing by the language in the rule, the proposed
4 rule?

5 MR. RADHAKRISHNAN: Right, it's in the
6 preamble.

7 COMMISSIONER O'MALIA: Yeah, right.

8 MR. RADHAKRISHNAN: That the Commission
9 could do this.

10 COMMISSIONER O'MALIA: Now the second
11 question -- Commissioner Sommers just asked about
12 39.12(b)(5), the issue that the contract unit and
13 the basis risk and the reg says "the Commission
14 recognizes that standard products may create basis
15 risk for some hedge positions." I think that was
16 -- I think you had a different take on that.

17 MR. LAWTON: Well, I think that was
18 intended to address that if there's a standard
19 size and if you do a trade that doesn't fit the
20 standard size, then you're not going to be able to
21 clear it. I mean, you have to clear it in the
22 size that the clearinghouse allows.

1 COMMISSIONER O'MALIA: Even if it does
2 create basis risk?

3 MR. LAWTON: I mean that would be the
4 choice of the parties.

5 COMMISSIONER O'MALIA: Okay. Now
6 obviously the much talked about margin liquidation
7 has -- the Chairman took a strong opinion of it,
8 and frankly, I don't know what the right number
9 is. And I've kind of advocated for a
10 principles-based approach. Now the rule has five
11 factors that the Commission is supposed to
12 consider in determining what the appropriate
13 liquidation risk is. Now there's been a couple of
14 different things. I'm unclear as to how we use
15 those factors and what balance we found because
16 everybody else up here has said that we used --
17 because that's what the current practice is --
18 five days for current practice for financials, and
19 we should just leave it at that. So are we using
20 this five-part test or are we using the
21 that's-because-that's-what-it-is test?

22 MR. LAWTON: I mean we're starting with

1 the bright line five days, but I guess, for
2 example, if there were a swap that started out
3 subject to the five-day liquidation time horizon
4 financial swap and it was subject to mandatory
5 clearing and then subject to mandatory trading and
6 then listed on a SEF and became liquid, I think
7 that would be an instance where the facts would
8 change and that overtime the liquidity would
9 increase and you might well have a DCO come in and
10 say we would like you to issue an order changing
11 this because it's now traded in a liquid market.
12 It's more like an exchange traded future. So I
13 think that's what the safety valve was designed
14 and those factors are -- just sort of think about
15 those kinds of situations.

16 COMMISSIONER O'MALIA: Well, that makes
17 me think about the last time we did this, which
18 was on the Dubai when we went from two to one day,
19 and that only took two years to get that done. So
20 I'm a little concerned that that's the process
21 we're setting up here.

22 Now specifically on the issue of the

1 race to the bottom, the final rulemaking has some
2 tools for the Commission to use to make sure that
3 we don't have a race to the bottom. First -- and
4 tell me if I'm wrong on any of these -- the final
5 rulemaking "requires a DCO to determine the
6 adequacy of the initial margin requirement on a
7 daily basis." Correct? That's our job, right?

8 MR. LAWTON: Yes.

9 COMMISSIONER O'MALIA: Okay. Second,
10 the final rulemaking "requires a DCO to conduct
11 back testing of its initial margin requirement on
12 a daily or monthly basis."

13 MR. LAWTON: Yep.

14 COMMISSIONER O'MALIA: Third, the final
15 rulemaking "requires a DCO to stress test its
16 default resources at least once a month and to
17 report to the Commission the results of such
18 stress tests at least once every fiscal quarter."

19 MR. LAWTON: Yep.

20 COMMISSIONER O'MALIA: Fourth, "the
21 Commission has the ability to independently back
22 test and stress test DCO margin requirements."

1 MR. LAWTON: Yes.

2 COMMISSIONER O'MALIA: And we're going
3 to do all those?

4 MR. RADHAKRISHNAN: That is the plan.

5 COMMISSIONER O'MALIA: So where does the
6 race to the bottom come in? How do we -- I'm
7 unclear. If we're going to be watching this on a
8 daily, quarterly, monthly basis --

9 MR. RADHAKRISHNAN: That is the plan,
10 but one thing I cannot control is how many
11 resources we get.

12 COMMISSIONER O'MALIA: Now the rule --
13 and I greatly appreciate this. Mr. Chairman, I
14 came to you early on and asked for the Ags, the
15 energies, and the metals --

16 CHAIRMAN GENSLER: It was a wonderful
17 lunch at Meiwah.

18 COMMISSIONER O'MALIA: The Meiwah summit
19 I'm going to call it.

20 CHAIRMAN GENSLER: Yeah, that was just a
21 good lunch.

22 COMMISSIONER O'MALIA: You're right, it

1 was a good lunch. At the summit, we -- no, no --

2 COMMISSIONER DUNN: I went to the corner
3 wiener shop. I don't know --

4 COMMISSIONER O'MALIA: I asked -- I just
5 posed the question. I said what's going to
6 happen? We've talked a lot about the
7 interconnection of the markets that led to the
8 financial meltdown. We've got an interconnection
9 of our rules, and we can't think of these
10 individually as much as we'd like to. We debate
11 obviously DCO core principles here today, but we
12 have to think about that looming Core Principle 9
13 and the DCM reg. Now if we take all those
14 contracts, the hundreds of contracts that may not
15 meet the 85 percent test in the proposed rule,
16 turn them into swaps. The original proposal said
17 we were going to have a five-day margin. We have
18 changed that to a minimum of one day. It can be
19 higher and appropriately it should be if the risks
20 are appropriate. Can you walk us through the
21 rationale of going to a minimum of one day?

22 CHAIRMAN GENSLER: I think the

1 question's on the energy and Ags. The rationale
2 on what Commissioner O'Malia and I discussed at
3 Meiwah.

4 MR. RADHAKRISHNAN: So you're asking us
5 to explain the rationale for the decision you
6 made?

7 COMMISSIONER O'MALIA: Yep.

8 MR. RADHAKRISHNAN: That's what you're
9 asking, right?

10 CHAIRMAN GENSLER: No, no, but you --
11 it's in the document.

12 COMMISSIONER O'MALIA: But you're
13 advocating for it, I assume?

14 MR. RADHAKRISHNAN: Why one day? You've
15 got to have one day, right? You've got to have
16 one day. If you don't have one day, you shouldn't
17 be running a DCO. So the reason why I think the
18 two of you in your summit agreed on one day for --

19 CHAIRMAN GENSLER: Well, the other
20 Commissioners have been brought into it since
21 August.

22 MR. RADHAKRISHNAN: Well, for the

1 ClearPort contract is because we have a history
2 since 2002 of these products being cleared and
3 being subject to a one-day minimum liquidation
4 horizon, and so far I've not seen any issues.

5 CHAIRMAN GENSLER: And I'll add,
6 Commissioner O'Malia, I think on the energy
7 products where we had some Commission orders in
8 '02 for ClearPort and then subsequently -- I'm not
9 certain it was by order, but by some Commission
10 action or staff action for ICE -- that that's
11 market practice.

12 MR. RADHAKRISHNAN: Right.

13 CHAIRMAN GENSLER: And that's actually
14 how commenters have commented. When the interest
15 rate market -- there is a different set of market
16 practices that have developed primarily around LCH
17 in London where not only is that market practice,
18 but their comment letter and I think it was ISDA's
19 comment letter and then the central bank said the
20 interest rate market, these markets that are at
21 the core center of the bank market, keep at this
22 market practice and not have the alternative that

1 some other clearinghouse might sort have been
2 trying to compete on three- or three-and-a-half or
3 four-day or some other margining. I mean that's
4 as I remember the discussions over August and
5 September because they went awhile.

6 And then I think there really is some
7 very real differences that the interest rate
8 markets and the credit default markets -- frankly,
9 they're bigger and they're more systemically
10 relevant; not that the energy markets aren't big,
11 but in comparison.

12 COMMISSIONER O'MALIA: I completely
13 agree. I'm just trying to figure out what if
14 somebody lists a plain vanilla swap interest rate
15 product on a DCM, and it gets one day. Its
16 identical twin on a swap is five day.

17 MR. RADHAKRISHNAN: I think the issue
18 has to do with liquidity because if you look at
19 any of the 40 orders that we proposed to the
20 Commission, the key issue is what I would call
21 observed liquidity. On a contract market, the
22 Commission observes liquidity because it's a

1 contract market. It's frail, and it's open and
2 transparent. On other platforms, it's just not
3 clear to me whether we can see the kind of
4 liquidity -- and liquidity is important when
5 you've got to manage the default.

6 CHAIRMAN GENSLER: And I think also we
7 preserve in this rule, if we finalize it today,
8 the opportunity for that clearinghouse to come to
9 us and petition and say, you know, there's enough
10 liquidity here. This now can move down in this
11 interest rate market. And though it does take
12 time, they can do that. It doesn't have to be a
13 full rule. It can just be bringing something
14 forward to us.

15 COMMISSIONER O'MALIA: Well, the
16 financial engineers are going to find various ways
17 to play this game, and I just want to make sure
18 that we are not catching ourselves in a kind of
19 government-knows-best and then not being able to
20 nimbly respond to these markets to make sure we
21 have the right rules in place. And we are trying
22 to do a very prescriptive rule-based solution here

1 that might not keep up with the pace of change in
2 the market. And I just want to make sure that we
3 have -- that we're doing good risk metrics using
4 those things and not substituting some arbitrary
5 judgment.

6 I have a number of other questions I'd
7 like to get to so I think we've touched on that.
8 The letter of credit issue that Commissioner
9 Sommers raised is an interesting thing, and I want
10 to get into that. Now in a memo to the Commission
11 we talked about letters of credit. Now one of the
12 big concerns I have is by eliminating letters of
13 credit predominantly used by Ag and energy users,
14 they're going to be forced to really change their
15 credit requirements and go to their FCM or
16 clearinghouse and get a collateral upgrade. That
17 amounts to a subsidy from Main Street to Wall
18 Street, and I'm trying to understand because it's
19 not in the cost benefit analysis to the extent
20 that, you know, what is the cost of that?

21 MR. RADHAKRISHNAN: What do you mean by
22 a subsidy from --

1 COMMISSIONER O'MALIA: Well, they're
2 going to have to upgrade that. As the memo states
3 here, which is not found in our cost benefit
4 analysis, there is \$6.3 billion worth of letters
5 of credit at DCOs today -- \$6.3 billion. That's a
6 big number. But then you compare -- what is it
7 compared to the rest of the margin held by DCOs
8 and it amounts to just a little over 6 percent.
9 So systemically -- it's a big number, but
10 systemically it doesn't seem like that big a
11 number yet we've banned that. So people who have
12 relied on it --

13 MR. RADHAKRISHNAN: We're not banning it
14 for future sale.

15 COMMISSIONER O'MALIA: Well, great, but
16 what if -- today they're our future, tomorrow
17 they're our swap due to our 85 percent rule or
18 whatever we select. We're talking about hundreds
19 of contracts that are going to be moved into
20 something else potentially. And even if we went
21 to a lower number, the numbers, you know, you're
22 not radically changing how many contracts will be

1 swept into SEF swap space. So I'm trying to
2 understand. We have some good metrics here --
3 \$6.3 billion.

4 MR. RADHAKRISHNAN: Right.

5 COMMISSIONER O'MALIA: Now that won't be
6 allowed. And I don't know what the breakdown --
7 it doesn't say in this memo how much is in futures
8 and what, but obviously --

9 MR. RADHAKRISHNAN: All of it is
10 futures.

11 COMMISSIONER O'MALIA: Right, until we
12 redesignate some of these from futures to swaps.

13 MR. RADHAKRISHNAN: So I don't know what
14 the Commission might do --

15 COMMISSIONER O'MALIA: Well, I'm just
16 trying to understand what the cost of this is
17 going to be when Ag and energy commercial hedgers
18 have to come in and get a margin upgrade for their
19 collateral -- what that cost will be as they have
20 to pay to put it -- to go from a flexible letter
21 of credit into a much more acceptable form of --
22 they're going to pay more, right?

1 MR. RADHAKRISHNAN: Are you assuming
2 that it's going to cost more to get some other
3 kind of collateral?

4 COMMISSIONER O'MALIA: That's my
5 assumption. Am I wrong?

6 MR. RADHAKRISHNAN: I don't know. Banks
7 don't do anything for free. It costs money to get
8 a letter of credit so it's a finance charge.

9 COMMISSIONER O'MALIA: I get that. It's
10 not in the cost benefit analysis though.

11 MR. RADHAKRISHNAN: You're asking me to
12 do a cost benefit analysis on something I don't
13 know because right now we're saying you can use
14 letters of credit in the futures industry, which
15 is the current practice. I don't know how many of
16 these products, if any, will be moved to SEFs
17 because of the DCO rule. I don't know. I don't
18 know what the rulemaking is so I don't know how to
19 do a cost benefit analysis on a scenario that I
20 don't know what the parameters are.

21 COMMISSIONER O'MALIA: So if it's only
22 6.5 percent of the market, and we're going to

1 preserve it for futures, it's still okay in that,
2 but it's not okay in the swaps market. Is it
3 systemically relevant to worth banning if it's
4 some number less than 6 percent?

5 MR. RADHAKRISHNAN: It's in the final
6 rulemaking because of comments that we got from
7 members of the Commission. First, staff didn't
8 think that it should be in the final rulemaking,
9 but members of the Commission wanted it so that's
10 --

11 COMMISSIONER O'MALIA: The ban?

12 MR. RADHAKRISHNAN: No, no, no, allowing
13 it for futures and not for swaps.

14 COMMISSIONER O'MALIA: I think what
15 you're saying is the staff recommendation was just
16 not to allow letters of credit for futures or for
17 swaps.

18 MR. RADHAKRISHNAN: Correct.

19 COMMISSIONER O'MALIA: All right. Can
20 we talk about the recent press stories on ICE
21 Clear Credit? Newedge and MF Global sent a letter
22 and said ICE Clear Credit lowered their adjusted

1 net capital requirement from whatever it was to
2 \$100 million.

3 MR. RADHAKRISHNAN: Correct.

4 COMMISSIONER O'MALIA: But then imposed
5 5 percent of customer seg must be held as excess
6 net capital.

7 MR. RADHAKRISHNAN: Correct.

8 COMMISSIONER O'MALIA: Now in the rule
9 we say \$50 million is our adjusted net capital
10 minimum. Nobody can go above that.

11 MR. RADHAKRISHNAN: Right.

12 COMMISSIONER O'MALIA: But it doesn't
13 say anything about a customer seg or default fund
14 or guarantee fund, so I'm trying to figure out
15 what the --

16 MR. RADHAKRISHNAN: I think we say it's
17 okay to scale the amount of risk that a fund takes
18 --

19 COMMISSIONER O'MALIA: No, I got that.

20 MR. RADHAKRISHNAN: -- to capital.

21 COMMISSIONER O'MALIA: Let me just
22 finish this here. So we get a letter from a

1 couple of firms saying huh, it's still barriers to
2 entry. How are we going to treat that? I'm just
3 -- how would we treat the ICE example?

4 MR. LAWTON: There's a couple of other
5 provisions that may turn out to be relevant.
6 There's a provision that says "a DCO shall not
7 adopt restrictive clearing member standards if
8 less restrictive requirements to achieve the same
9 objective and would not materially increase risk
10 could be adopted." So there's that one. There's
11 also one that says "a DCO shall not exclude or
12 limit clearing membership to certain types of
13 market participants unless the DCO can demonstrate
14 that the restriction is necessary to address
15 credit risk or deficiencies in the operational
16 capabilities." So again, those provisions -- I
17 mean, we're not judging a particular provision
18 right now, but it's possible that provisions of
19 that sort could be questionable under these even
20 if they had a \$50 million rule and they had some
21 other rule that effectively undermined the \$50
22 million rule.

1 MR. RADHAKRISHNAN: Because this rule
2 talks about adjusted net capital and not ENC. ICE
3 Clear Credit chose to do that for reasons best
4 known to themselves, but there was no Commission
5 regulation at that time. Now that there's
6 hopefully a regulation, as John points out, we
7 would look very poorly upon that practice.

8 COMMISSIONER O'MALIA: Pardon me?

9 MR. RADHAKRISHNAN: We would look very
10 poorly upon that practice.

11 COMMISSIONER O'MALIA: We'd look poorly
12 on it. So is there guidance as to -- any further
13 guidance than what you've read as to how we weight
14 this? We just talked about higher standards,
15 banning letters of credit, very restrictive
16 interpretations on five-day versus alternatives.
17 Now in this one we have the opposite. We're
18 trying to find the best opportunity to lower
19 access, and I want more access. I get that. But
20 I'm just trying to understand how we're not --
21 this isn't some -- the seesaw between going out of
22 our way to lower this standard to be a clearing

1 member, at the same time going out of our way to
2 be overly restrictive on some of the other
3 matters. I understand it's a balance, but I'm
4 trying to understand where we are on the teeter
5 totter here.

6 MR. RADHAKRISHNAN: So one of the key
7 elements is capital because as you're aware,
8 Scott, capital -- the ENC requirement for FCMs is
9 a function of the risk that they take, right?
10 It's 8 percent of the risk margin in the customer
11 origin and 8 percent of the risk margin in the
12 non-customer origin. So that in and of itself --
13 I mean, that's a hard number so you can track it
14 to the margin, right? You know what the margin
15 requirement is for all of your business. And it's
16 entirely appropriate for a DCO to ask an FCM --
17 let's say if an FCM is clearing in more than one
18 DCO, it's entirely appropriate for the DCO to ask
19 of it, tell me what your margin requirements are
20 elsewhere.

21 COMMISSIONER O'MALIA: Can I ask a real
22 quick question? Does the \$50 million -- is that

1 per clearinghouse membership or is that
2 accumulative and you can sign up for as many as
3 you like to the extent they'll have you?

4 MR. LAWTON: You can sign up for as many
5 as you'd like, but each DCO is expected to know
6 the kinds of risks its clearing members are taking
7 on. So presumably if somebody was a member of
8 just one DCO and somebody else with the same
9 capital at that same DCO was a member of multiple
10 DCOs, presumably that DCO would have a lower
11 scalable risk for that because they'd be aware
12 they're taking risks at other DCOs.

13 MR. RADHAKRISHNAN: For example, one of
14 the tools that was used before at NYMEX is
15 capital-based position limits. And in this case
16 what NYMEX used to do was to ask the clearing
17 member who cleared at more than one DCO what its
18 risk requirements were at the other. That's
19 certainly a fair question for people to ask.

20 COMMISSIONER O'MALIA: Do you think as a
21 result of some of these capital restrictions and
22 the way we view low capitalization that it would

1 result in a higher margin requirement or raising
2 of the guarantee fund contributions per firm? Is
3 that the tradeoff that we're going to making here?

4 MR. RADHAKRISHNAN: I'm trying to
5 understand your question. Can you tell me what
6 you mean?

7 COMMISSIONER O'MALIA: So if we have
8 adjusted net capital, the \$50 million, it is
9 reasonable to expect that firms will pay
10 potentially a higher margin, raising the margin
11 requirements or raising guarantee fund
12 contributions.

13 MR. RADHAKRISHNAN: That could be one of
14 the things. A DCO could say all right, give your
15 risk at other DCOs, I'm limiting you to these
16 positions. And that's basically what NYMEX used
17 to do. Or they could say if you want to exceed,
18 you'll have to pay super much or you'll have to
19 pony up more to the guarantee fund.

20 COMMISSIONER O'MALIA: And we're going
21 to make the call on all of those as we kind of go
22 forward, correct?

1 MR. RADHAKRISHNAN: I think we'll let
2 the DCOs make the call first, and we take a look
3 at it and see whether it's reasonable or not.

4 COMMISSIONER O'MALIA: Principles, I
5 like that. I'm done.

6 CHAIRMAN GENSLER: Thank you,
7 Commissioner O'Malia, for all of your input on
8 this rule. The Meiwah lunch, I think, made it a
9 better rule. I'd hoped we'd get to the place
10 where you were supporting the whole rule, but I
11 think your input has made it a better rule
12 throughout.

13 Mr. Stawick, you want to call the roll?

14 MR. STAWICK: Commissioner O'Malia?

15 COMMISSIONER O'MALIA: No.

16 MR. STAWICK: Commissioner O'Malia, no.
17 Commissioner Chilton?

18 COMMISSIONER CHILTON: Aye.

19 MR. STAWICK: Commissioner Chilton, aye.
20 Commissioner Sommers?

21 COMMISSIONER SOMMERS: No.

22 MR. STAWICK: Commissioner Sommers, no.

1 Commissioner Dunn?

2 COMMISSIONER DUNN: Aye.

3 MR. STAWICK: Commissioner Dunn, aye.

4 Mr. Chairman?

5 CHAIRMAN GENSLER: Aye.

6 MR. STAWICK: Mr. Chairman, aye. Mr.
7 Chairman, on this matter the yeas are three; the
8 nays are two.

9 CHAIRMAN GENSLER: Thank you, Mr.
10 Stawick. The ayes having it, we'll accept the
11 staff recommendation and send it to the Federal
12 Register. I suspect at some point I need to have
13 Unanimous Consent on technical corrections, so
14 maybe I'll just do that now for the three things
15 that we're doing today so that's done.

16 I'm going to take for the public a brief
17 break. It might just be 10 minutes, but since
18 we've been here through two long things and we're
19 about to take -- I know this position limit thing
20 is not going to be 10 minutes -- we're just going
21 to take -- there's no clock here, but hopefully
22 this is just a 10 minute recess, but it may go 15

1 minutes. Thank you. We'll be right back.

2 All right. Thank you. I'm going to
3 call the meeting back to order. It was a good
4 break and productive break. At this time I would
5 like to welcome Stephen Sherrod -- well, where's
6 Salman? -- Salman Banaei, Rick Shilts, all from
7 the Division of Market Oversight. Andrei
8 Kirilenko -- oh, you don't have the rest of your
9 staff up there. You don't want to come up,
10 Hannah?

11 MS. ROPP: No.

12 CHAIRMAN GENSLER: But you've been so
13 involved all along. Don't you want to take a seat
14 up here?

15 MS. ROPP: I'm good.

16 CHAIRMAN GENSLER: From our Chief
17 Economist Office. And Carlene Kim, Neal Kumar,
18 and Dan Berkovitz, all from the General Counsel
19 Office -- yeah, you need to be there. You never
20 know what question you can take -- to consider the
21 staff recommendation concerning the final rule as
22 amended on position limits for futures and swaps.

1 So I think I will allow for the staff
2 presentation.

3 MR. SHERROD: Good morning or I should
4 say good afternoon, Mr. Chairman, Commissioners.
5 Today staff recommends the Commission approve
6 final rules concerning limits on speculative
7 positions in certain physical commodity futures
8 contracts, economically equivalent swaps, and
9 foreign board of trade price-linked contracts
10 available for direct access trading in the United
11 States.

12 The final rules would implement
13 provisions of Section 737 of the Dodd-Frank Wall
14 Street Reform and Consumer Protection Act. The
15 Dodd-Frank Act requires the Commission "to
16 establish federal limits on the amount of
17 positions other than bona fide hedging positions
18 that may be held by any person with respect to
19 physical commodity futures, option contracts in
20 agricultural commodities, and exempt commodities
21 such as energies and metals that are traded on or
22 subject to the rules of a designated contract

1 market -- that's a futures exchange -- as
2 appropriate."

3 The Dodd-Frank Act also requires the
4 Commission "to establish position limits,
5 including aggregate position limits, for swaps
6 that are economically equivalent to futures
7 contracts in exempt agricultural commodities.
8 Such limits must be imposed simultaneously with
9 limits imposed on futures contracts."

10 The proposed final rules would implement
11 Commission-administered limits on speculative
12 positions in 28 core futures contracts on physical
13 commodities and their economically equivalent
14 futures, options, and swaps. The final rules
15 refer to these contracts collectively as
16 referenced contracts. The core referenced futures
17 contracts were selected because of their high
18 level of open interest and use as reference prices
19 for cash-settled futures and swaps.

20 Staff recommends the Commission
21 establish speculative position limits on
22 referenced contracts in two phases. In the first

1 phase, spot-month limits would be effective 60
2 days after the term "swap" is further defined
3 under the Dodd-Frank Act. In the second phase,
4 position limits for non-spot months -- that is,
5 all months combined and on single months other
6 than spot months -- the non- spot-month limits
7 would be imposed after the Commission has gathered
8 a year's worth of open-interest data that will be
9 needed to calculate the levels of these limits.

10 The initial spot-month limits would be
11 based on the levels currently in place at futures
12 exchanges. Subsequently, the spot-month limits
13 would be adjusted every two years for agricultural
14 contracts, and annually for energy and metal
15 contracts. These subsequent limits would be based
16 on the Commission's determination of deliverable
17 supply, using estimates developed by the futures
18 exchanges that are verified by the Commission.

19 For a specific commodity, the spot-month
20 limit would apply separately to the physically
21 delivered referenced contracts and to the
22 cash-settled referenced contracts in the same

1 commodity. The levels of the spot- month limits
2 and physically delivered contracts would be set
3 equal to 25 percent of estimated deliverable
4 supply. Cash-settled contracts also generally
5 would be subject to limits based on 25 percent of
6 estimated deliverable supply with the exception of
7 the cash-settled referenced contracts in the NYMEX
8 Henry Hub Natural Gas contracts. Those cash-
9 settled natural gas contracts would be subject to
10 a spot- month position limit set at five times the
11 level of the limit applicable to the physical
12 delivery natural gas contract. In addition, an
13 aggregate spot-month limit extending across
14 positions in both physical delivery and
15 cash-settled natural gas contracts also set at
16 five times the level of the limit applicable to
17 the physical delivery natural gas contract.

18 The final rule would not impose a
19 conditional restriction on these spot-month
20 limits. The initial non- spot-month limits for
21 the nine legacy agricultural referenced contracts
22 would go into effect, as I mentioned, 60 days

1 after the Commission further defines the term
2 "swap." By legacy contracts, I mean those
3 agricultural contracts currently subject to
4 Commission-administered limits under Part 150.
5 The new limits on legacy contracts would be equal
6 to the current levels of limits for ICE futures
7 U.S. contracts, and would be based on the levels
8 filed in a petition by the CME Group for other
9 agricultural contracts. That petition essentially
10 computed levels using the methodology in the final
11 rules. The legacy limits would provide for parity
12 with the wheat contracts traded on the Chicago
13 Board of Trade, the Kansas City Board of Trade,
14 and the Minneapolis Grain Exchange.

15 For non-legacy referenced contracts, the
16 non-spot-month limits would be made effective by
17 Commission order after the Commission has received
18 one year of open interest on physical commodity
19 swaps under the new Part 20, the large trader
20 reporting for physical commodity swaps.
21 Thereafter for the non-spot-month limits on
22 non-legacy contracts, the limits would be adjusted

1 every two years based on open interest in the
2 referenced contracts. The methodology to set
3 these limits is what we call the "10 and 2.5
4 percent formula" and that is 10 percent of the
5 first 25,000 contracts of open interest, and 2.5
6 percent for open interest beyond 25,000 contracts.
7 The open interest use in this 10 and 2.5 percent
8 formula would be the sum of the futures open
9 interest, the cleared swaps open interest, and the
10 uncleared swaps open interest. These limits would
11 be reset every two years.

12 Exemptions for bona fide hedging
13 transactions would be based on the Dodd-Frank
14 Act's new requirements for such transactions. In
15 response to the comments submitted by commercial
16 firms, the final rules in comparison to the
17 proposed rules would broaden the list of
18 exemptions to include, for example, a calendar
19 month exemption for certain anticipated
20 merchandizing transactions, as well as exemptions
21 for royalties and service contracts. The final
22 rules also would provide for exemptions for

1 positions that are established in good faith prior
2 to the effective date of the initial limits.

3 Regarding aggregation, the final rules
4 establish aggregation standards generally
5 consistent with the Commission's current
6 aggregation standards in Part 150, including the
7 recognition of the Commission's longstanding
8 independent account controller exemption,
9 clarifying that this exemption is limited to
10 customer positions.

11 The final rules also would establish a
12 position visibility reporting regime in certain
13 energy and metals contracts. The new position
14 visibility reporting regime would provide for
15 standard reporting requirements for very large
16 position holders. This reporting would assist the
17 Commission in conducting surveillance and the
18 analysis of large positions in these markets.

19 The final rules also establish
20 acceptable practices for futures exchanges and
21 swap execution facilities for setting position
22 limits for the 28 referenced contracts, as well as

1 position limits for accountability rules for all
2 other listed contracts, including the excluded
3 commodities.

4 I'd like to thank the team that worked
5 on it, particularly the guidance of my division
6 director, Rick Shilts. And in the Division of
7 Market Oversight, particularly Salman Banaei.
8 Others that participated from DMO include Ken
9 Danger, and consulting and advice received from a
10 variety of staff in Product Review: Tom
11 Littlefield, Martin Murray, and John Forkkio. In
12 Surveillance, including David Kass, Dave Amato,
13 Vincent Verrazano, Rafael Martinez, Jordan Grimm,
14 and others. In our Data Analytics group within
15 Surveillance, Jim Outen and Gary Martinaitis. Of
16 course, the people at the table, particularly
17 Hannah Ropp from the Office of Chief Economist.
18 Not at the table, but consulting with us was
19 Stephen Kane. And, of course, the Chief
20 Economist, Andrei Kirilenko. From the Office of
21 General Counsel, Dan Berkovitz gave us advice.
22 Yeoman's work performed by Neal Kumar and Carlene

1 Kim. We had consulting with Mark Higgins,
2 including while he still worked in Enforcement.
3 And, of course, I'd like to thank the Chairman for
4 his guidance and his direction, and the
5 Commissioners for their direction, and the advice
6 we received from all the Commissioners' staffs.

7 We'd be happy to answer any questions.

8 CHAIRMAN GENSLER: Thank you, Steve.
9 Thank you for thanking us. I didn't know that you
10 liked it every day.

11 The Chair will now entertain a motion to
12 accept the staff recommendation in consideration
13 of this final rule as amended.

14 COMMISSIONER DUNN: So moved.

15 COMMISSIONER SOMMERS: Second.

16 CHAIRMAN GENSLER: I am going to support
17 this final rule to establish position limits for
18 physical commodity derivatives, and I have a
19 longer statement that will go on our Website, and
20 it may even already be there. But I do want to
21 say a few things and ask a few questions, if I
22 might.

1 The CFTC does not set or regulate
2 prices. In fact, that seems to be something each
3 of us has said somehow in our opening statements.
4 It might even be worthwhile to put it in the
5 preamble so that it's a Commission statement. But
6 rather the Commission is charged with a
7 significant responsibility to insure that markets
8 are fair and open and efficient, functioning both
9 in the futures marketplace and now, with these new
10 responsibilities, in the swaps marketplace as
11 well. And it's our duty to protect both the
12 market participants and the American public from
13 fraud and manipulation and other abuses.

14 So where do position limits fit in? We
15 don't set or regulate prices, but we have to
16 insure for the integrity of markets and that
17 they're fair and they're without manipulation and
18 other abuses. Well, they've fit in since the
19 1930s, in fact, as a tool "to curb or prevent
20 excessive speculation that may burden interstate
21 commerce." Those are not my words; those are
22 Congress' words, and they seem to have been in one

1 version or another all the way through. And when
2 the CFTC has addressed position limits in the
3 past, the agency sought to insure that the markets
4 were made up of a broad group of market
5 participants with no one speculator having an
6 outside position. See, hedgers and speculators
7 meet in a marketplace. If you just limit a
8 marketplace to only hedgers, there might not be
9 enough liquidity in the marketplace. And, in
10 fact, if you take the classic example in corn and
11 wheat, you might have a lot of farmers and
12 merchants who want to -- naturally, they're long.
13 They have the corner wheat, and they need to lock
14 in their price -- somebody on the other side. And
15 that's where these speculators are providing risk
16 reduction and that adds to the marketplace.

17 But at the core of what Congress has
18 asked us to do and what we've done in the past is
19 this obligation of promoting market integrity,
20 which the agency has historically interpreted to
21 include insuring that markets do not become too
22 concentrated.

1 So you might say well, what is too
2 concentrated? We've actually had some formulas in
3 place for some time, and it leads to my first
4 question. But there's two forms of limits: One
5 in the spot month, and one for all months
6 combined. And we're considering finalizing a rule
7 today that says in the spot month that nobody will
8 have more than 25 percent of the deliverable
9 supply. That's the supply that's around where the
10 product is delivered. So my question, Mr.
11 Sherrod, or anybody else who's a good historian --
12 Mr. Berkovitz, you always have the history -- how
13 long have we used this 25 percent of deliverable
14 supply? Is it in a rule? Is it in guidance?
15 Where does it come from in our past? Now Rick
16 Shilts, who's been with the agency since we
17 actually came from -- what, 1975 you joined the
18 agency?

19 MR. SHILTS: Yes, that's right. I think
20 the rule goes back -- not as a rule, but more as
21 the kind of a rule of thumb. It was something
22 that the CFTC's predecessor, the Commodity

1 Exchange Authority, had basically used as kind of
2 a way to assess what should be a spot-month limit
3 in considering limits for the agricultural
4 products at that time. And it ultimately was
5 incorporated into our guidance, but I think it has
6 a very long history, probably 30 or 40 years. And
7 it's been kind of a rule of thumb that seems to
8 have made sense. It's something we've worked with
9 with the exchanges over the years in developing or
10 reviewing the speculative limits that they would
11 certify or send to us for approval.

12 CHAIRMAN GENSLER: And, Rick, I take it
13 though it has many reasons. At the center of it
14 is to insure against corners and squeezes and
15 manipulation around delivering a physical product
16 in those last few days.

17 MR. SHILTS: That's correct.

18 CHAIRMAN GENSLER: And then the same
19 question on limits on the rest of the curve,
20 what's called all months combined, this 10 and 2.5
21 percent. Where does that formula emanate or when
22 did we put it in rules in the past?

1 MR. BERKOVITZ: That also I believe has
2 essentially been, as Rick said with respect to the
3 spot- month limits, reflective of a longstanding
4 agency practice going back I believe into the
5 1940s, that essentially the limits were in that
6 percentage range as far back as then. It was in
7 the early 1990s that it became part of regulation,
8 the 10 and 2.5 formula.

9 CHAIRMAN GENSLER: And did we do that by
10 Notice and Comment at the time?

11 MR. BERKOVITZ: Yes.

12 CHAIRMAN GENSLER: So it's been in place
13 in our rules, both of these formulas, for some
14 time?

15 MR. BERKOVITZ: That's correct.

16 CHAIRMAN GENSLER: And was the 10 and
17 2.5 percent so we could respect the man that was
18 behind it, Blake Immel? Was that the gentleman
19 here?

20 MR. SHERROD: Blake Immel was the Deputy
21 Director in the Division of Economic Analysis,
22 that's correct.

1 CHAIRMAN GENSLER: So, as you can see,
2 these have been around for some time. In 1981, in
3 fact, the Commission said in addressing this, that
4 "capacity of any contract market to absorb the
5 establishment and liquidation of large,
6 speculative positions in an orderly manner is
7 related to the relative size of such positions,
8 i.e., the capacity of the market is not
9 unlimited." And that was about 30 years ago when
10 we addressed these things.

11 Well, then Dodd-Frank came along, and
12 Congress mandated that the CFTC set up aggregate
13 position limits for certain physical commodity
14 derivatives. The Dodd-Frank Act broadened the
15 CFTC's position as well to have authority to set
16 aggregate positions for not only futures, but also
17 economically equivalent swaps, and also some
18 contracts that might be on foreign exchanges or
19 what we now call foreign boards of trade that are
20 linked contracts.

21 Congress also narrowed the exemptions
22 traditionally available to position limits by

1 modifying the definition of bona fide hedge
2 transactions, and thus much of the discussion, and
3 I'm sure further questions. But it was
4 particularly focused on swap dealers. Is that
5 right? I just want to pause on that question.

6 MR. SHERROD: That's correct.

7 CHAIRMAN GENSLER: So, Steve, I guess I
8 do have a question for you. When you think of
9 commercial hedgers in the marketplace, in essence
10 the bottom line is will they be able to continue
11 to do that which they've been able to do in the
12 past and hedge in the futures and swaps markets,
13 in essence be bona fide hedgers and exempt from
14 some of this?

15 MR. SHERROD: Absolutely to the extent
16 commercial firms are engaging in risk-reducing
17 transactions. If their inventory positions, for
18 example, were fixed-price purchase or sales
19 contracts, absolutely.

20 CHAIRMAN GENSLER: And how about
21 anticipatory hedges? I know that's been something
22 that's been in the comment file.

1 MR. SHERROD: The Commission's current
2 regulations address anticipatory hedging in 1.48,
3 and we've pulled all of those over into the new
4 rules that are before you. And we've expanded
5 that somewhat.

6 CHAIRMAN GENSLER: And then just some of
7 the stuff that we were doing on the dais and so
8 forth, have you also given any of this amended
9 text an avenue? Do you want to describe that,
10 which we were talking about in the last hour?

11 MR. SHERROD: Absolutely. Besides
12 providing a list of examples of bona fide hedging
13 transactions in an appendix to the proposed final
14 rules, the staff has worked at your direction and
15 the Commissioners' directions to clarify in the
16 rule and in the preamble that persons that would
17 seek interpretation, to try to understand their
18 transaction whether it's bona fide or not, can
19 come to the staff or the Commission and receive
20 that interpretation. And further, the Dodd-Frank
21 Act provides that for those seeking relief, the
22 Commission has the ability to issue an order under

1 new Section 4(a)(a)(7).

2 CHAIRMAN GENSLER: So again, your answer
3 is you think we do cover all of the examples that
4 we -- you know, the common practices in the
5 industry today. Is that right?

6 MR. SHERROD: That's right.

7 CHAIRMAN GENSLER: But in addition to
8 that, if somebody thinks well, maybe we're not
9 covered, they can come and knock on the door, and
10 we can address that at staff level or Commission
11 level. Is that right?

12 MR. SHERROD: That's correct.

13 CHAIRMAN GENSLER: Today's final rule
14 implements those important provisions. It
15 fulfills, I think, the Congressional mandate that
16 we set aggregate position limits and for the first
17 time apply them to both futures and the
18 economically equivalent swaps and foreign board of
19 trade contracts.

20 As Steve went through, of course, it's
21 on 28 referenced contracts and energies, metals,
22 and in the agricultural areas. I won't go through

1 the details, but I will say that I think that
2 we've been significantly benefited by public
3 comment -- 15,100 comments -- is that, I think --

4 MR. SHERROD: And 600 and something more
5 this past week.

6 CHAIRMAN GENSLER: Yeah, and if I just
7 judge by the phone calls that each of us
8 Commissioners has gotten, maybe it's now over
9 16,000 comments.

10 We've also benefited from an earlier
11 proposal in January of 2010 that we got over 8,000
12 comments. We had three public meetings in the
13 summer of '09 on possibly bringing position limits
14 back to the energy space. We benefited one in
15 early 2010 possibly to bring them to the metals
16 markets. I think it's been an enormous engagement
17 with the public on this. But there'll be, no
18 doubt, some further engagement and implementation
19 of this if we finalize this today. And I think
20 that it's important for the public to understand
21 that the staff and the Commission stand ready if
22 we finalize this rule to address your questions,

1 interpretations, guidance, because at the core
2 these markets must work for bona fide hedgers,
3 have enough liquidity that is provided at times
4 from the speculators, but to fulfill Congressional
5 mandate.

6 I think that that's probably it for me,
7 but I might have a question or two as other
8 Commissioners weigh in, but I'm going to turn it
9 over to Commissioner Dunn.

10 COMMISSIONER DUNN: Thank you, Mr.
11 Chairman, and I want to thank the staff, both the
12 staff of the Commission that has worked so hard on
13 this, but collectively the staffs of the
14 Commissioners that have worked together to pound
15 out issues and right down to the wire even moments
16 before we reconvened of coming up with amendments
17 that make this as workable as possible. And Mr.
18 Chairman, it is well known that I was very
19 skeptical of this provision, and my negotiations
20 with you personally have been exceptional in
21 providing opportunity to have input and to address
22 the needs I have. I do look forward for you

1 coming out to wash the windows and clean the
2 gutters before the snow flies.

3 CHAIRMAN GENSLER: Anywhere you want me,
4 Commissioner Dunn.

5 COMMISSIONER DUNN: But you did agree to
6 have a colloquy with me that will provide me with
7 some assurances that will make me comfortable with
8 the final vote on this.

9 So if you would, Mr. Chairman, once this
10 final rule is implemented and goes into effect for
11 the spot month and for other months, will we be
12 actively monitoring the trading to determine if
13 the limits have any beneficial or detrimental
14 impact on the trading that takes place in the
15 futures or swaps markets?

16 CHAIRMAN GENSLER: Yes, we will. In
17 fact, Congress has mandated that we conduct a
18 study regarding the impacts of position limits on
19 excessive speculation and on the movement of
20 transactions from U.S. exchanges to foreign
21 exchanges. We're supposed to do this 12 months
22 after the limits are effective. So the answer is

1 yes, and in addition we have a study to do.

2 COMMISSIONER DUNN: If we discover that
3 the position limit rule is a cause of a major
4 market disruption or has an unintended consequence
5 we realize must be addressed, are you committed to
6 working with the Commissioners, the exchanges, and
7 market participants to correct the problem as
8 expeditiously as possible?

9 CHAIRMAN GENSLER: Absolutely, yes.

10 COMMISSIONER DUNN: If the market user
11 comes to us because these rules have had an
12 adverse impact on a legitimate business or hedging
13 practice, how will you advise them to proceed?

14 CHAIRMAN GENSLER: The market user
15 should come and ask staff -- and, in fact, I think
16 this additional amendment helps in that regard,
17 Commissioner Dunn -- but even beyond the
18 additional amendment to 151.5. Staff can clarify
19 whether there is an issue, providing guidance to
20 that market participant or working with the
21 Commission or General Counsel to provide such
22 interpretation; there are various means to do

1 that. If those routes do not address the concern,
2 of course, the market participant can come
3 straight to the Commission as well through various
4 means of petition and otherwise for changes. But
5 I do think that we have exemptive provisions, as
6 Steve Sherrod mentioned, under 1.4(a)(7)?

7 MR. SHERROD: 1.4a(a)(7).

8 CHAIRMAN GENSLER: 1.4a(a)(7), but also
9 I think this additional provision that we just
10 worked out is helpful in this regard.

11 COMMISSIONER DUNN: This may be
12 redundant at this point, but as I said in my
13 opening, I believe the agency is in the business
14 of protecting and promoting the price discovery
15 process and not in the business of setting price.
16 Do you agree with that statement?

17 CHAIRMAN GENSLER: Wholeheartedly.

18 COMMISSIONER DUNN: How will this rule
19 impact disruptive trading practices and market
20 manipulation and the resources the Commission
21 expends to combat them?

22 CHAIRMAN GENSLER: I think this rule is

1 another tool that we have to protect price
2 discovery and promote fair and open and
3 competitive markets. It helps protect against
4 parties having excessive market power and,
5 therefore, protects against corners and squeezes
6 and other manipulative schemes. The position
7 reporting included in the position visibility
8 portion of the rule will provide the Commission
9 with valuable information regarding large market
10 participants in the markets. This information
11 will allow us to be more efficient in our
12 surveillance and enforcement activities. It will
13 also allow us to leverage off of additional staff.
14 I think it was estimated -- Rick Shilts has given
15 us some estimates -- that there will be a need for
16 about a dozen more staff. But I think this rule
17 will allow us to be more efficient elsewhere
18 whether it be in enforcement and surveillance.

19 COMMISSIONER DUNN: Mr. Chairman, I've
20 saved those arrows for you and not the staff
21 because they've been working all along with us,
22 but I do have one particular question of the

1 staff. And it's a question that was posed to you
2 on June 15th by Senator Roberts that you answered
3 orally, but I do want to get this on the record
4 from the staff as they perceive it. And the
5 question the Senator had was that "a Sumner
6 County, Kansas, elevator expected in the near
7 future to enter into a forward contract with area
8 wheat farmers at a fixed price with delivery at a
9 later date. To hedge this risk, the elevator goes
10 short at Kansas City Board of Trade wheat futures.
11 Under the CFTC's proposed rule" -- and that's as
12 amended now -- that wasn't in his question. Let
13 me get back to just quotes on his question. "This
14 would seem to make the elevator futures
15 transaction a speculative one and, therefore, not
16 eligible for the commercial hedge exemption from
17 any position limits since at the time the
18 elevator's futures position was taken, there in
19 fact was not an underlining physical contract."
20 Steve, in your opinion with the amendments that
21 were made this morning here in this proposed rule,
22 what is your answer to this question?

1 MR. SHERROD: I think -- I was listening
2 carefully, and I think the answer is yes, the
3 commercial participants trying to reduce risk in
4 the operation of their commercial enterprise --
5 and that's the essence of a bona fide hedging
6 transaction.

7 COMMISSIONER DUNN: You had me at yes.
8 I want to thank you, and I want to make sure that
9 those common practices that have been out there in
10 the agricultural sector are not in any way at
11 risk. And if the people feel they are, that they
12 will get a prompt response from the staff.

13 CHAIRMAN GENSLER: I, too, just want to
14 make sure of that last part. You know, if they're
15 common practices that are risk reduction and
16 market participants have questions, they certainly
17 should knock on the door to get the comfort and
18 the certainty that they think appropriate. We
19 think we've addressed the common practices in this
20 list of the enumerated pieces, which is in Section
21 151.5, but again, if there's something that we
22 haven't addressed, to let us know.

1 COMMISSIONER DUNN: Thank you, Mr.
2 Chairman.

3 CHAIRMAN GENSLER: Commissioner Sommers.

4 COMMISSIONER SOMMERS: Thank you, Mr.
5 Chairman. I'm going to start with some questions
6 on deliverable supply, and I want to clarify that
7 the spot-month limits will change annually for
8 agricultural contracts, but every other year for
9 energy and metals. Is that correct?

10 MR. SHERROD: Yes.

11 COMMISSIONER SOMMERS: Okay. So right
12 now how long has it been for some of the major
13 agricultural contracts -- how long has it been
14 since we've changed a spot-month limit?

15 MR. SHERROD: So for the nine legacy
16 contracts?

17 COMMISSIONER SOMMERS: Uh-huh.

18 MR. SHERROD: The Commission does that
19 by rulemaking, and I think the last rulemaking's
20 been quite a few years, right? Do you want to --

21 MR. SHILTS: It's been a few years. I
22 don't remember exactly.

1 MR. SHERROD: And I believe the last
2 time we put out a Notice, and we did not go final
3 -- 2005?

4 COMMISSIONER SOMMERS: So it's been six
5 years since we've updated limits on the nine
6 legacy contracts. Going forward, those spot-month
7 limits will change every year based on deliverable
8 supply from the previous year. Is that correct?

9 MR. SHERROD: The exchanges will provide
10 us with their estimate of deliverable supply, and
11 I would expect it would cover at least the prior
12 year and it's likely to cover many years. And so
13 if the level of deliverable supply doesn't change,
14 I would not expect the spot-month limit to change.

15 COMMISSIONER SOMMERS: And how likely is
16 it that from crop year to crop year there isn't a
17 change in deliverable supply?

18 MR. SHERROD: It is true that from crop
19 year to crop year, absolutely, the harvests vary.
20 The amount of supply that's available at the
21 different delivery points because of their local
22 focused delivery points in the normal cash

1 marketing channel. My view is that they probably
2 shouldn't change much. Rick, you want to provide
3 anything?

4 MR. SHILTS: And I think typically what
5 we would do is look at something beyond a
6 one-year, kind of try to look at a five-year
7 average of production and supplies at the delivery
8 points. And I think generally, when you look at
9 any specific commodity, I mean they're specifying
10 delivery at a specific point and the cash market
11 generally doesn't change that fast or that much.
12 So I would guess that typically -- even though
13 we'll get updated estimates of the deliverable
14 supplies -- that you're not going to see a lot of
15 changes from year to year, that it will be more
16 evolutionary as the situation changes at a
17 particular delivery point.

18 COMMISSIONER SOMMERS: So I guess that
19 brings me to another concern of mine and that's
20 the methodology that we're going to use to allow
21 the exchanges to calculate what the deliverable
22 supply is. The preamble states that there were

1 comments urging the Commission "to include supply
2 committed to long-term supply contracts" in its
3 definition of deliverable supply "to avoid
4 artificially reduced spot- month position limits."
5 Instead of doing that, we have revised
6 151.4(d) (2) (iv) to clarify "for purposes of
7 estimating deliverable supply, the DCMs may use
8 any guidance issued by the Commission set forth in
9 the acceptable practices for Core Principle 3."
10 So we're not dealing with it here. We're going to
11 deal with it in another rule, and I guess just
12 hope for the best.

13 MR. SHILTS: Well, I think there's been
14 a little bit of confusion, and maybe it was in the
15 way we characterized this in the discussion about
16 long-term contracts. But the real focus is on
17 what might be committed for other uses at the
18 delivery point. And typically if something's
19 under a long-term contract, it may be committed
20 and not available. But in some circumstances,
21 depending on the commodity, the commodity might be
22 under some long-term contract, but be available

1 for delivery. And that is something we want to
2 clarify when we do the acceptable practices in the
3 DCM rulemaking. I've already had some discussions
4 with some of the exchanges about that, so it's not
5 this rigid, that if it's a long-term contract it's
6 automatically out. We want to clarify that it
7 really goes to, are the supplies committed to some
8 other use and really not available.

9 COMMISSIONER SOMMERS: So just in case
10 in some certain commodities there may be 100
11 percent of the deliverable supply that's under
12 some long-term agreement, we intend to be flexible
13 with whether or not we use those.

14 MR. SHILTS: We don't want to get into
15 whether it's under a long-term contract or some
16 other contract. It really goes to the essence of
17 that and whether those supplies really are
18 available if you're short and you want to make
19 delivery.

20 COMMISSIONER SOMMERS: Okay.

21 MR. SHILTS: So it's entirely possible
22 for some commodities that most of the production

1 or the supplies at a particular point might be
2 under a long-term contract, but in fact be made
3 available to the market. And it's specific to
4 each commodity, but we would look at that.

5 COMMISSIONER SOMMERS: I think it's
6 unfortunate that we didn't make that more clear
7 here, that we didn't clarify that we didn't mean
8 to suggest that in calculating deliverable supply
9 we were making some wholesale change from current
10 practice and from the way that exchanges currently
11 make those calculations, but we chose not to do
12 that.

13 The other question I have with regard to
14 deliverable supply is the answer to the previous
15 question: We haven't updated those numbers since
16 2005. And do we intend to allow exchanges to
17 update those numbers between now and the time that
18 this rule goes into effect? Because it may make a
19 difference to some commodities as to whether those
20 numbers are allowed to be updated.

21 MR. SHERROD: So the draft rules that
22 are before you do not make that provision. The

1 exchanges were generally on notice since January
2 of this year of the intended approach. My
3 concern, for example, would be that the spot-month
4 limits will go into effect 60 days following the
5 definition of swap going final, and that date is
6 still uncertain. When we do in Division of Market
7 Oversight receive the exchanges' estimates of
8 deliverable supply, we go through a process of
9 verifying those including trade interviews, and
10 that can take some time. So my concern is that we
11 would not be delaying the implementation of spot-
12 month limits because of perhaps every single
13 spot-month limit being filed with new deliverable
14 supply estimates.

15 So again, I think the exchanges were on
16 notice, and if they had intended to change them,
17 they certainly would have submitted them.

18 COMMISSIONER SOMMERS: Well, I think
19 unfortunately there was no way to know in January
20 that we were not going to allow them to update the
21 numbers. So if I can just go through a real quick
22 calculation: If a swap is defined in spring of

1 2012 and spot-month limits will be updated as of
2 January 1st of the second calendar year after the
3 spring of 2012, it puts us at January of 2014 to
4 even redo an estimate of deliverable supply. So
5 we haven't updated the numbers since 2005, and we
6 may not update them again until 2014. I think
7 that's a problem.

8 I'm going to move on to bona fide
9 hedging, and I understand that we've made an
10 amendment to allow people to come to the
11 Commission and ask for some sort of exemptive
12 relief. But I just want to clarify a couple of
13 things.

14 The statute did narrow the definition of
15 bona fide hedging to exclude risk management
16 exemptions. But it didn't exclude anticipatory
17 hedges or disallow non- enumerated hedges. Is
18 that correct?

19 MR. SHERROD: That's correct.

20 COMMISSIONER SOMMERS: And so has there
21 been a problem in the past with these types of
22 hedge exemptions to where commercial end-users,

1 producers, processors -- the list that I went
2 through in my opening statement -- they have
3 qualified for and used these types of hedging
4 strategies. Have we seen a huge problem with
5 this?

6 MR. SHERROD: In my experience in
7 Surveillance over the past few years and in a
8 current accounting of exemptions that were used
9 under existing 1.47 for non- enumerated, for
10 example, 21 are for swap dealers for risk
11 management, one is for a government entity that's
12 covered in the bona fide hedging exemption, and
13 there are no others outstanding.

14 COMMISSIONER SOMMERS: Well, I guess
15 it's possible that those types of hedging
16 strategies have been granted by the exchange,
17 right? So the exchange has allowed an entity to
18 use those types of hedging strategies to receive a
19 hedge exemption so it wouldn't necessarily be
20 something that we've done?

21 MR. SHERROD: That's correct. Outside
22 of the nine legacy contracts, the exchanges have

1 been implementing their own position limits.

2 COMMISSIONER SOMMERS: So I'm just
3 saying, in general, if we've seen a problem with
4 the exchange granting an exemption for some of
5 these hedging strategies that we are now
6 disallowing, is there a reason for disallowing
7 them?

8 MR. SHERROD: I've got to say I'm not
9 familiar with the disallowed transactions. We
10 looked carefully at the comment letters and tried
11 to provide for everything that we reasonably could
12 foresee in the enumerated list. And as we've
13 mentioned, we provide two different avenues,
14 either an interpretive avenue for staff or an
15 exemptive order by the Commission to allow for
16 bona fide hedges that aren't in the enumerated
17 list.

18 COMMISSIONER SOMMERS: We can agree to
19 disagree here I guess. I feel like the list has
20 been narrowed, and it's now -- there's nothing
21 beyond that list. We have a list of what
22 qualifies as enumerated hedge, and that is what

1 the definition is now.

2 I have one more question, and this is
3 with regard to something that I have mentioned a
4 number of different times. And we received a
5 comment letter on this issue from Senator Lincoln
6 last year, advocating that we treat unleveraged
7 index funds differently for position limit
8 purposes. We're not doing that, but the preamble
9 says that additional analysis is needed. So I
10 wanted to ask you, what additional analysis is
11 required before we would look to impose a separate
12 position limit regime or establish an exemption
13 for a group or class of traders?

14 MR. SHERROD: I'll turn to our Chief
15 Economist and see what his thoughts are on an
16 exemptive regime. My very basic thoughts are that
17 we should have a reasoned basis to provide an
18 exemption for a particular class or group of
19 traders or a particular type of trader in the
20 marketplace. And what we've done in the proposal
21 before you is pull over the existing bona fide
22 hedging exemptions, replicate those, and add to

1 those based upon the comment process where they
2 fit the traditional view of what a bona fide
3 hedger is.

4 And in terms of whether someone's
5 leveraged or not, the question of margin hasn't
6 been a relevant factor in determining whether
7 someone's a bona fide hedger. Andrei, you have --

8 MR. KIRILENKO: I think on the
9 additional analysis, there is on a classic group
10 of traders or on the impact of non-leveraged
11 commodity index traders on this. We at the Office
12 of the Chief Economist are continuing to monitor
13 what kind of studies are being done, and there are
14 studies being done both internally and externally
15 on the impact of commodity index, traders
16 commodity index funds. And so far there is no, as
17 Commissioner Dunn stated in his opening statement,
18 there is a sort of legitimate debate going on with
19 this. And we'd like to be able to validate
20 quantitatively first the impact on the role of
21 commodity index traders. We'd also like to
22 perhaps go and look more closely at the

1 categorization of index traders. As you know, we
2 had a supplemental COT report out there for a
3 period of time. There is, as I said, we have a
4 supplemental COT report, therefore, a period of
5 time since 2006.

6 So the overall role of these is a
7 relatively new entrance into this market that has
8 become relatively important. So their overall
9 role with regard to other participants and how
10 they interact with other participants has to be
11 examined; and whether or not the benefits or
12 whether or not what they were supposed to provide
13 which was the long side to potentially short
14 commercial hedgers is something that they really
15 satisfy and at what cost.

16 COMMISSIONER SOMMERS: I appreciate that
17 answer, and I guess I look forward to us
18 conducting the type of analysis that would give us
19 the ability to make a decision as to whether or
20 not a different class or group of traders should
21 be treated differently because Congress
22 specifically gave us that authority, and I'd like

1 to see us be able to analyze whether that's
2 appropriate.

3 I claimed I only had one more question,
4 but I just thought of my last question, which I
5 also talked about in my opening, which is if any
6 of you at the table actually believe that position
7 limits will control the price of a commodity or
8 stabilize market volatility?

9 MR. SHERROD: I think position limits
10 are not to set prices. I think they are to
11 address the situation where there is an
12 extraordinarily large trader. And that's the
13 proposal that we've presented to you.

14 COMMISSIONER SOMMERS: Thank you.

15 CHAIRMAN GENSLER: Thank you,
16 Commissioner Sommers. Commissioner Chilton.

17 COMMISSIONER CHILTON: Mr. Kirilenko, do
18 you have any evidence that speculators, whether
19 index funds, have any impact on price? Have you
20 looked at that?

21 MR. KIRILENKO: Yes, as I said just now
22 in my response to Commissioner Sommers, there are

1 a number of -- there is a very healthy research
2 effort underway looking at exactly that issue.

3 And we are -- the position limits team, when we
4 were working on this, reviewed 52 studies. These
5 52 studies were specifically submitted during a
6 Notice and Comment period, and some of those
7 studies do look into this issue.

8 COMMISSIONER CHILTON: But you and your
9 shop -- I'm sorry to interrupt and feel free to
10 finish if you want -- but I was asking about the
11 economist at the CFTC, have you done anything --
12 if not, go ahead and finish your answer with
13 regard to other studies, but I was curious about
14 in-house here.

15 MR. KIRILENKO: Whether or not we're
16 able to quantitatively validate the exact nature
17 of the impact of commodity index traders, we're
18 looking at it. We're not yet at a point where I
19 would be comfortable saying that we have reached a
20 firm quantitative conclusion.

21 COMMISSIONER CHILTON: Thank you and
22 thank you all for your work on this. I know it's

1 been time consuming and a pain at times, and I've
2 been part of that pain. But thank you for your
3 perseverance.

4 I have several questions. On the
5 conditional limits, Mr. Sherrod, first. So what
6 the rule says is that we're going to go 1:5 on
7 natural gas, and we're going to go 1:1 on
8 everything else. We do have some experience in
9 the 1:5 on natural gas because it's an SPDC
10 contract, so we've got some evidence there,
11 something to hang our hat on. And then in 12
12 months after we've collected the data, we will go
13 final on the swaps limits. And at that time when
14 we're doing that, we have the authority to
15 reassess all of the limits if the Commission so
16 desired it. Is that correct?

17 MR. SHERROD: I'm sorry. I think the
18 answer is yes, and Commissioner Dunn said that was
19 a good answer so I should stop there.

20 COMMISSIONER CHILTON: I'll accept that,
21 too. Okay. Now, Mr. Berkovitz, 737 says -- and
22 help me if my memory does not serve me -- that

1 there are four criteria that we look at with
2 regard to how we are to establish position limits.
3 The first one deals with guarding against
4 excessive speculation. The second one asks us to
5 insure and deter manipulation, squeezes, and
6 corners, I believe. Is that correct?

7 MR. BERKOVITZ: That's correct.

8 COMMISSIONER CHILTON: Okay. The third
9 is that we insure that there is appropriate
10 liquidity in the market so that hedgers have the
11 ability to continue to hedge. And the fourth
12 criterion is to insure that there is appropriate
13 price discovery going on. Those are the four
14 criteria that we were supposed to look at in
15 setting these limits. Correct?

16 MR. BERKOVITZ: That's correct.

17 COMMISSIONER CHILTON: The 1:5, the 1:1,
18 the conditional limits, does this rule satisfy the
19 legal requirements under 737 as we've just
20 described?

21 MR. BERKOVITZ: The rule sets forth the
22 Commission's determination that these criteria are

1 satisfied. So in that respect, yes, Commissioner.

2 COMMISSIONER CHILTON: Thank you. I
3 want to -- and I'm sorry I'm going around here
4 because my colleagues have all asked good
5 questions, so it's not really a logical order when
6 Commissioner Sommers, who I always follow, is
7 going. And I kept saying well, then I'll follow
8 on to that. So I apologize for being a little bit
9 discombobulated here.

10 I wanted to go back on the anticipatory
11 hedging just a little bit -- and thank you for the
12 colloquy between Commissioner Dunn and the
13 Chairman. The last thing that Commissioner
14 Sommers asked you, Mr. Sherrod, was what about all
15 these things we don't know. And your answer is
16 essentially well, I don't know. I don't know
17 about them. But I'm concerned also that, as
18 Commissioner Dunn often says, we don't know what
19 we don't know, and so there may be something out
20 there that is a practice that we aren't familiar
21 with. I'm going to ask about those in a couple of
22 seconds here. But in general, the list that we

1 have in the rule, do you view that as an exclusive
2 list?

3 MR. SHERROD: No, not an exclusive list.
4 It's the available bona fide hedging exemptions
5 that we've enumerated.

6 COMMISSIONER CHILTON: Yes, okay. So
7 it's not exclusive. There may be other things
8 that we don't know about yet and people can
9 explain them to us, so let's get into those, shall
10 we? So say you have a history of having a
11 contract. Every year some country you always sell
12 them wheat or beans or whatever it is. Every year
13 they come to you -- this is before the crop's in
14 the ground -- and every year you sign a contract,
15 but you don't have any skin in the game yet.
16 You're a large commercial Ag, you don't have any
17 skin in the game yet, but you know it's going to
18 happen. It happens every year. That's something
19 that we don't necessarily address precisely in the
20 rule. How would we deal with that because it's my
21 understanding that that is a practice? It may be
22 one of these things we don't know enough about,

1 but it is a practice that occurs.

2 MR. SHERROD: Right, so when a person
3 would be seeking the staff's views about whether
4 something would be bona fide, we would look to the
5 particular facts and circumstances of the
6 situation. So if they're reducing risk, if it's
7 inventory, if it's fixed-price contracts, we also
8 provide a number of anticipatory requirements and
9 input provisions, then it's bona fide. If it's
10 not --

11 COMMISSIONER CHILTON: Nothing's in the
12 ground yet. They're just anticipating what has
13 happened maybe for a couple of years. Would that
14 evidence, for example, of previous contracts over
15 the last few years, would that potentially be
16 something that could be on your list of things
17 that would be anticipatory with regard to the bona
18 fide hedging exemption?

19 MR. SHERROD: I think what I was trying
20 to refer to -- because I wasn't quite sure of the
21 facts of your hypothetical -- is that, for
22 example, someone that's an anticipatory producer,

1 that's an enumerated bona fide hedging
2 transaction. So they don't have to have already
3 produced it; likewise they don't have to have
4 already produced their output if it's an input
5 into their process or manufacturing. Those are
6 well recognized anticipatory hedging transactions.

7 COMMISSIONER CHILTON: What are we doing
8 with regard to large product offering, that issue?

9 MR. SHERROD: I would need to know more.
10 I'm not sure what you mean.

11 COMMISSIONER CHILTON: Have we insured
12 that we've taken care of this issue about large
13 product offerings? Do you need more than that?

14 MR. SHERROD: I need more than that.

15 COMMISSIONER CHILTON: Okay. How have
16 we insured that the commercials can use the
17 anticipatory hedge exemption for the pass-through?
18 I mean -- and Commissioner Dunn and Commissioner
19 Sommers talked about this -- you've got a grain
20 silo and you fill it up and maybe it's -- or you
21 have 85 percent in the elevator there. So your
22 capacity you might say to somebody that doesn't

1 know anything about Ag well it's 15 percent,
2 you've got the remaining. But this elevator could
3 be filled a dozen times or five times throughout
4 the harvest. So how do we address that?

5 MR. SHERROD: Okay, now I've got it. So
6 in the list of enumerated bona fide hedging
7 transactions, we provided a new one in response to
8 comments. It allows someone that has either owned
9 or leased storage capacity, either currently
10 unfilled or reasonably anticipated to be unfilled
11 -- and perhaps they will fill it and unfill it a
12 number of times -- those would be available as a
13 bona fide hedging transaction in the form of a
14 calendar spread to reduce their risk of having
15 that unfilled capacity.

16 COMMISSIONER CHILTON: Okay, thank you
17 for those.

18 CHAIRMAN GENSLER: Can I, Commissioner
19 --

20 COMMISSIONER CHILTON: Yep.

21 CHAIRMAN GENSLER: Ask a question in
22 there? You asked the word about pass-through, and

1 so I just want to make sure. The pass-through --
2 Congress has a pass-through exemption as well. Is
3 that available to agricultural cooperatives that
4 presumably are not going to be swap dealers and so
5 forth? We have to finalize that rule, but a
6 non-swap dealer, do they get the benefit of this
7 pass- through as well?

8 MR. SHERROD: And so I was reading
9 Commissioner Chilton as turnover in a storage
10 facility --

11 CHAIRMAN GENSLER: Right. I'm asking --

12 MR. SHERROD: But you're referring to
13 the swap counterpart.

14 CHAIRMAN GENSLER: I'm asking another
15 piece of his question just to make sure that we
16 can have that addressed as well.

17 MR. SHERROD: Right. So with respect to
18 a party to a swap that's opposite a bona fide
19 hedger, that counterparty gets to treat both that
20 pass-through swap and the risk-reducing
21 transaction, which will net them down to no risk,
22 as bona fide as long as they're reducing that risk

1 down.

2 CHAIRMAN GENSLER: So an agricultural
3 cooperative or a grain elevator operator that
4 might not be a cooperative, if they have a swap
5 with a member of the co-op on one side and then
6 they go to some risk-reducing swap on the other
7 side, they get the same pass-through or look-
8 through that Wall Street gets.

9 MR. SHERROD: Any counterparty opposite
10 a bona fide gets that treatment.

11 CHAIRMAN GENSLER: Okay, anybody gets
12 it.

13 MR. SHERROD: Whether it's a co-op or
14 other.

15 CHAIRMAN GENSLER: Well, I happen to be
16 interested in co-ops right now, but yeah.

17 COMMISSIONER CHILTON: Well, let me just
18 -- you went down this little cul-de-sac and so I
19 want to -- I'll stay down there with you just for
20 a moment. So how will agricultural co-ops be
21 treated under this rule? If they're laying-off
22 risk to their members, will those risks in essence

1 pass through to the members and not be attributed
2 to the co-op for the purpose of complying with the
3 position limits?

4 MR. SHERROD: So to the extent just like
5 any other firm, a co-op has inventory or fixed
6 price contracts. Those are bona fide hedges. To
7 the extent they enter into a swap contract with a
8 farmer and they don't actually have the physical
9 commodity but it's a cash-settled swap, then they
10 would be a bona fide for the look-through
11 provision that they could -- I know it's kind of
12 complicated -- but then they could lay it off.
13 And the combination is the co- op hasn't taken on
14 risk between the transactions. And that's their
15 intent.

16 COMMISSIONER CHILTON: Thank you.
17 That's good. Thank you. I appreciate you
18 explaining. Now you sort of addressed this in a
19 couple of ways, but I want to ask a question
20 specifically about capacity. How are we defining
21 capacity? I assume it's based upon annual volume
22 of a commodity that moves through a merchant and

1 not the unfilled capacity like we talked about, a
2 grain bin or whatever. But is it a volume? How
3 will we do that? Is it five times what could be
4 in the bin or is it ten times?

5 MR. SHERROD: So the rule text doesn't
6 define the term capacity specifically. We've
7 always looked to what is reasonable when we use
8 the plain English language. So in terms of
9 unfilled capacity, whether it's current or
10 anticipated, someone can reasonably anticipate
11 knowing how many times they can turn over their
12 capacity. So we would look to whether that's a
13 reasonable turnover.

14 COMMISSIONER CHILTON: And is it based
15 upon like historical data or based upon what farm
16 equipment they have that year and then they buy
17 another combine the next year? Or how do you --

18 MR. SHERROD: This again is -- this
19 particular exemption is for storage capacity. So
20 it would be based upon what's a reasonable
21 load-out capacity of the facility, and that could
22 change as they make improvements.

1 COMMISSIONER CHILTON: Okay. By the
2 way, when does the new definition of bona fide
3 hedging go into effect under the rule?

4 MR. SHERROD: So the new bona fide
5 hedging definition would take effect in the spot
6 month in particular, 60 days after the term swap
7 is further defined.

8 COMMISSIONER CHILTON: Okay. Give me
9 just a moment here because my colleagues have
10 asked so many of these, but I want to make sure
11 that I get to all of those.

12 Independent account controller -- have
13 we adequately addressed the issue with regard to
14 energy and agricultural entities that are part
15 commercial and part financial? And how do you
16 deal with these guys if they've got part of their
17 shop doing financial speculation and part of it is
18 actually hedging their business risk, and you've
19 got them together? They have lunch in the same
20 lunchroom. They're not separate management
21 structures or anything. How do you divide that up
22 or do you divide it up?

1 MR. SHERROD: We don't divide that up.
2 In this final rule it follows the existing
3 practice of treating such a conglomerate of
4 different organizations that are commonly owned
5 and controlled as a single person. We aggregate
6 them for purposes of the position limits. Now,
7 that single person may have bona fide hedging
8 activities, and they would qualify for the bona
9 fide hedging exemption to the extent they're
10 reducing risk in their commercial --

11 COMMISSIONER CHILTON: But they would
12 have to prove that, sort of my thing about the
13 boss and you've got to prove it all night. They'd
14 have to be coming in -- you don't have to accept
15 my prove-it-all-night thing -- but they would be
16 coming in and explaining to us their strategy for
17 and why they need this business risk. And so if
18 they couldn't explain the speculative part, they
19 wouldn't be able to get the exemption for that.

20 MR. SHERROD: Right. We wouldn't ask
21 them to explain the speculative part --

22 COMMISSIONER CHILTON: Right.

1 MR. SHERROD: But to the extent they're
2 filing a notice --

3 COMMISSIONER CHILTON: But the
4 speculative part would fit under the limit.

5 MR. SHERROD: Under the limit, and to
6 the extent they wish to exceed the limit, they
7 would file a notice to claim the legitimate
8 business purposes for bona fide hedge.

9 COMMISSIONER CHILTON: And just to be
10 clear to folks who might be listening, when we
11 look at these -- provided we have the resources
12 Ananda was talking about earlier on his rule -- to
13 look at these things, that the bona fide hedging
14 strategy that they're going to give to us every
15 month, they're going to prove to us that they need
16 these hedge exemptions. If we determine --
17 assuming we have the resources -- if we determine
18 that they are abrogating that strategy and that
19 they are engaged in speculative activity outside
20 of the constructs of the bona fide hedge
21 exemption, we can shut them down for that purpose.
22 Is that correct?

1 MR. SHERROD: Well, in the Division of
2 Market Oversight, we would refer them to the
3 Division of Enforcement.

4 COMMISSIONER CHILTON: But CFTC may shut
5 them down if they're inappropriately using such a
6 hedge exemption.

7 MR. SHERROD: And again, I think we
8 would --

9 COMMISSIONER CHILTON: Let me say, we
10 will shut them down if they're inappropriately
11 using a hedge exemption.

12 Okay, adjustment to limits. Now the
13 rule says that we will examine, readjust,
14 recalibrate is the word I use every two years.
15 But also we're going to be considering the
16 spot-month limits next year and that may have some
17 impact on other limits. That doesn't mean that we
18 will change the 10 and 2.5 -- although as I
19 mentioned in my opening statement, there's some I
20 think should be a little bit tighter, particularly
21 metals -- but that is also a time at which the
22 Commission may avail itself the opportunity to

1 readjust or recalibrate these limits. In fact, is
2 it not correct that the Commission may at any
3 time, tomorrow -- well, we have to wait till
4 they're in effect -- 61 days from today we may
5 reassess. If there is some big, huge, change in
6 open interest and we determine -- the Chairman
7 wanted to bring it up and add two other votes --
8 we could determine that the levels of the 10 and
9 2.5 were inappropriate, and we could readjust
10 them. So the rule requires that we do it every 24
11 months, but there's nothing in the rule that
12 prohibits the Commission under plenary authority
13 from reassessing this matter at any time. Is that
14 correct?

15 MR. SHERROD: That's correct. As you
16 noted, that is the Commission's plenary authority,
17 and there's nothing in the rule which would
18 restrict that authority.

19 COMMISSIONER CHILTON: Okay. Again,
20 pardon me for just a moment so I'm not redundant.

21 You have survived? Thank you,
22 appreciate your time.

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

3 COMMISSIONER O'MALIA: I think it's
4 tough going after Commissioner Sommers. What
5 questions are left?

6 COMMISSIONER SOMMERS: Oh, I left you
7 several.

8 COMMISSIONER O'MALIA: Let me dig around
9 in my bag of tricks.

10 CHAIRMAN GENSLER: Yeah, there's just
11 such a --

12 COMMISSIONER O'MALIA: There's a few
13 here.

14 CHAIRMAN GENSLER: We all work so well
15 together. We left you a few.

16 COMMISSIONER O'MALIA: Before I start
17 with my script, back to this anticipated
18 merchandising. What are the rules today for
19 anticipated merchandising? What do anticipated
20 merchandisers have to prove today?

21 MR. SHERROD: So the current provisions
22 in Commission regulation 1.3(z)(3), the third

1 provision, have a specific example that says, for
2 example, someone that is merchandising that has a
3 contractual agreement. They're acting as an agent
4 for a party that is actually bona fide. Then if
5 that agent is laying-off the risk, that's the
6 extent of what we currently have recognized.

7 COMMISSIONER O'MALIA: So in all of
8 this, we have several more -- several different
9 criteria other than that, and we have not defined
10 merchandising in the reg. Correct?

11 MR. SHERROD: That's correct. It's a
12 term in the statute.

13 COMMISSIONER O'MALIA: Okay. Oh, in the
14 statute. Okay. So we have this -- the new
15 requirement is that they have to demonstrate they
16 have unfilled capacity, owned or leased, and the
17 anticipated merchandising activity which may not
18 exceed one year. I assume that's the amount of
19 storage that they have to prove? They're only
20 limited --

21 MR. SHERROD: That's the time horizon.

22 COMMISSIONER O'MALIA: The time horizon

1 for one year --

2 MR. SHERROD: Right.

3 COMMISSIONER O'MALIA: For what they
4 have to prove the unfilled storage capacity is for
5 that one-year period, right?

6 MR. SHERROD: That's correct.

7 COMMISSIONER O'MALIA: They have
8 off-setting sales and purchases, and then we have
9 another (c), which is "no such position is
10 maintained in any physical delivery referenced
11 contract during the last five days of trading for
12 the core referenced futures contract in an
13 agricultural or metal commodity during the spot
14 month for other physical delivery commodities."
15 What does that mean?

16 MR. SHERROD: So essentially if a
17 merchandiser has unfilled storage capacity, they
18 would not appear to have a need to make or take
19 delivery on the nearby contract; that is the spot
20 contract that's nearing delivery.

21 COMMISSIONER O'MALIA: Okay. So
22 merchandisers ought to be on notice. We have

1 provided for them. It's a different set of rules,
2 and it's complicated. But if they can prove these
3 factors, then they're eligible to come in and get
4 their merchandising exemption.

5 MR. SHERROD: That's correct.

6 COMMISSIONER O'MALIA: Now in this new
7 exemptive authority that we've amended here, are
8 they also entitled to use that if they have
9 something slightly outside of this prescriptive
10 three-part test?

11 MR. SHERROD: So the exemptive authority
12 is the Commission's authority under 4(a)(a)(7) to
13 issue an order. And so any person's free to
14 petition the Commission for relief.

15 COMMISSIONER O'MALIA: Including these
16 guys? Outside of the three-part test?

17 MR. SHERROD: Yes.

18 COMMISSIONER O'MALIA: Thank you.

19 CHAIRMAN GENSLER: Commissioner O'Malia,
20 can I just ask, because I think it helps your
21 question, but I just want to make sure.

22 COMMISSIONER O'MALIA: Great.

1 CHAIRMAN GENSLER: The thing that's
2 currently in 1.3(z)(3) -- was that it, the agency
3 piece? -- did we pick that up and move it? Is
4 that still available, this agency piece?

5 MR. SHERROD: I think that's in there,
6 yes. We tried to pick up everything that was in
7 there and move it over.

8 CHAIRMAN GENSLER: Okay, I just want to
9 make sure we didn't lose that somehow. If you
10 might tell us which section, if somebody else as
11 you're answering -- I don't want to take you from
12 Commissioner O'Malia -- but maybe, Neal, you can
13 find the section.

14 COMMISSIONER O'MALIA: What is the
15 Commission's working definition of "excessive
16 speculation?" And what criteria do we rely on to
17 determine what speculation becomes excessive?

18 MR. SHERROD: So we don't particularly
19 have a working definition, but Congress directed
20 us to implement these. And I'll turn to General
21 Counsel Berkovitz.

22 MR. BERKOVITZ: Steve is correct. The

1 Commission does not have a definition of excessive
2 speculation, nor -- that's correct.

3 COMMISSIONER O'MALIA: Okay. So how
4 does the Commission determine that price movements
5 are caused by excessive speculation?

6 MR. SHERROD: And again, the limits are
7 designed to address traders with extraordinarily
8 large positions. So they're targeted to the
9 position size, not the impact that any particular
10 trader has at a moment. These are based upon a
11 formula, either based on the amount of available
12 supply or the open interest in the market,
13 designed to prevent a speculative trader from
14 being extraordinarily large.

15 COMMISSIONER O'MALIA: Okay. So the
16 Commission did not attempt to conclude that the
17 limits are appropriate if it cannot identify a
18 situation in which excessive speculation caused an
19 unwarranted price movement. Correct?

20 MR. BERKOVITZ: Well, I think I'd like
21 to clarify what the -- the Commission in the rules
22 determined the appropriate levels to prevent the

1 undue burdens on interstate commerce that Congress
2 has found results from excessive speculation, so
3 the Commission's judgment regarding the
4 appropriate levels for the limits that would
5 prevent these undue burdens.

6 COMMISSIONER O'MALIA: But we did -- in
7 doing that, we did not link-up what excessive
8 speculation was and the price movement they had in
9 order to set these limits. We have just made a
10 determination.

11 MR. BERKOVITZ: Pursuant to the
12 Congressional direction, yes.

13 COMMISSIONER O'MALIA: Using Ag
14 formulas.

15 MR. SHERROD: The formulas that we're
16 recommending have been in place and been guidance
17 in a variety of different physical commodity
18 markets, as well as in financial contracts as well
19 in the citation of the agent provisions
20 151.5(a)(2)(iv).

21 COMMISSIONER O'MALIA: So today's
22 position limit regime is largely designed to

1 address if anything the undue accumulation as you
2 said, Dan, of a position owned by a single entity
3 or person. How do today's rules address the
4 overall speculation of markets brought about by
5 the financialization of commodities, the herding
6 phenomenon? And how will these rules address
7 speculation by groups or classes of traders?

8 MR. SHERROD: So in the proposal before
9 you, we do not address, as we did not address in
10 the proposed rule, trading by a class or group of
11 traders. The rule uses the traditional
12 aggregation standard for two or more parties
13 acting pursuant to expressed or implied agreement.
14 And Andrei, would you want to comment about a
15 herding phenomenon?

16 MR. KIRILENKO: I think I would agree
17 with Steve that speaking of the rule before you,
18 this is what the rule is supposed to do. And my
19 answers to Commissioner Sommers and Commissioner
20 Chilton, the phenomenon that -- and it may have
21 been an interpretation of that that we need to
22 make -- phenomena such as herding or such as

1 taking positions that are going in the same
2 direction or taking position across multiple
3 commodities that correspond to an index, for
4 example -- these are relatively new phenomena and
5 in this market, as you know, for every buyer there
6 is a seller. So to the extent that the
7 composition of participants on one side is
8 balanced out by a composition of participants on
9 the other side and the risk profile of the
10 marketplace is affected one way or the other, this
11 is something that needs to be sort of further
12 examined and needs to be validated and needs to be
13 -- we need to find indicators of that.

14 The rule before you looks at preventing
15 large traders from amassing positions that could
16 become destabilizing. To the extent there could
17 be multiple participants who act as one large
18 trader, we need to look at who's on the other side
19 as well.

20 COMMISSIONER O'MALIA: Thank you. The
21 owned-non- financial -- in our continuing attack
22 on commercial businesses, we've compromised a

1 previously workable aggregation rule and changed
2 it to a more rigorous and unfair standard when
3 compared to both public corporations and financial
4 firms. What is the legal rationale for
5 eliminating the proposed owned-non-financial
6 aggregation exemption?

7 MR. SHERROD: The Commission did propose
8 an exemption from aggregation for
9 owned-non-financial entities. That is not in the
10 current aggregation provisions in Part 150, and
11 it's not in the staff's recommendation before the
12 Commission today. That's correct.

13 COMMISSIONER O'MALIA: So what is the
14 legal rationale for eliminating it?

15 MS. KIM: If I can just add a statement.
16 I'm not so sure that I would characterize this as
17 really a legal rationale for not adopting the
18 non-financial-owned entity. It's more of a policy
19 rationale in that given that we are preserving the
20 independent account control exemption, which
21 largely addresses most of the disaggregation
22 issues.

1 And in addition to that, we are adopting
2 new exemptive provisions to address it in hardship
3 situations, such as when we have traders that are
4 prohibited by federal securities law from sharing
5 information and, therefore, cannot come into
6 compliance with position limits, we do allow for
7 exemptive relief or disaggregation.

8 So given those two factors, we thought
9 at this time it would not be appropriate to expand
10 our disaggregation policy. Now that is not to say
11 that going forward the Commission, or the staff
12 would not recommend to the Commission, that we
13 consider adopting some form of an exemption that
14 mirrors or is similar to what was proposed.

15 COMMISSIONER O'MALIA: I'm just totally
16 confused as to why we would treat them
17 differently. Maybe you can explain?

18 MS. KIM: Actually, I think -- we've
19 heard that from commenters; that actually most of
20 the commenters on the issue of this particular
21 exemption complained that we were being unfairly
22 discriminatory to financial entities because this

1 was directed -- the proposal was directed just to
2 non-financial-commercial entities.

3 COMMISSIONER O'MALIA: Yeah, and we
4 fixed that. We responded to the concern, but
5 we've treated these owned- non-financials, I
6 think, in an equally unfair standpoint. And I'm
7 just trying to figure out what the rationale for
8 that was. We fixed that -- the financial and the
9 issue of the public corporations -- but some of
10 these commercial firms that are going to be forced
11 to aggregate --

12 MS. KIM: I should just clarify. I
13 think when we say we fixed it, we're preserving
14 mainly the status quo. The status quo is that the
15 commercial or non-commercial entities are not
16 entitled to disaggregation to the extent that
17 their proprietary positions are involved. So we
18 are preserving. So we're not necessarily -- as I
19 explained, we are preserving the status quo, and
20 we're not expanding the disaggregation policy at
21 this time. So I wouldn't characterize this as a
22 matter of discriminatory treatment towards the

1 commercials.

2 COMMISSIONER O'MALIA: How will the
3 Commission define identical trading strategies in
4 this area in terms of aggregation for these
5 non-discriminated entities?

6 MR. SHERROD: Well, by way of example, I
7 can envision a trader that has reached a position
8 limit by going long in a particular commodity, and
9 then entering one or more positions by buying
10 shares of a fund that is long only. That trader,
11 if we didn't aggregate that, would have a loophole
12 to increase their position beyond the limit simply
13 by buying more and more shares in a long-only
14 fund. And they could replicate that by buying
15 those shares in multiple long-only funds.

16 COMMISSIONER O'MALIA: Is that the same
17 for the owned-non-financial?

18 MR. SHERROD: That I will need some help
19 on. I'm not connecting that out.

20 COMMISSIONER O'MALIA: The aggregation
21 rules are the same for the owned-non-financial?

22 MR. SHERROD: So the aggregation rules

1 treat as a person. A company that owns equity
2 interest in other companies, and we treat that one
3 entity as a single person. That's the existing
4 treatment under Part 150.

5 COMMISSIONER O'MALIA: Is our ownership
6 threshold at 10 percent? How does that compare to
7 the SEC's current rules?

8 MR. SHERROD: Our ownership threshold is
9 10 percent as you mentioned. It's been at that
10 level for a very long period of time. Under case
11 law at the SEC, generally control is presumed if
12 ownership is greater than 25 percent.

13 COMMISSIONER O'MALIA: Well, I have a
14 lengthy dissent that I will include in the Federal
15 Register to address this, and I have no further
16 questions.

17 CHAIRMAN GENSLER: Thank you,
18 Commissioner O'Malia. I know that Commissioner
19 Dunn asked me whether we could include in our
20 record Steve Sherrod's well-written response to
21 his ten questions for the public. Commissioner
22 Dunn did a terrific service to the public and to

1 the staff that he always asked. It used to be
2 nine, now it's ten, questions on resources and the
3 nature of our rules. And we Commissioners do get
4 those memos, but I'd like it in the public record
5 is what you'd asked us to do. So Steve, you now
6 know; that's in the public record as well.

7 COMMISSIONER CHILTON: Mr. Chairman?

8 CHAIRMAN GENSLER: Sure.

9 COMMISSIONER CHILTON: I'm sorry. I do
10 have a couple of other strays when I reread my
11 notes based upon all the good questioning from my
12 colleagues.

13 Commissioner Sommers was talking about
14 the deliverable supply issue, and she sort of left
15 it on so, we're not going to do anything until
16 2014, and it sort of left it on the table. And my
17 question is, can't we do better than that? I mean
18 is there some way that we can say we're not
19 putting it off for three years?

20 MR. SHERROD: It's up to the Commission
21 literally.

22 CHAIRMAN GENSLER: But also isn't it up

1 to an exchange. I mean if an exchange comes
2 forward and petitions us and says -- as they could
3 have four months ago -- and said this one's too
4 tight. A thousand contracts or 2,500 contracts,
5 and we can accept that. Isn't that right?

6 MR. SHERROD: I think the point I was
7 trying to make is that -- and Rick and I both made
8 this point earlier -- is that the deliverable
9 supply, if they're using a long measure of
10 deliverable supply, it doesn't tend to change that
11 rapidly. The exchanges take the initiative to
12 update their spot-month limits. And to the extent
13 an exchange finds a spot-month limit to be too
14 high rather than too low, they can under the final
15 rules impose a tighter spot-month limit.

16 CHAIRMAN GENSLER: But if they knocked
17 on our door in June of 2012 and said X spot month
18 should be Y instead of Z, I mean we might have to
19 put it out to Notice and Comment, but aren't we
20 allowed to put that out to Notice and Comment at
21 that point in time?

22 MR. BERKOVITZ: Certainly, the

1 Commission, as Commissioner Chilton noted earlier,
2 we continue to have that discretion. The rule
3 does not prevent the Commission from taking up any
4 petition like that at any time.

5 CHAIRMAN GENSLER: Thank you.

6 COMMISSIONER SOMMERS: If I could
7 quickly follow up, can an exchange -- because I
8 thought I asked this earlier -- can an exchange
9 self-certify changes to spot- month position
10 limits right now?

11 MR. SHERROD: There's nothing in the
12 rule that would prevent that. The rule has a
13 fixed schedule of spot- month limits that would be
14 implemented 60 days after the further definition
15 of swap under Dodd-Frank.

16 COMMISSIONER SOMMERS: Right. So the
17 schedule for us changing them doesn't start until
18 that 2014 date?

19 MR. SHERROD: The schedule to initially
20 implement them would be a few months from now,
21 presumably when the definition of swap goes final,
22 plus 60 days.

1 COMMISSIONER SOMMERS: No, the reset.

2 MR. SHERROD: The reset would be
3 subsequently a couple of years down the road.

4 CHAIRMAN GENSLER: That's the automatic
5 reset. If an exchange wanted to come in, whether
6 it's Notice and Comment or not, they can come in
7 before that later date. Is that right, Dan and
8 Steve?

9 MR. BERKOVITZ: Yes, that's correct.

10 MR. SHERROD: Right and that would be
11 necessary if the exchange wanted to increase their
12 level beyond what's in the schedule.

13 CHAIRMAN GENSLER: Right. So a lot of
14 this is dependent upon the exchanges. I mean we
15 might have to automatically do it every two years
16 and we're resource constrained obviously, but if
17 they want to come in earlier, I think they can.

18 MR. SHERROD: And for the agricultural
19 contracts, that's on an annual basis.

20 CHAIRMAN GENSLER: Every year, right.
21 Sorry, Commissioner Chilton.

22 COMMISSIONER CHILTON: No, that was

1 good. Commissioner Sommers, did you have anything
2 else on that one?

3 COMMISSIONER SOMMERS: No.

4 COMMISSIONER CHILTON: Okay. I still
5 have another one, Mr. Chairman. I apologize.

6 I want to thank you, Mr. Chairman, and
7 my colleagues for dealing with something that a
8 number of us, including Commissioner Sommers, had
9 talked about. And that's in the amended version,
10 I'm glad we fixed that excluded commodities issue
11 and thank you for the discussion and thank you for
12 including it.

13 The last one I had was -- Commissioner
14 O'Malia got me thinking on what's excessive
15 speculation, and it reminded me of Potter Stewart
16 on pornography. "I know it when I see it." When
17 I go out and give talks, I say who thinks in the
18 audience 80 percent of a market is too much?
19 Everybody raises their hand. Everybody thinks 80
20 percent's too much. And then as you go down the
21 percentages, they think less and less. I say
22 well, ours is 10 percent.

1 So here's what I know on excessive
2 speculation. I know it when I see it. I'm not
3 saying it's 10 percent or 11 percent, but 30, 40
4 percent of a market, 50 percent of a market, it's
5 excessive speculation. And to be honest, what
6 I've seen? Some of it is pornographic when they
7 own so much, and I think they've moved markets.
8 So I don't have anything else, Mr. Chairman.
9 Thank you.

10 CHAIRMAN GENSLER: I don't know where to
11 go from there, but Mr. Stawick, you want to call
12 the roll?

13 MR. STAWICK: Commissioner O'Malia?

14 COMMISSIONER O'MALIA: No.

15 MR. STAWICK: Commissioner O'Malia, no.
16 Commissioner Chilton?

17 COMMISSIONER CHILTON: Aye, finally.

18 MR. STAWICK: Commissioner Chilton, aye.
19 Commissioner Sommers?

20 COMMISSIONER SOMMERS: No.

21 MR. STAWICK: Commissioner Sommers, no.
22 Commissioner Dunn?

1 COMMISSIONER DUNN: Aye.

2 MR. STAWICK: Commissioner Dunn, aye.

3 Mr. Chairman?

4 CHAIRMAN GENSLER: Aye.

5 MR. STAWICK: Mr. Chairman, aye. Mr.
6 Chairman, on this matter the yeas are three; the
7 nays are two.

8 CHAIRMAN GENSLER: I thank you, Mr.
9 Stawick. With the majority having supported the
10 rule, this too will be sent to the Federal
11 Register. It might take -- I'm saying this to the
12 public -- a few extra days because there were
13 these modest, but they're already tight,
14 amendments but we just have to get these things
15 in. I think I did Unanimous Consent to allow
16 technical corrections to the documents voted on
17 today. Did I do that? I just want to confirm I
18 did that.

19 Our next scheduled public meeting I
20 think will be November 1st. The subjects of the
21 rulemaking presented in that meeting will
22 published on the Commission Website 7 days before

1 the meeting. If for any reason we don't publish
2 something 7 days before, that's because we're not
3 going to have a meeting on November 1st. But we
4 do have things in front of the Commissioners, and
5 you'll find from time to time we do this in a
6 rolling way.

7 If there is no other Commission
8 business, then I'd take a motion to adjourn the
9 meeting.

10 COMMISSIONER DUNN: So moved.

11 COMMISSIONER SOMMERS: Second.

12 CHAIRMAN GENSLER: All in favor?

13 ALL COMMISSIONERS: Aye.

14 CHAIRMAN GENSLER: I want to thank
15 everyone again, thank my fellow Commissioners, and
16 I'm going to enjoy the rest of my birthday.

17 (Whereupon, at 2:08 p.m., the
18 PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

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

(Signature and Seal on File)

Notary Public, in and for the District of Columbia

My Commission Expires: January 14, 2013

