

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

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

Washington, D.C.

Wednesday, April 27, 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 Presentation No. 1: Produce Definitions Contained
9 in Title VII of the Dodd-Frank Act

10 Office of General Counsel

11 TERRY ARBIT

12 JULIAN HAMMAR

13 DAVID ARON

14 DAN BERKOVITZ

15 Presentation No. 2: Protection of Cleared Swaps
16 Customer Contracts and Collateral; Conforming
17 Amendments to the Commodity Broker Bankruptcy
Provisions

18 Division of Clearing and Intermediary Oversight

19 ROBERT WASSERMAN

20 JOHN LAWTON

21 NANCY SCHNABEL

22 LAURA ASTRADA

1 PARTICIPANTS (CONT'D):

2 Office of General Counsel

3 MARTIN WHITE

4 Presentation No. 3: Capital Requirements of Swap
5 Dealers and Major Swap Participants

6 Division of Clearing and Intermediary Oversight

7 TOM SMITH

8 THELMA DIAZ

9 JOHN LAWTON

10 Presentation No. 4: Amendments to Adopt Certain
11 CFTC Regulations to the Dodd- Frank Act

12 Division of Clearing and Intermediary Oversight

13 JOHN LAWTON

14 PETER KALS

15 Division of Market Oversight

16 NADIA ZAKIR

17 Office of General Counsel

18 DAVID ARON

19 Also Present:

20 DAVID STAWICK, Office of the Secretariat

21 VINCENT A. MCGONAGLE, Enforcement Division

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P R O C E E D I N G S

(9:36 a.m.)

CHAIRMAN GENSLER: Good morning. This meeting will come to order. This is a public meeting of the Commodity Futures Trading Commission to consider issuance of a proposed rule-making under the Dodd-Frank Wall Street Reform and Consumer Protection Act regarding four proposed rules.

These proposed rules relate to product definitions which is a joint rule with the Securities and Exchange Commission. They relate to segregation of customer collateral for cleared swaps, those swaps taken to a clearinghouse, capital requirements for non-bank swap dealers and major swap participants, and then some conforming amendments to certain CFTC regulations as we've done at least twice during this proposed rule-making phase.

In addition, the Commission will consider aligning the comment period on the margin rule that was proposed on April 12th, and this is

1 to align that rule with the capital rule.

2 I'd like to welcome members of the
3 public, market participants, and members of the
4 media to today's meeting as well as welcome those
5 listening to the meeting on the phone or watching
6 the live webcast. We look forward to receiving
7 public comments on the proposed rules we're
8 considering today, and the rules as well as
9 factsheets and Q&As and documents will all be
10 posted on our website shortly as we've done in our
11 prior meetings. This is the 14th meeting,
12 actually, as we consider Dodd-Frank rule- makings.
13 And at this point, as we consider these four rules
14 and, hopefully, share them with the public. With
15 the Commission's support we will have
16 substantially completed the proposal phase of our
17 rule-writing to implement the Dodd-Frank Act.

18 And so I want to take this opportunity
19 and thank the staff for their extraordinary work.
20 I think this is 40 weeks since the President
21 signed the bill; they're probably counting, the
22 staff. But it's just a remarkable work, with good

1 humor and thoughtfulness, to comply with
2 Congressional intent and the law, to take hundreds
3 of meetings -- in fact, between regulators and the
4 public, probably over 1,000 meetings. And they've
5 started to review what is now tens of thousands of
6 comments.

7 Similarly, I want to thank Commissioner
8 Mike Dunn and Commissioner Jill Sommers, Bart
9 Chilton, and Scott O'Malia for all of their hard
10 work during this process. The Commissioners and
11 their very able staff have diligently evaluated
12 all of these staff proposals, provided insightful
13 comments throughout, I think made the rules better
14 for the public. Since the President signed the
15 Act the Commission has promulgated rules and will,
16 with today, covering all of the areas set out in
17 the Act for swap regulation, with the exception of
18 the Volcker Rule, which the Act itself set a
19 different timeline for.

20 With this substantial completion of this
21 proposal phase of the rule-writing, the public now
22 has the opportunity to review the whole mosaic of

1 rules. This will allow the market and all the
2 market participants to evaluate the entire
3 regulatory scheme as a whole. And to further
4 facilitate this process, this morning we'll
5 consider possibly reopening or extending the
6 comment periods for most of the Dodd-Frank
7 proposed rules for an additional 30 days.
8 Specifically, for rules where the comment period
9 has closed, the comment period would be reopened
10 for 30 days. Or if it's about to close, it would
11 at least be extended so that the total would be 30
12 days.

13 This time will allow the public to
14 submit any comments they might have after seeing
15 the entire mosaic and, as part of this, I'm hoping
16 the market participants will continue to comment
17 about potential compliance cost as well as the
18 phasing and implementation dates with regard to
19 these rules.

20 One opportunity, actually a very key
21 opportunity, to comment will be next week. The
22 SEC and CFTC's staffs will have a two-day

1 roundtable to hear from the public on the best
2 schedule for implementation dates for effective
3 dates of these final rules. We've also opened, a
4 few weeks ago, a public comment file which is
5 open, I think, through June 10th or so on some of
6 these implementation and effective date processes.

7 Before we hear from staff on these four
8 rules that we'll consider today, I'd like to
9 recognize my fellow Commissioners. I believe that
10 Commissioner Dunn -- I don't see the camera, but
11 -- and Commissioner Chilton are together in
12 Chicago, so Commissioner Dunn?

13 COMMISSIONER DUNN: Thank you, Mr.
14 Chairman, and I want to thank all the folks
15 joining us today for this important meeting
16 regarding the implementation of the Dodd- Frank
17 Act.

18 Today, as we near the end of our
19 meetings regarding proposed rule, we will finally
20 consider our product definitions rule, a joint
21 rule with the SEC, which, in a perfect world,
22 would have been one of the first rules proposed

1 because meaningful input from those who will be
2 under the new regulatory regime depends upon
3 knowing precisely what constitutes a swap and what
4 does not. We will also discuss our conforming
5 rules whose purpose is, in part, to ensure that
6 what is required for swaps is required for futures
7 and visa versa.

8 In a perfect world conforming rules
9 would be the last proposed and final item because
10 to do them correctly depends on having a view of
11 all of the other rules. However, this is not a
12 perfect world and the Commission and its staff is
13 doing what it can, when it can, with the resources
14 we have. And, Mr. Chairman, I join you in
15 saluting the staff for doing an outstanding job.

16 In considering the proposed rule for
17 capital requirements for swap dealers and major
18 swap participants, I will be particularly
19 interested in hearing staff's thoughts on the
20 public comments on how much this rule will cost
21 not only the industry, but the CFTC. I believe
22 this rule is a necessity, but I'm interested to

1 hear if or how these proposed requirements will
2 affect the cost of transacting swaps. At the very
3 least, the proposed capital rules will increase
4 the burden on current Commission staff and will
5 require the hiring of additional staff.

6 I'm also very interested in hearing the
7 public comments regarding the proposed rule on
8 protection of clearance swap, customer contracts,
9 and collateral. While staff makes its specific
10 recommendations today regarding the approach that
11 the Commission should take, the proposed rule also
12 lays out a number of alternatives that staff has
13 considered. I look forward to reading the
14 comments on this rule, so that the Commission can
15 determine the best approach.

16 As we move from the process of proposing
17 rules to the process of final rules, I will rely
18 heavily on the comments we receive from the
19 public, informing my opinion on the final rules.
20 While I have specific questions regarding each
21 final rule, there are two broad themes of
22 questions that I have for each of the final rule

1 teams.

2 First, how can the rule be made more
3 principle- based and less prescriptive or
4 restrictive? And second, how much will the rule
5 cost the Commission to implement, maintain, and
6 enforce, particularly in terms of staffing?

7 I have provided a series of questions
8 regarding these themes to the rule teams and will
9 look forward to the answers to those questions as
10 we move to the final rules. I would like to once
11 again thank the staff at CFTC for all their hard
12 work on these very important proposed rules and I
13 look forward to their presentations.

14 CHAIRMAN GENSLER: Thank you.
15 Commissioner Chilton? Commissioner Sommers?

16 COMMISSIONER SOMMERS: Thank you, Mr.
17 Chairman. And I want to thank all the teams that
18 are here today for all of the hard work that they
19 have put in on the proposals that we are
20 considering today.

21 As all of you know, a number of these
22 proposals today are lynchpins in the new

1 regulatory structure that we are creating. And I
2 know that the public, end users, and members of
3 Congress have been anxiously awaiting these
4 proposals.

5 Before moving to the specific proposals
6 before us today, I would like to focus on the
7 Dodd-Frank repeal of certain provisions of the
8 Commodity Exchange Act that were added by the
9 Commodity Futures Modernization Act of 2000 to
10 provide legal certainty to over-the-counter
11 markets, namely 2(d), 2(e), 2(g), 2(h), and 5(d).
12 These provisions will be rescinded on July 16th,
13 less than 3 months from now, even though the new
14 regulatory framework for trading and clearing
15 swaps will most certainly not be operational by
16 that date.

17 Last September, the Commission issued an
18 order outlining a process for grandfather relief
19 for exempt commercial markets operating pursuant
20 to 2(h)(3), an exempt Board of Trade operating
21 pursuant to Section 5(d).

22 The Commission order is an order to be

1 entitled "Grandfather Relief." Among other things
2 to be entitled, the ECMS or EBOTs must have filed
3 a SEF or DCM application within 60 days after the
4 effective date. The final regulations
5 implementing Sections 733 or 734 of Dodd-Frank and
6 the SEF or DCM application must be currently
7 pending before the Commission.

8 The wording of these requirements
9 clearly presumed that final regulations
10 implementing Sections 733 and 734 would be issued
11 before July 16th and may not make sense in the
12 absence of final regulations. I believe the
13 Commission should re-address its order to ensure
14 that it provides market participants with
15 sufficient certainty as to the status of ECMS and
16 EBOTs on July 16th or thereafter, particularly in
17 light of the fact that it will likely be
18 impossible for ECM or EBOT to have an SEF
19 application currently pending on July 16th.

20 At the same time the Commission issued
21 its order outlining a process for granting
22 grandfather relief to ECMS and EBOTs, the

1 Commission declined to grant grandfather relief to
2 market participants transacting swaps in reliance
3 of Section 2(h)(1) and said nothing about Sections
4 2(d), 2(e), and 2(g).

5 With the Dodd-Frank effective date
6 looming and no grandfather relief or no action
7 relief process yet announced for market
8 participants transacting in reliance on these
9 critical provisions, the level of uncertainty in
10 these markets is mounting. Again, I think it is
11 imperative that the Commission publicly announce
12 as soon as possible how it intends to address the
13 legal uncertainty that will be reintroduced into
14 the OTC swaps market on July 16th when the Section
15 2 provisions are repealed and the certainty
16 provided by the CFMA goes away.

17 It is my hope that the Commission will
18 issue specific guidance to market participants as
19 soon as possible to clarify for them what happens
20 in these markets on Monday, July 18th.

21 I would also like to discuss the next
22 phase for us in the rule-making process. Although

1 I completely understand interested parties'
2 anxiety regarding the implementation phase or the
3 staggering of effective dates for final rules, I
4 am actually more concerned with our internal
5 process for moving forward with issuing final
6 rules. The process for issuing proposed rules was
7 rushed and, in my view, was guided by meeting the
8 tight deadlines that were set by the statute.
9 There was often insufficient time for us to fully
10 consider the implications of all aspects of some
11 of the proposals, particularly when we were
12 getting revisions the night before the vote and
13 sometimes on the morning of a vote.

14 I would have preferred that the
15 Commission spend more time on many of the
16 proposals to get them in the state as close to
17 final as possible. We often did not do that. On
18 the contrary, we have issued a number of proposals
19 in which at least three Commissioners have voiced
20 concerns regarding the possibility of unintended
21 consequences.

22 While there is room for error when

1 issuing proposed rules, there is no room for error
2 when issuing final rules, which is why I believe
3 our internal process for finalizing rules is
4 vitally important. We must ensure that we have
5 sufficient time to analyze each and every rule,
6 that final rules changed at the last minute are
7 not called up for a vote, and that we set a
8 meeting schedule to allow sufficient time between
9 meetings for serious internal consideration by all
10 of us of the views of staff, the views of the
11 commenters, and, most importantly, the views of
12 each other.

13 I am, of course, looking forward to the
14 guidance from the joint roundtable next week on
15 implementation, but I also look forward to
16 finalizing the specific process we will operate
17 under internally to make sure that we move forward
18 in an orderly fashion, guided by policy and not by
19 deadlines.

20 Finally, before I address the proposals
21 before us today, I would like to say that I
22 wholeheartedly agree to us extending or reopening

1 the comment periods for most of the proposals that
2 we have issued. However, I'm objecting to this
3 today since I did not receive it until late last
4 night and haven't had the chance to look at it.
5 Given the number of proposals and the complexity
6 of the proposals that we are reopening, I also
7 question whether 30 days is sufficient time to
8 comment on over 32 different releases.

9 And finally, to the agenda before us
10 today, I think it represents an enormous effort on
11 the part of our staff and the work that they have
12 put into the giant stack of paper that we have in
13 front of us. While I have a number of concerns
14 with regard to these proposals, my votes in no way
15 express dissatisfaction with the quality of work
16 that's been done to get these proposals ready for
17 today's vote.

18 On the Product Definitions Proposal,
19 obviously I'm pleased that we're finally able to
20 get to this critical proposal. But as has been my
21 practice throughout the rule-making process, I
22 have voted against proposals that I thought were

1 over-reading our mandate or simply overreaching.
2 I think that the proposed anti-evasion provisions
3 within this document do just that.

4 I agree that Section 721(c) directs the
5 Commission to modify certain definitions to
6 include products or entities that may be
7 structured to evade the requirements of
8 Dodd-Frank. However, I don't agree that being
9 directed to modify definitions equates being
10 directed to propose broad anti-evasion provisions
11 and I think it's an overreach.

12 I'm also troubled that this proposal
13 does not discuss issues raised by multilateral
14 development institutions in which the United
15 States is a member -- such as the World Bank, the
16 Bank of International Settlements, the
17 International Bank for Reconstruction and
18 Development, and the International Finance
19 Corporation, among others -- that have come to us
20 with very specific concerns. All of these
21 organizations share the same fundamental mission,
22 which is to provide economic development and

1 reduce poverty in developing countries, and I do
2 not believe they should be included in the
3 proposal that we have before us.

4 The draft that I received two weeks ago
5 included a discussion of their issues and
6 contained a number of questions for the public to
7 comment on. All of that has been omitted in the
8 document before us today, and I think that is a
9 mistake. These entities have legitimate issues
10 and I do not see the harm in highlighting them and
11 asking questions. I don't recall us highlighting
12 their issues in any other proposals, so I
13 question, why not include them in this proposal?

14 Not raising the issues at all because we
15 think the entities will comment anyway may not
16 cause others that are not directly impacted with
17 helpful information that may want to comment on
18 these issues. As a result, in my dissenting
19 statement on this specific proposal, I will
20 include the discussion and questions as written by
21 staff that they provided in their earlier draft,
22 and I hope that the public will take the

1 opportunity to comment.

2 With regard to the segregation in
3 bankruptcy proposal, I have a number of
4 reservations because I think it mistakenly fails
5 to retain sufficient optionality for FCMs and DCOs
6 to implement different models based upon the needs
7 of their customers. The proposal clearly favors
8 adopting the complete legal segregation model as
9 providing the best balance between benefits and
10 costs. I'm not convinced of that and I welcome
11 comments on the bankruptcy rules and other issues
12 surrounding optionality.

13 I also believe that the contrast between
14 Sections 4d(b) and 4d(f).6 of the CEA -- namely
15 the use of the terms "customer" versus "customers"
16 -- is suggestive of nothing more than a drafting
17 error.

18 Finally, I also have strong objections
19 to including two important substantive provisions
20 within the conforming amendments today: One
21 governing bunched orders, and the other one
22 requiring new duties with respect to creating and

1 maintaining audio files of all oral communications
2 leading to the execution of a transaction in a
3 commodity interest or cash commodity. I believe
4 these significant issues should be addressed
5 separately and do not belong in a conforming
6 amendments document. I encourage the public to
7 read these conforming amendments very closely and
8 to comment as appropriate.

9 Again, I want to thank all of the teams
10 for their hard work today on these very
11 significant proposals and I look forward to
12 hearing your presentations.

13 CHAIRMAN GENSLER: Thank you,
14 Commissioner Sommers. Commissioner Chilton, back
15 to Chicago.

16 COMMISSIONER CHILTON: Thanks, Mr.
17 Chairman. I actually agree with Commissioner
18 Sommers on a few things, but I diverge at one
19 point here, maybe a couple of points.

20 You know, I don't think that it was
21 possible for us to get these rules right
22 immediately out of the gate. Some of them we had

1 a very steep learning curve on. And the reason
2 that we put them out, in my view, is that we
3 needed to get comments to further fine-tune the
4 rule. I agree with her that it's really the final
5 rules where the rubber meets the road -- and
6 Commissioner Dunn's talked about that, also --
7 that we need to get it right, and we will.

8 And, as the Chairman said, we're not
9 going to get things done on time as Congress
10 suggested, so I think we are going to be
11 deliberate. I think we have been deliberate. I
12 think this effort that the Chairman's put forward
13 for an additional 30 days on some selected rules
14 -- and I'm going to ask some questions about that
15 later -- but I think that's a good effort. But I
16 do get concerned and I want to make sure I'm
17 specifically not talking about Commissioner
18 Sommers or anybody else at the CFTC.

19 I think the deadlines that Congress
20 passed are important deadlines for us. I think
21 that the urgency that existed last year when
22 Congress passed the bill and the President signed

1 it, that urgency still exists today. And there
2 are dangers out there in the OTC world that we've
3 got to get a handle on with these rules and
4 regulations.

5 But obviously we want to do them right,
6 but I think there are some out there that want to
7 sort of run out the clock, and, again, I'm not
8 talking about anybody in this meeting or at the
9 CFTC. But I think some -- and I think many of
10 these people are folks that oppose the bill to
11 begin with, really want to run it out until maybe
12 after the next presidential election. Maybe
13 consumers will not be as hot on financial reform
14 then. And I think that would be a mistake.

15 So I know my colleagues and I, all of
16 us, want to do what we believe is the right thing,
17 but we want to be deliberate about it. And I
18 respect that and I think we'll get there. We may
19 need some pushing from the outside once in a
20 while, and that's all well and good, but we need
21 to be thinking about these things as we go
22 forward. Thank you, Mr. Chairman.

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

3 COMMISSIONER O'MALIA: Thank you, Mr.
4 Chairman. And let me thank the teams who have
5 spent many, many long hours negotiating and
6 developing the rule proposals before us today.
7 Greatly appreciate your hard work and being on the
8 front line on negotiations.

9 Let me begin by making a comment on the
10 rule- making process going forward. After the May
11 2nd and May 3rd staff roundtables on the
12 implementation process, it is my hope that the
13 Commission will release a comprehensive schedule
14 of the sequencing of final rule-makings and a
15 proposed implementation plan to be put in the
16 Federal Register to allow public comment on it
17 before we finalize the rules under Dodd-Frank.

18 Like you, Mr. Chairman, I believe
19 transparency will benefit this process by allowing
20 the public to comment on both the sequencing of
21 the final rules and the proposed implementation
22 plan. Those affected by the rules will have the

1 transparency and certainty they will need to make
2 budget, investment, and staffing decisions.

3 Now let me turn to the proposed
4 rule-makings. After almost 10 months, the
5 products rule that will define the definition of a
6 swap is finally before us. I think the public
7 will be surprised that this rule-making is over
8 300 pages in length and by the number of
9 differences that still exist between the two
10 commissions with respect to insurance products,
11 foreign sovereign debt instruments, and swap
12 indexes.

13 I have a particular concern about the
14 anti- evasion proposal and how the Commission will
15 conduct its analysis and implement this provision
16 going forward. While I believe that our
17 implementation of the forward exclusion is
18 consistent with the years of Commission practice,
19 I would like to hear from the public whether they
20 will allow the forward market to continue to
21 operate under Dodd-Frank in the same manner as it
22 does today.

1 With regard to the financial
2 transmission rights and electricity markets, this
3 proposal recommends the Commission use the Public
4 Interest Waiver authority provided under 722(f) of
5 Dodd-Frank Act. And I believe that is the
6 appropriate process.

7 As I was reviewing the treatment of
8 single name CDS and index credit default swaps in
9 the proposal, it struck me that the market
10 participants who purchase these products will not
11 be able to margin them on a portfolio basis.
12 Congress gave the SEC and the CFTC a mandate under
13 Section 713 of the Dodd-Frank Act to propose a
14 joint rule on portfolio margining. Unfortunately,
15 we're now at the end of the proposed rule-making
16 process and we have not proposed a portfolio
17 margining rule. Portfolio margining is
18 non-controversial and the entire market wants it.
19 And it is one of the few, if not the only, cost
20 savings tools in the entire Title VII.

21 Now let me turn to the Capital Rule.
22 Let me first say that I strongly believe that swap

1 dealers must be adequately capitalized, a swap
2 dealer with enough regulatory capital to stand
3 behind a trade, give the comfort to
4 counterparties. While I realize that
5 undercapitalized financial institutions were at
6 the heart of the financial crisis, I want to point
7 out the commercial entities that used swaps and
8 were not the root of the problem. And this
9 proposal seems to ignore the flexibility of the
10 statute and the congressional direction as it
11 relates to the application of capital charges on
12 end users.

13 With that said, I want to read the
14 language of Section 731 of the Dodd-Frank Act
15 which states: To offset the greater risk to swap
16 dealer in the financial system, capital
17 requirements for uncleared swaps shall be
18 appropriate for the risk associated with the
19 non-cleared swap held by the swap dealer or major
20 swap participant.

21 I cite this language because I do not
22 feel the proposal gives enough consideration to

1 the phrase "as appropriate for the risk." In
2 particular, non-bank, non- FCM swap dealers will
3 be required to calculate and hold capital for each
4 and every swap they enter into with a commercial
5 end user, beginning with the first dollar of
6 exposure. This regulation provides no thresholds,
7 no exemptions, and certainly no consideration of
8 the statutory flexibility in the Dodd-Frank Act.

9 Just so we're clear, commercial end
10 users are cooperatives, captive finance companies,
11 farmers, municipalities, and other non-financial,
12 non-systemically risky counterparties. If a
13 commercial swap dealer does not collect margin
14 from the commercial end user, then it must take a
15 capital charge equal to its credit risk, exposure
16 to the end user, and the market risk of the swap.

17 Two outcomes will result from this
18 regulation: Either the swap dealer will require
19 commercial end users to post margin to avoid
20 taking a capital charge or they will point to the
21 regulation as a reason to increase the bid-ask
22 spread of swaps for end users to cover the capital

1 charge mandated by this rule. Either way, the
2 cost of hedging commercial risk for end users is
3 going up.

4 What I've described is contrary to the
5 intent of Congress. I quoted from the
6 Lincoln-Dodd letter in the last meeting, but I
7 feel compelled to do it again. It says that,
8 "Congress clearly stated in this bill that the
9 margining capital requirements are not to be
10 imposed on end users." The letter goes on to say
11 that "the capital in margin standards should be
12 set to mitigate risk in our financial system, not
13 punish those who are hedging their own commercial
14 risk."

15 Our proposed capital rule does just
16 that. As a result, I will not support this
17 proposal.

18 Another concern that I have is with the
19 impact the rule will have on non-bank, non-FCM
20 commercial firms that are likely to be captured by
21 the overly broad definition of "swap dealer"
22 proposed by the Commission. A non-bank, non-FCM

1 swap dealer is an entity that generates the
2 overwhelming majority of its income from
3 commercial activities and engages in de minimis
4 dealing activities.

5 I predict this capital rule, combined
6 with a broad swap dealer definition, will drive
7 commercial firms to pose little, if any, systemic
8 risk to the financial system out of the
9 market-making business and concentrate the swap
10 dealing business with the Wall Street banks.
11 Higher costs and less competition for commercial
12 end users is not a proposition I favor, especially
13 when I consider the source of the financial
14 contagion in 2008.

15 Be it as the Commission put forward as
16 swap dealer rule-making in December 2010 -- long
17 before the capital and margin rules were completed
18 -- the swap dealer team did not have the benefit
19 of comparing the costs impact to the broad swap
20 dealer definition with the margin and capital
21 rules proposed in the last two meetings.

22 I also believe that the recently

1 released CFDC Inspector General report on
2 cost-benefit analysis has appropriately
3 highlighted the lack of attention that was paid to
4 assessing the true cost of the swap dealer rule in
5 the first place. The agency needs to take that
6 report very seriously.

7 I'm in favor of a complete re-proposal
8 of the swap dealer definition rule. The
9 re-proposal must narrow the definition of a swap
10 dealer and perform a more rigorous analysis of the
11 costs of the rule-making to both the market and
12 the Commission.

13 Finally, let me turn to individual
14 segregation. As my colleagues have noted, this is
15 a complicated issue on how clear customer
16 collateral should be segregated, and this was a
17 significant debate back in December. After
18 receiving several comments on the proposal, the
19 Commission has narrowed its options by eliminating
20 the complete physical segregation model from
21 consideration. The current proposal leans toward
22 adopting a complete legal segregation model. To

1 get this issue right, though, I believe we need to
2 continue to consider other options that are viable
3 alternatives and let the market decide which model
4 best balances higher operational costs against the
5 benefit of increased levels of consumer collateral
6 protection.

7 As a result, I've asked the team to
8 consider the current futures model as well, and
9 this proposal signals in its preamble that the
10 Commission is still considering that alternative.
11 I recognize, though, that the futures model
12 represents certain challenges to fellow customers
13 of an FCM who don't currently have the benefit of
14 knowing enough about the risk profile of their
15 fellow FCM customers. I'm particularly interested
16 in comments regarding how we might address that
17 challenge, including requiring certain disclosures
18 by FCMs.

19 I'm pleased to see that the preamble
20 reflects the strong debate inside the Commission
21 on the effect of each option under the bankruptcy
22 code as well. Finally, I'm pleased that the

1 preamble to this proposal includes language that
2 will allow the Commission to adopt a final rule
3 which lets a DCO choose which model is right for
4 its business. I believe this flexibility allows
5 the market to determine which option is the best
6 way to move forward in the cleared swaps world.

7 All in all, I recognize the hard work of
8 the teams and greatly appreciate their efforts in
9 putting these extensive and very detailed rules
10 together. Thank you.

11 CHAIRMAN GENSLER: Thank you,
12 Commissioner O'Malia. Thank you to all of my
13 fellow Commissioners and I think now the staff
14 will present their proposals and recommendations.
15 After each of these presentations the floor will
16 be open for questions and comments from each of
17 the Commissioners and, following that, we'll take
18 a vote.

19 To that end, let's see, I think I've
20 already done this, but it says I'm supposed to ask
21 for unanimous consent that final votes on the
22 proposed rules be done by recorded vote and it be

1 put in the Federal Register. I thought we did
2 that already, always, but in case I hadn't, not
3 hearing any objections, we'll do this by recorded
4 votes.

5 And so then I'm going to turn to this
6 team that's been working with the Securities and
7 Exchange Commission on further defining swap,
8 securities-based swap, securities- based swap
9 agreement, and the regulation of mixed swaps as
10 the Dodd-Frank was very specific on these matters
11 but asked the SEC and CFTC to jointly give further
12 clarification. Dan Berkovitz, our general
13 counsel, and with him Terry Arbit, Julian Hammar,
14 and David Aron from the Office of General Counsel,
15 the floor is yours.

16 MR. HAMMAR: Good morning. This
17 rule-making proposal and interpretive guidance,
18 which is being proposed jointly with the SEC,
19 further defines the terms swaps, security-based
20 swap, and security-based swap agreement. It
21 provides for the regulation of mixed swaps and
22 addresses books and records requirements for

1 security-based swap agreements.

2 I'd like to thank my CFTC colleagues on
3 the definitions team, including from OGC, Terry
4 Arbit, Mark Fajfar, and David Aron, in particular;
5 Dan Berkovitz, our general counsel; and members
6 from other divisions, including Rose Troin, Somi
7 Seong, and Steve Cane; as well as our SEC
8 colleagues, including Brian Bussey on the SEC
9 team, for their contributions to the proposal.

10 I should say this really was a team
11 effort. In a wide-ranging rule-making we tapped
12 into the expertise of a lot of people and I'm very
13 grateful for that.

14 In developing this proposed rule in
15 Interpretive Guidance we reviewed more than 80
16 written comments in response to an Advance Notice
17 Of Proposed Rule-Making that the Commission issued
18 last summer. We met with market participants,
19 trade associations, and other members of the
20 public. We had many meetings with our SEC
21 colleagues and consulted with the Federal Reserve
22 Board as well as the other credential regulators.

1 We're grateful for the input we've had so far and
2 we look forward to continuing to meet with the
3 public and our fellow regulators to develop the
4 final rules in Interpretive Guidance.

5 The Dodd-Frank Act contains detailed and
6 specific definitions of the terms "swap" and
7 "security-based swap," which were designed to
8 comprehensively cover previously unregulated
9 derivatives, including interest rate swaps,
10 currency swaps, commodity swaps, equity swaps, and
11 credit default swaps. We do not believe that
12 extensive further definition of these terms is
13 necessary. Many commenters to the ANPR pointed
14 out, however, if read expansively, the definitions
15 could cover other products, such as insurance,
16 that traditionally have not been considered to be
17 swaps. And nothing in the legislative history of
18 the Dodd-Frank Act suggests that Congress intended
19 such products to be regulated as swaps or
20 security-based swaps.

21 To address these concerns raised by the
22 commenters, the proposal clarifies that certain

1 products are not swaps or security-based swaps.
2 In brief, with respect to insurance -- without
3 going into the details -- the proposal provides
4 that regulated insurance products that are offered
5 by regulated insurance companies are not swaps or
6 security-based swaps.

7 In addition, commenters to the ANPR
8 requested that the Commissions clarify that
9 certain consumer and commercial arrangements that
10 historically had not been considered swaps or
11 security-based swaps -- such as consumer mortgage
12 rate locks, contracts to lock the price of home
13 heating oil, and contracts related to inventory or
14 equipment in someone's business -- should not be
15 considered within the swap definition. The
16 proposal contains interpretive guidance to clarify
17 that these types of products are not swaps or
18 security-based swaps.

19 Commenters to the ANPR also asked for
20 clarification regarding the forward contract
21 exclusion from the swap definition. Under the
22 Commodity Exchange Act, forward contracts are

1 excluded from futures regulation. The Dodd-Frank
2 Act excluded from the swap definition "any sale of
3 a non-financial commodity or security for deferred
4 shipment or delivery so long as the transaction is
5 intended to be physically settled."

6 Although the wording of this forward
7 exclusion is slightly different than the forward
8 exclusion applicable to futures, there is
9 legislative history to the Dodd-Frank Act
10 indicating that Congress intended that the
11 Commissions interpret the two exclusions
12 consistently. To implement this congressional
13 intent the proposal provides guidance that the
14 forward contract exclusion from the swap
15 definition with respect to non-financial
16 commodities should be interpreted in a manner
17 consistent with the CFTC's historical
18 interpretation of the forward contract exclusion
19 from futures.

20 It further clarifies the book-out
21 transactions and non-financial commodities that
22 meet the requirements specified in the

1 Commission's Brent Interpretation and that are
2 effectuated through a subsequent separately
3 negotiated agreement should qualify for the
4 forward exclusion from swaps in futures.

5 Commenters also requested clarification
6 regarding the CFTC's 1993 order exempting energy
7 contracts from regulation under the CEA, the
8 Energy Exemption, after enactment of the
9 Dodd-Frank Act. The Energy Exemption basically
10 extended the Brent Interpretation and its guidance
11 regarding book-outs to energy commodities other
12 than oil. Because the proposal extends the Brent
13 Interpretation to all the non-financial
14 commodities, the proposal would withdraw the
15 Energy Exemption as no longer necessary.

16 So that wraps up the types of
17 transactions the proposal clarifies are not swaps
18 or security-based swaps. While, as I mentioned at
19 the outset, the definitions of "swap" and
20 "security-based swap" are comprehensive, the
21 proposal does clarify that a few types of
22 transactions in particular are swaps or

1 security-based swaps. For example, foreign
2 exchange forwards and swaps are defined as swaps
3 subject to the Treasury Secretary's determination
4 to exempt them from the swap definition. Even if
5 the Treasury Secretary determines to exempt them,
6 however, the statute provides that certain
7 provisions of the CEA apply to FX forwards and
8 swaps and the proposed regulations reflect this.

9 The proposal also clarifies that certain
10 FX products do not fall within the definitions of
11 FX swaps and forwards, and so they are not subject
12 to the Treasury's determination to exempt. These
13 products include foreign currency options,
14 non-deliverable forwards involving foreign
15 exchange currency swaps, and cross-currency swaps.

16 Outside of the FX suite of products the
17 proposal also would clarify that forward rate
18 agreements, notwithstanding their forward label,
19 are swaps. Proposed guidance would further
20 clarify that options and swaps and forward swaps
21 are swaps.

22 The proposal then turns to the

1 relationship between swaps and security-based
2 swaps, how we distinguish the two. The proposal
3 specifies a couple of principles about how
4 agreements, contracts, or transactions that are
5 subject to Title VII of the Dodd-Frank Act --
6 which are referred to in the release as Title VII
7 instruments -- are to be classified as swaps,
8 security-based swaps, or mixed swaps. That
9 classification of a Title VII instrument is to be
10 made at the time it is entered into and that
11 classification is retained throughout the tenure
12 of the instrument unless the instrument is
13 materially amended or modified.

14 This simple guidance, we believe, is
15 meant to ensure that market participants are not
16 unnecessarily burdened in determining the
17 classification of their Title VII instruments.
18 The proposal goes on to clarify whether Title VII
19 instruments are swaps, security-based swaps, or
20 mixed swaps in certain areas. So, for example,
21 clarification is provided regarding whether Title
22 VII instruments based on interest rates, monetary

1 rates, and yields are swaps or security-based
2 swaps.

3 In brief, Title VII instruments based on
4 interest rates and other monetary rates, including
5 inner-bank offer rates, money market rates,
6 government target rates, and so forth, are swaps.
7 Title VII instruments based on yields, where yield
8 is used as a proxy for price or value of a
9 security, loan, or certain security indexes, are
10 security- based swaps except in the case of U.S.
11 Treasuries and certain other exempted securities
12 which the Dodd-Frank provides are swaps.

13 In addition, guidance is provided in
14 several other areas, including total return swaps
15 and Title VII instruments based on futures
16 contracts. In a few areas it really sets out
17 alternative approaches and requests comment.

18 The proposal then turns to the use of
19 the term "narrow-based security index" in the
20 security-based swap definition. In general, with
21 respect to Title VII instruments on security
22 indexes, the CFTC has jurisdiction over such

1 instruments on broad-based security indexes while
2 the SEC has jurisdiction over Title VII
3 instruments on narrow-based security indexes.

4 The proposal clarifies that the existing
5 criteria for determining whether a security index
6 is narrow-based and the past guidance of the
7 Commissions regarding those criteria in the
8 context of security futures applies to Title VII
9 instruments. Credit default swaps are also
10 subject to this same jurisdictional division. CDS
11 on broad-based security indexes are regulated by
12 the CFTC while CDS on narrow-based security
13 indexes, as well as CDS on single names or loans,
14 are regulated by the SEC.

15 The proposal provides new criteria
16 tailored to CDS for determining whether CDS is
17 based on an index that is a narrow-based security
18 index. In addition, it provides guidance
19 regarding the term "index" and provides proposed
20 rules governing tolerance and grace periods for
21 the Title VII instruments on security indexes
22 traded on trading platforms.

1 So that's the end of swap and
2 security-based swap. Turning to mixed swaps,
3 which are both swaps and security-based swaps, the
4 proposal expresses the expectation that this will
5 be a narrow category. It addresses regulatory
6 treatment of bilateral, uncleared mixed swaps
7 where one counterparty is a dual registrant with
8 CFTC and the SEC. It also establishes a process
9 for requesting a joint order from the Commissions
10 to determine the appropriate regulatory treatment
11 of mixed swaps that do not fall into that
12 category.

13 With regard to security-based swap
14 agreements, or SBSA, the Dodd-Frank Act provides
15 the SEC with anti-fraud authority over and access
16 to information from certain CFTC regulated
17 entities regarding SBSAs, which are a type of
18 swap-related securities over which the CFTC has
19 full regulatory authority under the statute. The
20 proposal provides guidance on SBSAs and clarifies
21 that there would not be an additional books and
22 records requirements regarding SBSAs other than

1 those that have been proposed by the CFTC for
2 swaps.

3 The proposal also includes a process for
4 members of the public to request a joint
5 interpretation from the Commissions regarding
6 whether a Title VII instrument is a swap,
7 security-based swap, or mixed swap. Finally, it
8 includes proposed anti-evasion rules and guidance
9 for the CFTC.

10 These are the highlights of the
11 proposal. Because of time constraints, I've
12 necessarily skipped over many details, but if the
13 Commission votes today to publish this proposal in
14 the Federal Register, the public will be able to
15 review it in its entirety and provide comments.
16 Again, we would welcome comments on all aspects of
17 the proposal.

18 Thank you for your attention and I and
19 the team would welcome any questions you may have.

20 CHAIRMAN GENSLER: Thank you so much,
21 Julian and the team. With that I would entertain
22 a motion to accept the staff recommendation on

1 this Joint Rule on Product Definition.

2 COMMISSIONER SOMMERS: So moved.

3 COMMISSIONER O'MALIA: Second.

4 CHAIRMAN GENSLER: With that, I guess
5 I'm just going to ask a few questions. I do
6 support this rule. I think it's -- as Julian
7 said, the Dodd-Frank Act is very specific with
8 regard to the definition of swap and
9 securities-based swap, but the CFTC was directed,
10 along with the SEC, to give further definition.
11 And we worked closely with the SEC, in
12 consultation with the Federal Reserve, on the
13 proposed rule to define these terms.

14 And we were greatly benefited by the
15 public comment. I think it was somewhere in the
16 order of 80+ specific comments to the ANPR. But
17 even with regard to many other meetings and many
18 other commenters, I think that number probably is
19 a low count, the 80. And the statute is clear:
20 Interest rate swaps, currency swaps, commodity
21 swaps, equity swaps, CDS are swaps, and I think
22 the rule is consistent with that.

1 And I think where there was ambiguity,
2 we've addressed that. Insurance offered by a
3 regulated insurance company is not a swap.
4 Commercial transactions, what the public normally
5 thinks of as commercial transactions or consumer
6 transactions, are not swaps.

7 And in a very important area for this
8 agency is the question of forwards -- forwards in
9 the commodity space. And specifically, Congress
10 addressed this and said that any sale of a
11 non-financial commodity or security for deferred
12 shipment or delivery, so long as the transaction
13 is intended to be physically settled, that's not a
14 swap. We've had something similar -- not
15 identical words, but very similar -- in the
16 Commodities and Exchange Act since the 1930s, that
17 forwards were not futures. And I'm glad to see
18 that I think this rule supports that, but we're
19 going to look for it in public comment on this as
20 well.

21 But, Julian, I do have one question in
22 that area because it's come up in so many meetings

1 with farm co-ops and energy companies and so
2 forth. If somebody has an embedded option in a
3 forward, where did we come out on that?

4 MR. HAMMAR: Basically, we followed the
5 Commission's decision -- recent decision in In re
6 Wright and which also followed the OGC
7 interpretation from 1985, which basically says
8 that if the option is related to price, then we
9 won't consider that to be a swap. But if the
10 optionality is to delivery, then that's something
11 we have to take a look at.

12 CHAIRMAN GENSLER: Did we ask further
13 questions on that regard, to get public comment,
14 particularly in the electricity area? I think I
15 seem to have had a recent meeting with a bunch of
16 very thoughtful people from electricity companies
17 that had some questions on this and wanted to be
18 able to comment. So I just want to make sure we
19 did include some questions.

20 MR. HAMMAR: Yes, we did.

21 CHAIRMAN GENSLER: Good. I think
22 further, consistent with Dodd-Frank, the proposal

1 clarifies that these issues as to where the line
2 is between the SEC and the CFTC, and it took us a
3 few extra months, but I think this was time well
4 spent because I think it will provide the public
5 greater certainty as to the jurisdictional lines
6 without creating gaps in the regulatory oversight.
7 But I just had a couple questions there and credit
8 default swaps.

9 So if a credit default swap is on a
10 single name or on a narrow group of names it would
11 be regulated by the SEC, is that correct?

12 MR. HAMMAR: That's correct.

13 CHAIRMAN GENSLER: And I thought that
14 one provision that's in here that you might
15 explain a little bit is what if it was on a broad
16 group, maybe even it's 50 or 100 names, but one of
17 the counterparties has an opportunity to change
18 those names or actually direct what the names are
19 after the fact.

20 MR. HAMMAR: Well, in that situation, if
21 a party does have discretion, then it would be a
22 security-based swap or it could be a mixed swap.

1 If the parties do not have that discretion, it's
2 set right from the start, then it would be a
3 broad-based index and subject to CFTC (inaudible).

4 CHAIRMAN GENSLER: Right. So if
5 discretion's retained, it's over a security-based
6 swap and at the SEC, but if it's what's the
7 classic broad-based indices, whether it's sort of
8 iTraxx or CDS in this marketplace. Those would be
9 considered swaps as I understand it, generally
10 speaking.

11 And then could you comment on the
12 anti-evasion provision a little further as to what
13 we did there?

14 MR. HAMMAR: Well, essentially what we
15 did was our proposed rule further defines as a
16 swap a transaction that has been intentionally
17 entered into to evade Dodd- Frank Act
18 requirements. We are comfortable. Our general
19 counsel's comfortable that we have the authority
20 to do this. And we think that it makes, you know,
21 it makes sense.

22 What it would do is we would treat the

1 transaction as a swap and we have intent built
2 into it, so that, you know, people will -- you
3 know, it will have to be shown that somebody
4 intentionally structured it to evade, you know,
5 not -- and if they have a valid business purpose
6 or something like that, you know, then they have a
7 valid defense. So we think it is cabined in
8 enough so that, you know, the market won't be, you
9 know, chilled.

10 CHAIRMAN GENSLER: So what you're --
11 Dan?

12 MR. BERKOVITZ: That's correct. We've
13 examined the precedent for anti-evasion language
14 in other statutes and case law and interpretation,
15 and generally agencies are given a wide range in
16 applying anti-evasion. We have narrowly crafted
17 it, as Julian mentioned, so that it has to be
18 structured willfully to evade the definitional
19 requirements in order for the instrument to be
20 captured within under this provision. And one of
21 the factors is whether it's a legitimate business
22 purpose for structuring the transaction in that

1 particular manner. But we're comfortable with the
2 proposal.

3 CHAIRMAN GENSLER: Thank you.
4 Commissioner Dunn?

5 COMMISSIONER DUNN: Thank you, Mr.
6 Chairman. I commend the staff for the tough work
7 on putting this interp out. I note that the ANPR
8 went out back in August of 2010, with closing in
9 September of 2010. And staffs between the CFTC
10 and SEC worked jointly on putting these proposals
11 together. And as staffs often do, they do have
12 different interpretations of who's in charge of
13 what. And Mr. Chairman, I commend you and
14 Chairwoman Schapiro for the direction given the
15 staffs and getting us to where we are.

16 Julian, could you elaborate on what are
17 the major areas of difference between what the SEC
18 is proposing today and what we have here in the
19 CFTC proposal?

20 MR. HAMMAR: Yes, Commissioner. We have
21 -- I guess there are four areas where we have
22 differences with the SEC. The first is

1 anti-evasion, although that is because our statute
2 requires us to further define swap and
3 security-based swap to prevent evasion whereas the
4 SEC has discretionary authority to do so under the
5 statute. And so they are requesting comment on
6 the issue.

7 So the remaining three are the ones that
8 staff had differences on and those are insurance
9 on swaps, whether they should be regulated swaps
10 or security-based swaps; swaps linked to futures
11 on the 21 foreign sovereign debt securities that
12 SEC has exempted for purposes of futures trading;
13 and the last one is with respect to index CDS,
14 whether if the index is provided by a third party
15 index provider and it's listed for trading on a
16 DCM, SEF, or registered FBOT, whether that should
17 be under the CFTC's jurisdiction and satisfy
18 what's called the public information test prong of
19 the index CDS test.

20 But, you know, overall, you know, in my
21 judgment, I mean, this is an over 300-page
22 document. The staffs did reach agreement on a lot

1 of topics and on a comprehensive rule-making
2 covering various topics. So I -- you know, we do
3 have these areas, but, you know, we expressed our
4 different views. And we're requesting comment to,
5 hopefully, better inform you and they to inform
6 the SEC on the appropriate treatment of these
7 products.

8 COMMISSIONER DUNN: I note that there is
9 a provision that a person can ask for a joint
10 interpretation when they seem to be at loggerheads
11 and that there is a period of time that the two
12 commissions are required to answer that request
13 for a joint interpretation. Could you amplify on
14 that a bit?

15 MR. HAMMAR: Sure. Yes, under the
16 process the two commissions would have 120 days in
17 order to make a determination, you know. Based on
18 our past experience and, you know, some of these
19 new products with the SEC, you know, lots of times
20 these things have gone on, you know, for years
21 sometimes. And so we thought that, you know, it
22 would be good to have a process where people can

1 come in, request an interpretation about the
2 status of their instrument, and within a set
3 timeframe. And moreover, if we can't do it in the
4 120-day period of time, we will publicly state our
5 reasons why we can't so that there is
6 accountability as well. So we think that that is
7 a very good proposal.

8 COMMISSIONER DUNN: Thank you, Julian.
9 Mr. Chairman, I know other commissioners have
10 questions, so I'll yield back to you.

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

13 COMMISSIONER SOMMERS: Thank you, Mr.
14 Chairman. I have a couple of different questions,
15 first of all, on the issue that I raised in my
16 opening statement on the multilateral development
17 institutions.

18 And I have a question with regard, I
19 guess, first of all, to say thank you for the
20 discussion and questions that you had drafted that
21 were in the earlier draft, but to ask whether or
22 not you believe that there are any specific

1 concerns that you have with asking these
2 questions. I intend on putting them in a dissent
3 and ask you if you have any concerns with asking
4 questions with regard to their concerns.

5 MR. ARBIT: Commissioner, we have
6 included those questions in the draft for sort of
7 discussion purposes, and they certainly serve that
8 purpose. As staff thought about the issues some
9 more which had come up kind of late in our process
10 our concern about it was that it was focusing, as
11 you say, on a very legitimate question, but in the
12 wrong place. This is a product definition
13 rule-making whereas Julian was explaining we're
14 trying to provide guidance to the public what is a
15 swap, what isn't a swap, and how you distinguish
16 swaps from security-based swaps. I think
17 everybody agrees that these products by these
18 multilateral development institutions are swaps.
19 So staff was reluctant to ask questions about
20 whether there should be exclusions to the swap
21 definition based on the party that's entering into
22 the transaction. I think that's -- to use the

1 phrase -- the very slope that we prefer not to go
2 down.

3 We have met with some of these
4 organizations and what we have stressed to them is
5 that what staff believes would be more helpful
6 information, the questions would be more helpful
7 to us, is to talk about these entities and these
8 transactions in the context of the specific
9 requirements of Dodd-Frank: The clearing
10 requirement, capital margin requirements,
11 reporting requirements. And help us try to
12 understand where difficulties may exist and where
13 there may not be difficulties. If they're carved
14 out of the soft definition, they're out, the
15 counterparties are out, and that was the concern.
16 It may be that there are good and valid reasons
17 why certain requirements under Dodd- Frank should
18 not apply and those are questions that we would
19 much prefer to be discussing with these kinds of
20 organizations.

21 COMMISSIONER SOMMERS: I appreciate
22 that. I don't have a specific solution in mind

1 for how to take care or address their concerns.
2 But because we have not included any of these
3 questions in previous proposals, I'm just hoping
4 that by including some questions with regard to
5 it, we'll be able to get comment and then put it
6 in wherever staff agrees is an appropriate place.

7 An additional question I have on this
8 subject is with regard to their comment letter,
9 which is on behalf of a number of the multilateral
10 development institutions, and they reference
11 different privileges and immunities that are
12 conferred on them by a series of statutes dating
13 back to Bretton Woods. And I'm wondering whether
14 you have analyzed our regulation of the activities
15 of these entities and whether or not they would
16 conflict with any of these other statutes and the
17 immunities or privileges that have been granted to
18 them.

19 MR. ARBIT: We have read those letters
20 and we have considered the issue. I don't think
21 we've reached, from staff's point of view, a firm
22 judgment on it. Those certainly are important

1 questions that we do need to determine how, when
2 Congress layered on the Dodd-Frank, how that does
3 apply to preexisting statutory regimes. And so
4 there is the question of the authority and the
5 extent to which the Commission can reach some of
6 these activities. We welcome comment on that
7 question.

8 I would also say in a related vein,
9 because you had -- Commissioner, you referenced
10 the multilateral development institutions, but
11 there's, you know, various other sorts of
12 international organizations as well. And the
13 question of the extra territorial reach of Title
14 VII is also a question that just permeates all of
15 the efforts that the Commission is undertaking.
16 We got some very thoughtful comment letters in
17 response to various proposed rule- makings and the
18 Commissioner's extra territorial application of
19 Title VII, and those are issues that the staff is
20 working on as people start looking to develop
21 final rules on the specific requirements.

22 COMMISSIONER SOMMERS: Thank you. I

1 think for the record I'd also like to note that in
2 the EU draft, EMIR considers the status of these
3 entities and suggests that their regulation will
4 not apply to them. So in order to be consistent
5 with our international counterparts, I think that
6 this is something that we should consider.

7 On a couple of other issues where we
8 have inconsistencies and in reference to
9 Commissioner Dunn's question with regard to where
10 there are differences, I'm wondering on both of
11 the issues of the insurance wraps and the futures
12 on sovereign debt, I'm wondering what your
13 concerns would be with taking the SEC's approach
14 on either one of those issues, and specifically on
15 the insurance wraps. Would those policies go
16 unregulated if we were to adopt the SEC's
17 approach?

18 MR. HAMMAR: Well, I guess, in the case
19 of insurance on swaps that would really be up to
20 the state regulators how they would want to
21 address that if, you know, we didn't deal with it.
22 And I guess, you know, we were concerned with

1 respect to the mono lines, that this was an issue.
2 And, you know, we are -- you know, we haven't sort
3 of definitively stated that insurance on a swap is
4 a swap. We are requesting comment on it, though,
5 because of the economic similarities that we think
6 that could be drawn between the two. And, you
7 know, I guess, you know, we haven't really made up
8 our minds on that issue yet. So I think it's just
9 a matter of we'd like to get comment from the
10 public and, you know, see what they come back
11 with.

12 On foreign sovereign debt, I guess the
13 issue there really is that, you know, futures on
14 the foreign sovereign debt are traded on our
15 regulated markets, designated contract markets. I
16 think the CME just announced that they're going to
17 do yield spreads on the foreign sovereigns,
18 futures on them. And, you know, the issue is
19 really, you know, a guiding principle of Dodd-
20 Frank was whatever we had regulation over in
21 futures, we would have regulation over swaps in
22 order to prevent, you know, things like gaming and

1 arbitrage and, you know, that our regulatory
2 regime would apply. The SEC, though, has a
3 concern on their side because security-based swaps
4 and foreign sovereigns, the instruments
5 themselves, are subject to them as security-based
6 swaps. And so they see swaps on futures as a way
7 to game or get out of the SEC's regulatory regime.

8 I don't know what the resolution will be
9 and we're hoping to get some, you know, good
10 comments from the public how to deal with it, but
11 that's the approach we've taken.

12 COMMISSIONER SOMMERS: Thank you. I
13 appreciate that. I just want to say specifically
14 to this team I know that you've had lots of long
15 months and long hours putting all of this
16 together, and we realize that a lot of your
17 disagreements have ended in positive resolution,
18 so appreciate all of your hard work.

19 CHAIRMAN GENSLER: I would echo that and
20 extend that to the SEC, who's meeting today, too,
21 because there were a remarkable number of places
22 that the two staffs and the two commissions could

1 find disagreement and there were hundreds of
2 places where we found resolution and agreement.
3 And if there's two or three that we're asking the
4 public for further help on, it's really -- to
5 bring more into the discussion on these two or
6 three and, of course, bring the public into where
7 we've reached resolution as well. Because, you
8 know, final rules always change from the
9 proposals.

10 Commissioner Chilton?

11 COMMISSIONER CHILTON: Thank you, Mr.
12 Chairman. The one thing about following
13 Commissioner Sommers is a lot of times it hurts my
14 interest in something, so thank you for that,
15 Jill.

16 I'm curious, Mr. Berkovitz, if the
17 questions in Commissioner Sommers dissent get
18 comments, can we include those comments as part of
19 the decision-making process for the rule, the
20 final rule? And if the Commissioner,
21 theoretically, all thought that the comments said
22 something and that we wanted to make a change

1 reflective of the questions, is that something we
2 could incorporate in a final rule?

3 CHAIRMAN GENSLER: Dan, can you broaden
4 it to final rules? Because it might elicit
5 comments on other rules.

6 MR. BERKOVITZ: Yes, Commissioner
7 Chilton and Mr. Chairman, that if we did receive
8 comments on those questions, the Commission would
9 be able to consider them and evaluate them and
10 incorporate responses into the final rules. We
11 would be able to do that.

12 COMMISSIONER CHILTON: Okay. So we have
13 the latitude to alter the rule because of the
14 questions that are asked in a dissent?

15 MR. BERKOVITZ: If the comment is
16 submitted to the Commission it wouldn't
17 necessarily depend on how the comment or what
18 motivated the comment or what prompted the
19 commenter to submit that comment. As long as the
20 comment was relevant to the Commission's rule and
21 pertained to something in the Commission's rule,
22 the Commission could consider it in many instances

1 if it was a material comment that went to a
2 material comment that went to the substance of the
3 rule the Commission would be actually obligated to
4 consider it, so.

5 COMMISSIONER CHILTON: I'm sorry. Then
6 I'm just wondering, Dan, is it an easier mechanism
7 for the public to comment on a question that the
8 Commission would ask as part of the rule as
9 opposed to an individual commissioner -- in this
10 case Commissioner Sommers -- asking as part of her
11 dissent? I mean, would it be an easier logistical
12 mechanism for the staff to be looking at these
13 questions as part of the actual proposal as
14 opposed to as part of a commissioner's dissent?

15 MR. BERKOVITZ: In terms of the staff
16 reviewing the comments, it's been my experience
17 and my observation to date -- and we've gotten
18 many, many, many comments and the staff is working
19 very hard to summarize all of the comments. We
20 have a late comment policy where it's
21 discretionary to consider them and we have
22 considered them in a number of instances, and

1 staff has to date been able to incorporate all of
2 those to the same extent. So to date we've been
3 able to accommodate all the comments regardless
4 of, as I said, what might have motivated the
5 commenter. I hope I'm answering the question. I
6 might have missed it.

7 CHAIRMAN GENSLER: There's a mechanical
8 thing on a joint rule, if I might, Commissioner
9 Chilton, that this is a joint rule with the SEC
10 that they're voting on at the same time. So that
11 also is sort of a unique circumstance on this
12 right here.

13 COMMISSIONER CHILTON: So, Mr. Chairman,
14 so are you suggesting that if we added questions
15 in our proposal that that might cause some
16 idiosyncratic issues with the SEC's proposal?

17 CHAIRMAN GENSLER: Well, actually I
18 don't think we can just as a matter of -- like
19 their vote -- I don't know if they voted on it 10
20 minutes ago or in half an hour from now. They're
21 meeting today and voting on a joint rule in the
22 same document.

1 COMMISSIONER CHILTON: Well, let me just
2 ask Mr. Berkovitz -- unless you know, Mr. Chairman
3 -- would questions somehow obfuscate the actual
4 thing that we're doing in the rule or do we have
5 to have it just letter for letter, you know,
6 dotted I for dotted I on the proposal?

7 MR. BERKOVITZ: Well, let me try to
8 answer that. I hope I'm answering the right
9 question.

10 Clearly, if the questions are within the
11 four corners of the Commission's proposal, the
12 proposal that the Commission has put forth -- and
13 the Commission in the this case, the joint
14 commissions -- if the questions are within that
15 document and the Commission considered a comment
16 that was resulting from those comments and then
17 the Commission in the final rule went a certain
18 direction because of those comments, the
19 Commission -- and it varied from the proposed rule
20 -- the Commission would have a very strong case
21 that what it was doing was a logical outgrowth and
22 the public was on notice that the Commission was

1 considering this alternative.

2 If it's just in the case of a
3 commissioner through a separate opinion or through
4 a public speech or something outside of the four
5 corners of that document that suggest to people
6 please submit your comments, we will consider
7 them, as I said, the staff is obligated to
8 consider the comment no matter how it's received
9 if it's on the rule. It might be more difficult
10 for the Commission to modify the final rule as a
11 logical outgrowth and that the public was on
12 sufficient notice if it came through one of those
13 different avenues rather than the four corners of
14 the text. But that might be a different -- where
15 it would make a difference. But, then again, it
16 would depend on the circumstances or particular
17 circumstances of the rule.

18 COMMISSIONER CHILTON: All right. Thank
19 you. Well, I commend Commissioner Sommers for
20 asking some questions and I hope we get comments
21 on them.

22 I just have one final thought and that

1 is that this group has done a really good job on
2 what I know is an arduous task. I remember right
3 when Commissioner Sommers and I started I had a
4 meeting with -- I won't say who, but one
5 individual who was concerned about an issue that
6 Commissioner Sommers had also raised a bunch of
7 times on portfolio margining. And this individual
8 said, well, that won't get resolved until
9 so-and-so at the SEC dies or retires. And that's
10 not the way that government should work. You
11 know, the staff could only do so much and then it
12 will come up to the commissioners. And I think
13 there's been some lack of leadership over the
14 years because the staff just comes to loggerheads.
15 And so this will require us on some of these
16 issues that haven't been resolved to actually make
17 a decision, and I look forward to doing so in a
18 deliberative process, but one that's also
19 expeditious and realizes the urgency of doing some
20 of these things.

21 Thank you, Mr. Chairman.

22 CHAIRMAN GENSLER: Thank you,

1 Commissioner Chilton. Commissioner O'Malia?

2 COMMISSIONER O'MALIA: Thank you. And
3 following Jill and then following Bart, I always
4 learn something and I think that discussion,
5 Commissioner Chilton, was very helpful and I
6 appreciate you asking those questions.

7 Julian, I would like to go back to the
8 insurance wrap issue. And if you could just
9 characterize the differences between the two
10 positions right now and just enlighten me to the
11 thinking behind why we came up with two different
12 proposals.

13 MR. HAMMAR: Yes. Well, Commissioner,
14 the SEC believes that insurance on a
15 security-based swap should not be considered a
16 security-based swap. And in the preamble, we ask
17 the -- we say that the insurance may have, you
18 know, characteristics that, you know, what we're
19 asking about is, you know -- what we're really
20 trying to do is just how we distinguish it or, you
21 know, are they the same? You know, what -- you
22 know, how do we deal with it? And so we're asking

1 comments about, you know -- because the thing is
2 if, you know, you're insuring a swap, you know, in
3 some sense you are, you know, taking on the
4 economic exposure of the counterparty to the swap.
5 And, you know, in the case of CDS in particular,
6 the distinction is quite blurry and so we are
7 requesting comment on it.

8 COMMISSIONER O'MALIA: Yes. Well, I
9 think it's a great question because I do agree
10 that it is a blurry area, I mean, especially with
11 some of the products that have come out related to
12 CDS. So I think I'm quite comfortable with that.

13 Let me ask you about the forward
14 exclusion. As I read it the forward exclusion
15 would consider to work the same way after this
16 rule is implemented as it works today. Is that
17 your -- is that the consensus of what your reading
18 is?

19 MR. HAMMAR: Yes. That's essentially
20 correct. We are extending it to all non-financial
21 commodities, though, which in the past was the
22 Brent oil and then Energy expanded it to certain

1 other energy commodities. And we are -- but the
2 basic gist of it, the book-out transactions would
3 be excluded if they're entered into by commercials
4 in reliance on the guidance and brand interp.

5 COMMISSIONER O'MALIA: Okay. I am a
6 little uncertain about a fix for floating interest
7 rate swap entered into in connection with a bond
8 offering made by a municipality or a loan given to
9 a corporation. So will we have jurisdiction over
10 the swap or does the SEC have jurisdiction over a
11 floating fix for --

12 MR. HAMMAR: If it's an interest rate
13 swap we would have jurisdiction.

14 COMMISSIONER O'MALIA: Okay. The FTR
15 process, who will have to apply for an FTR
16 exemption under the provision we've provided,
17 under 722?

18 MR. HAMMAR: That's right. Yes, we
19 aren't actually addressing that issue in this. We
20 are saying that people will have to go through the
21 Section 722 process to list an exemption.

22 COMMISSIONER O'MALIA: Okay. If we

1 exempt the FTR from regulation under this separate
2 process could you -- and maybe this is outside
3 your reach here, but will the RTO or ISO that that
4 FTR trades on also be exempt from regulation? Are
5 we regulating the product or the entity?

6 MR. ARON: Well, actually I think that's
7 part of a separate team going to brief you. Is it
8 tomorrow? So that's what that other team is
9 considering right now. You know, they're coming
10 in actually Friday again and speaking to, you
11 know, Bob Wasserman and the rest of our team about
12 that, so, you know, it's going towards an order on
13 that, but to be determined by the Commission, of
14 course.

15 COMMISSIONER O'MALIA: Great, thank you.
16 Again, let me offer my -- you know, there's no way
17 I'm going to go through all 300 pages and
18 questions and ask you every question I have on
19 this one, but I do think time is overdue for this
20 rule-making. It is essential going forward, so
21 I'm pleased to get comment on it. It is
22 complicated, it is extensive, and I know the

1 public will need plenty of time to take a look and
2 digest all of this. So I'm happy to put it out
3 and support this to get the comment on it and look
4 forward to all the input coming back. So thank
5 you very much for all your hard work.

6 CHAIRMAN GENSLER: I do have one
7 question, Dan, if I -- because I thought
8 Commissioner O'Malia was talking about this issue
9 of electricity contracts traded on regional
10 transmission organizations and ISOs as well. And
11 it might be helpful for the public just if you
12 want to give a little briefing. I know it's
13 unusual, but just take two minutes and say, where
14 does his stand. I know some of the -- you've had
15 not just you, but the clearing folks and other
16 folks have had extensive meetings with these
17 organizations and they do plan to put an order and
18 -- put a request in front of us. But could you
19 give us a little bit more?

20 MR. BERKOVITZ: Yes, Mr. Chairman, and I
21 think this is consistent with the approach Terry
22 was mentioning earlier in connection with how to

1 treat the consequences of something being a swap
2 or not. These instruments are instruments that
3 are used by regional transmission organizations
4 and participants in the electricity market to
5 provide some type of financial protection,
6 financial certainty for -- in the transmission of
7 electricity. The question that the agency has
8 been asked is, are these swaps? And if they're
9 swaps, how would they be regulated? These
10 instruments are used in regional transmission
11 organizations which are basically regulated by
12 FERC, so there's the question of whether it's CFTC
13 or FERC regulation.

14 Congress provided in Dodd-Frank a
15 specific provision that if the Commission finds
16 it's in the public interest to exempt these from
17 regulation, that these instruments that are within
18 FERC's jurisdiction, that it shall do so. So we
19 have received many requests are these swaps, and
20 the agency -- the staff's response is we will
21 treat these through the process that Congress set
22 out in Section 4(c) to consider whether they

1 should be exempted. So the regional -- we've been
2 on occasion discussions with the regional
3 transmission organizations and these participants
4 in the electricity market to determine what would
5 be the appropriate terms and conditions of any
6 exemptive order that the Commission would consider
7 so that we could make such a public interest
8 finding and not regulate these instruments.

9 We've been in discussions with the
10 regional transmission organizations. We have had
11 a very productive interchange of -- exchange of
12 information, the types of information that we
13 would need to make such a finding that it would be
14 in the public interest for an exemption to be
15 issued; the types of information that we would
16 need them -- to be submitted from them. And that
17 process, that dialogue is going back and forth

18 with the ultimate goal that they would be able to
19 submit a document to us that we could consider.

20 CHAIRMAN GENSLER: I thank you. I don't
21 know if any of them are listening, but I look
22 forward -- I personally look forward to their

1 submission. I think that would be very
2 constructive and consistent with congressional
3 intent, so that'd be good.

4 And I also want to thank all my fellow
5 commissioners, particularly on this rule. I know
6 that you've been patient. There's been the staff
7 negotiations. There's even been the chairman
8 negotiations. But I really -- and I thank you for
9 highlighting the need for this one to be done and
10 so a personal thanks to all of you that gave me
11 your support and the staff support to end up with
12 what I think is nearly total agreement with the
13 SEC. There are these two or three items, but --
14 and I look forward to the public.

15 But with that, Mr. Stawick, would you
16 care to call the roll?

17 MR. STAWICK: Commissioner O'Malia?

18 COMMISSIONER O'MALIA: Aye.

19 MR. STAWICK: Commissioner O'Malia, aye.
20 Commissioner Chilton?

21 COMMISSIONER CHILTON: Aye.

22 MR. STAWICK: Commissioner Chilton, aye.

1 Commissioner Sommers?

2 COMMISSIONER SOMMERS: No.

3 MR. STAWICK: Commissioner Sommers, no.
4 Commissioner Dunn?

5 COMMISSIONER DUNN: Aye.

6 MR. STAWICK: Commissioner Dunn, aye.

7 Mr. Chairman?

8 CHAIRMAN GENSLER: Aye.

9 MR. STAWICK: Mr. Chairman, aye. Mr.
10 Chairman, on this question the yeas are four, the
11 nays are one.

12 CHAIRMAN GENSLER: The vote being in the
13 affirmative I look forward to hearing from the SEC
14 if their vote's affirmative, and then I guess
15 we'll jointly send it to the Federal Register.
16 But I thank you so much.

17 And whoever is up next, is it capital or
18 segregation? Who is it? Segregation, Mr.
19 Wasserman and team.

20 I also want to thank -- I see Dave
21 Johnson came back for a cameo. Dave Johnson's one
22 of our excellent staff who now works for Senator

1 Pat Roberts and it's just always good to see
2 alumni here.

3 The next group of presenters will
4 include Bob Wasserman, John Lawton, Nancy
5 Schnabel, Laura Astrada -- all from the
6 Commission's Division of Clearing and Intermediary
7 Oversight -- as well as Martin White from the
8 Office of the General Counsel. They'll present
9 the staff report on the proposed rule concerning
10 protection of cleared swaps, of customer contracts
11 and collateral. There's also certain conforming
12 amendments to the commodity broker bankruptcy
13 provision. We benefited by significant public
14 input through Advance Notice of Proposed
15 Rule-Making and many other meetings. So I turn it
16 over to the team.

17 MR. WASSERMAN: Thank you, Mr. Chairman.
18 I'm Bob Wasserman, lead for the Segregation
19 Bankruptcy Team. And I'd first like to express my
20 deep appreciation to my deputy, Nancy Liao
21 Schnabel, and the other members of the team;
22 Martin White of the Office of General Counsel; my

1 DCIO colleagues Laura Astrada, Jon DeBord, and
2 Jennifer Bauer; and from the Office of Chief
3 Economist David Reiffen and Todd Prono. This work
4 simply could not have happened without their
5 assistance.

6 As the Chairman mentioned, last November
7 the Commission published an advanced notice
8 proposed rule- making seeking to obtain comment
9 about the issues of segregation and bankruptcy
10 and, in particular, cost issues relating to four
11 models: A model for complete physical
12 segregation; a model for complete legal
13 segregation that had been referred to as legal
14 segregation with commingling; a model for legal
15 segregation with recourse that had been referred
16 to as moving customers to the back of the
17 waterfall; and the futures model which had been
18 referred to as the baseline model.

19 The Commission asked members of the
20 public to detail the costs they would incur and
21 the benefits they would enjoy under those
22 potential models. We received more than 30 very,

1 very thoughtful comments from swaps customers,
2 investment managers, futures commission merchants,
3 and derivatives clearing organizations. These
4 comments included a variety of keen observations:
5 That swaps are significantly different from
6 futures; that swaps customers were accustomed to
7 bearing the cost and enjoying the benefits of
8 individual collateral protection; that the futures
9 model includes implicit costs to customers; and
10 that the moral hazard issue applies both to
11 derivatives clearing organizations' incentive to
12 risk manage its FCM members as much as to a
13 customer's incentive to risk manage its FCM.

14 In the comments derivatives clearing
15 organizations and firms expressed great concerns
16 about the costs and about the very real transfer
17 of wealth they would bear if customer collateral
18 were protected individually. With mandatory
19 clearing of swaps baseline amounts of all cleared
20 swaps, customer collateral margin that is, and
21 clearing guarantee funds. Amounts required
22 completely independent of this rule-making will be

1 many times larger than the corresponding amounts
2 for futures today. Under the assumptions in those
3 comments, one or both of these amounts would
4 increase significantly depending on the model for
5 customer collateral protection adopted by the
6 Commission.

7 ISDA noted the critical importance of
8 the ability to support positions of non-defaulting
9 swaps customers in the event of an FCM insolvency
10 rather than liquidating those positions en masse.
11 And the DCO observed that an FCM default could be
12 perceived by a gradual decline during which
13 customers transferred positions and collateral to
14 other FCMs, thereby rendering reliance on the
15 collateral of those customers for use in a default
16 scenario, potentially imprudent, and calling into
17 question some of the cost estimates discussed
18 previously.

19 As part of this process, we've also
20 consulted with fellow financial regulators, both
21 domestically and outside the U.S. In light of
22 these comments, and in particular the fact that

1 (inaudible) side commenters indicated that they're
2 accustomed to bearing the cost of individual
3 collateral protection and the importance of
4 portability, the Notice of Proposed Rule-Making
5 before you proposes the complete legal segregation
6 model. Staff believes that this model strikes the
7 best balance between achieving the goals of
8 customer collateral protection and fostering
9 portability at the least cost.

10 The cost, however, does remain a
11 continuing concern. And as a number of
12 commissioners have alluded to earlier, the NPRM
13 asked for comment on a very broad and deep variety
14 of questions concerning alternative models,
15 including legal segregation with recourse, the
16 futures model, and various optional models.

17 The discussions of optionality note the
18 limitations of the bankruptcy code, in particular
19 the requirement for ratable distribution. We look
20 forward to comments on these issues to help us
21 decide how to proceed.

22 I should note that this Notice of

1 Proposed Rule- Making has a fairly wide scope of
2 areas for natural outgrowth.

3 I'd like to spend just a few moments
4 discussing some of the specifics in the proposed
5 regulations. I should note that regulations in
6 proposed Part 22 apply only to cleared swaps
7 contracts and collateral. They do not affect
8 futures or futures customer collateral.

9 Sections 22.1 through 22.10 in the
10 proposal set forth the basic architecture for
11 segregation cleared swaps customer collateral and
12 mostly parallel or in a number of cases
13 incorporated by reference Regulations 1.20 to 1.30
14 and 1.49, which are the corresponding regulations
15 for futures. The definitions in Section 22.1
16 embody a recognition that 4(d) orders that the
17 Commission has issued previously which permit
18 commingling in a futures account of foreign
19 futures or swaps transactions now under Dodd-Frank
20 may also be issued pursuant to 4(d)(f) of the
21 Commodities Exchange Act to permit commingling in
22 the swaps account of exchange-traded futures or

1 foreign futures transactions.

2 To have cleared swaps accounts treated
3 in accordance with U.S. bankruptcy law, Regulation
4 22.8 in the proposal requires that the situs of
5 the account relationship between FCMs and their
6 cleared swaps customers and between DCOs and their
7 FCM members be located in the U.S. That speaks to
8 the account relationship. The location of the
9 actual collateral is regulated in 22.9 and
10 incorporates the existing Regulation 1.49 as it
11 applies to futures or, indeed, 1.49 as it may be
12 changed in the future.

13 Proposed Regulations 22.11 through 22.16
14 implement the complete legal segregation model,
15 establishing a structure by which risk information
16 is passed upstream daily. Swaps may be cleared
17 through a multi-tier system with certain FCMs
18 clearing swaps directly and other FCMs clearing
19 swaps for customers through one or more
20 intermediate FCMs.

21 22.11 requires clearing member FCMs to
22 daily provide their DCOs information identifying

1 the portfolio cleared for each swaps customer.

2 22.12 requires DCOs to calculate daily
3 the amount of collateral required for each
4 customer. A DCO, however, will not be required to
5 monitor whether a cleared swaps customer has, in
6 fact, posted sufficient collateral. If not, the
7 FCM essentially will have made a loan outside of
8 the relationship with the DCO.

9 Proposed Regulation 22.13 sets forth two
10 tools that DCOs may use to manage the risks they
11 incur. A DCO may increase the collateral required
12 of particular cleared swaps customers or may
13 require FCM members to post additional collateral
14 out of their own funds. And I should note that
15 these tools are neither mandatory nor exclusive.

16 Proposed Regulation 22.14 requires an
17 FCM that fails to meet a margin call to provide
18 such information and collateral from
19 non-defaulting swaps customers as it has.

20 And 22.15 requires a DCO to treat the
21 collateral of each cleared swaps customer as
22 belonging to that customer. I should note that

1 what is protected is the value of the collateral,
2 not any specific item. I should also note that
3 the proposed rule-making discusses the changes to
4 22.15 that would be made in the event the
5 Commission were to choose to adopt the segregation
6 -- excuse me, the legal segregation with recourse
7 model. And I should also note that if the
8 Commission were to choose to adopt the futures
9 model, essentially a number of these provisions
10 would not need to be adopted. So, in other words,
11 they would not be replaced, but rather some would
12 be pulled back.

13 I'm going to take just a few moments to
14 talk about the cost of supervision and oversight,
15 another issue that was of concern that was
16 mentioned previously. Day-to- day implementation
17 of these proposed rules is sufficiently similar to
18 the existing futures rules that for any model that
19 the Commission may adopt on final rule-making we
20 do not expect a significant difference in
21 monitoring, methodology, or cost over the present,
22 either with respect to DSRO supervision if they're

1 member FCMs or with respect to CFTC staff
2 supervision of DCOs.

3 Now, again, I'm speaking solely with
4 respect to this rule. Obviously there are a lot
5 of complications introduced by Dodd-Frank in terms
6 of clearing swaps, and I'm not speaking of
7 additional costs there, just with respect to this
8 rule. And I should also note that because of the
9 changes in risks, DCOs may well change the
10 intensity of their supervision of their members'
11 risk management of customers.

12 The amendments to Part 190, the
13 Commission's FCM bankruptcy regulations, are
14 technical and conforming. For example, references
15 to DCMs are amended to include parallel references
16 to swaps execution facilities. Some amendments do
17 apply to exchange-traded futures, but only with
18 respect to an FCM and bankruptcy.

19 And I should note proposed amendments to
20 Rule 190.06 clarify that nothing constrains the
21 contractual right of a clearing organization to
22 liquidate open commodity contracts and, in order

1 to promote portability, prohibits the trustee from
2 avoiding certain pre-partition transfers made by a
3 clearing organization on behalf of customers.
4 Partial transfers which are provided for in the
5 current rule are still permitted because a
6 transfer of all contracts and all accounts may be
7 impractical.

8 I thank you for your attention and would
9 be happy to answer your questions.

10 CHAIRMAN GENSLER: Thank you. I'll
11 entertain a motion to support the staff
12 recommendation on segregation of cleared swaps.

13 COMMISSIONER SOMMERS: So moved.

14 COMMISSIONER O'MALIA: Second.

15 CHAIRMAN GENSLER: I thank you. I will
16 support the rule on protection of cleared swaps,
17 but I do have a few questions and I have a
18 statement that will go, you know, into the record.

19 But, Bob, as I understand it, we put out
20 four options in this ANPR earlier. Is that
21 correct?

22 MR. WASSERMAN: Yes.

1 CHAIRMAN GENSLER: And where this comes
2 out is though it has rule text and there's a
3 preferred path called legal segregation with
4 operational commingling -- first, did I get the
5 title right?

6 MR. WASSERMAN: I think at this point
7 we've decided to call it complete legal
8 segregation to distinguish it from --

9 CHAIRMAN GENSLER: All right. Maybe if
10 I call it complete legal segregation it comes out
11 with that, though is it correct the funds could be
12 operationally commingled?

13 MR. WASSERMAN: Yes, indeed, under all
14 of the models that we're continuing on, they --

15 CHAIRMAN GENSLER: Okay. So, but as the
16 rule text comes out with that, as I understand it,
17 there's a series of well-written questions and
18 options that retains this Commission's flexibility
19 that in the final rule we might go with one of the
20 other options that (inaudible) in this document.
21 Is that correct?

22 MR. WASSERMAN: Correct.

1 CHAIRMAN GENSLER: And, Mr. Berkovitz,
2 is that correct? I just want to get the general
3 counsel on the record. You can come back to the
4 table and I'll ask it. He's got that BlackBerry
5 all the time.

6 The question is though we've in the rule
7 text on this proposed one path and that path is
8 this legal segregation with what I'll call
9 operational commingling, there are these other
10 paths that are pretty fully described in the
11 preamble. Does that retain our flexibility? You
12 know, when the commenters come in it's, you know,
13 four to six months from now, we have some
14 flexibility here in the final rule.

15 MR. BERKOVITZ: Yes, Mr. Chairman.
16 We've looked at this and we believe that there's
17 adequate notice to the public that the Commission
18 is considering these alternatives and we're
19 providing -- seeking comment. And we believe it
20 satisfies the APA requirement for adequate notice
21 and opportunity for comment on the proposed action
22 and the alternatives in the document.

1 CHAIRMAN GENSLER: I ask that because I
2 think it's very important for this Commission to
3 retain that flexibility, but also for the public
4 to understand that we have that flexibility. So
5 what Bob described on optionality, that the
6 clearinghouses would have optionality, we could
7 put that into the final rule text, correct, if we
8 -- you know, subject to public comment, et cetera?

9 MR. BERKOVITZ: Yes, Mr. Chairman.

10 CHAIRMAN GENSLER: And so the people
11 should take as seriously the preamble as they're
12 taking the rule text, that there are a number of
13 paths, the optionality's an important one, we can
14 put that in the final rule.

15 MR. BERKOVITZ: We would consider it if
16 it were to be adopted, presumably. Obviously we'd
17 look at the final document, but sufficient
18 flexibility, that would be a logical outgrowth of
19 what's being considered and there's adequate
20 notice and opportunity for public comment.

21 CHAIRMAN GENSLER: Right. And in the
22 same way I want to make sure -- because there's a

1 lot of people that will comment on this. I gather
2 -- I mean, from the commenters, the 32 comments
3 that came in the ANPR, that a number of firms on
4 what's usually called the "buy side" -- asset
5 managers, hedge funds, money managers, mutual
6 funds -- were concerned and wanted to have such
7 legal segregation. Is that correct?

8 MR. WASSERMAN: Yes.

9 CHAIRMAN GENSLER: Yes. But the
10 clearinghouses' letters, as I read them, raised
11 significant concerns about costs. Is that
12 correct?

13 MR. WASSERMAN: Most of them did. There
14 was at least one exception.

15 CHAIRMAN GENSLER: Right. So I suspect
16 the comments will come in on both sides of this
17 debate and that we still have the flexibility that
18 -- to the final rule to possibly do exactly what
19 we did here or move slightly away from it. Is
20 that correct?

21 MR. WASSERMAN: Yes, and thus I think
22 those on each side of the debate should have great

1 incentive to explain which models they like and
2 which models they don't like and why.

3 CHAIRMAN GENSLER: Yes. I mean, I will
4 say I support this because I think that the swaps
5 marketplace will be moving to clearing, that this
6 is consistent with congressional intent, that one
7 customer's funds or collateral are not used to
8 secure another customer's funds. And I think
9 Congress was specific about that. But we do have
10 the futures model that has allowed for some of
11 that for decades. So I very much look forward to
12 the public's comments. And I, too, am going to
13 keep an open mind on this, but -- because I think
14 that we've made a proposal here, but we've clearly
15 indicated to the public there's a very close
16 second or third that might get -- you know,
17 depending upon public comment, still is keeping an
18 open mind towards.

19 Commissioner Dunn?

20 COMMISSIONER DUNN: My thanks to Mr.
21 Wasserman and his team. They did the ANPR. They
22 did the roundtable. And they've come up with this

1 proposed rule and this has been one that has
2 really taken a lot of time and effort, and I
3 appreciate what they have done in this arena.

4 Bob, I'd like to know in your opinion
5 which one of the proposals offers the best
6 protection to customers from other customers'
7 risk? And which proposal offers the best
8 portability for the customer?

9 MR. WASSERMAN: And I think that the
10 model that the proposal has, namely the legal
11 segregation with commingling or complete legal
12 segregation -- however we refer to it -- provides
13 the best protection for the customers in that
14 under that model the fellow customer collateral,
15 that is to say the collateral of the non-
16 defaulting customers, is protected from the start.
17 And because that money is essentially set aside
18 and cannot be accessed by the clearinghouse
19 because of the default of another customer, that
20 collateral then is available to support a transfer
21 to healthy FCM. I mean, healthy FCM is not, in
22 most cases, going to be eager to take a transfer

1 unless the positions are supported by collateral.
2 And so having that collateral available from the
3 beginning is, I think, most conducive to
4 portability.

5 COMMISSIONER DUNN: Is it contemplated
6 that there will be some type of risk assessment
7 made to allow the customers to know exactly what
8 they're at risk with the other entities involved?

9 MR. WASSERMAN: I'm not sure I
10 understand.

11 COMMISSIONER DUNN: Will the customer
12 know what's in the portfolio of the FCM they're
13 using? And is there some type of assessment that
14 will allow them to understand the risk that they
15 have in the lane that they take for this clearing?

16 MR. WASSERMAN: And so under the
17 complete legal segregation essentially their risks
18 would be separate from those of fellow customers
19 and so they would not be exposed to those risks.
20 Under a number of other options they would be
21 exposed to those risks. There are in the Notice
22 of Proposed Rule-Making some questions as to how

1 one might usefully advice customers of the risks.
2 One of the issues is there's some limitations as
3 to how far you can go on that. And so while there
4 might -- it seems to me -- and I should note that
5 we should, to a certain extent, wait from the
6 comments, but, on the one hand, you might
7 profitably give out certain information about an
8 FCM's policies in general. On the other hand,
9 it's unlikely that customers would feel
10 comfortable with FCMs sharing information with
11 other customers about their specific risks. So I
12 think there's some possibilities there, but also
13 some limitations.

14 COMMISSIONER DUNN: Then would it be
15 incumbent upon the CCP or for the Commission to do
16 some type of audit and financial review to
17 determine that risk?

18 MR. WASSERMAN: CCPs already, under the
19 present futures system, do that to a certain
20 extent. And we've seen some very excellent risk
21 management review programs and DSRO supervision
22 where -- unlike a customer where, of course, the

1 customer coming in does not have that kind of
2 relationship with the FCM to ask about fellow
3 customers; there are certain privacy issues. The
4 DCOs and the DSROs already are supervising their
5 members. And so when they ask questions, they
6 want to know what are you doing both as your
7 general policies and what are you doing with
8 respect to specific customers. The DSRO
9 essentially by rule has the power to essentially
10 demand that information and to obtain it.

11 And so I think what we will see is that
12 the DCOs will build upon the excellent programs
13 they already have. I think there may be some
14 sharpening of incentives to the extent that they
15 have some closer financial exposure, but I rather
16 expect that they'd be building on a base that's
17 already there, namely their existing risk
18 supervision programs.

19 CHAIRMAN GENSLER: Can I help out a
20 little? Isn't the answer just straightforward?
21 We as an agency can see into an FCM's risk, but a
22 customer can't.

1 MR. WASSERMAN: Yes.

2 CHAIRMAN GENSLER: All right. I think
3 that might be responsive.

4 MR. WASSERMAN: And the DC --

5 CHAIRMAN GENSLER: That's great. That's
6 it, isn't it?

7 MR. WASSERMAN: Yes.

8 CHAIRMAN GENSLER: It's just the
9 customer can't. I mean, you can answer other
10 questions, but isn't that what he's asked?

11 MR. WASSERMAN: Yes. We and the DCOs
12 can do that; the customers cannot.

13 COMMISSIONER DUNN: Thank you, Mr.
14 Chairman, because it then builds upon my next
15 question. And when you were saying that as far as
16 CFTC goes it's not going to require any additional
17 staff, but won't we have to be able to perform
18 some type of audit and financial review to make
19 that determination?

20 MR. WASSERMAN: Again, this is something
21 that we already supervise in terms of the risk
22 management that DCOs do with respect to their

1 members. And so I think there may be some
2 expansion of intensity, but it's essentially the
3 same sort of program that we're already doing.

4 And I think I'd add that we do
5 anticipate we would need additional staff for
6 overseeing DCOs that will get new products, new
7 members, and so forth. There'll be potentially
8 new FCMs. So in all those ways I think swaps
9 coming in will ultimately require more staff
10 probably in both the audit and review side and the
11 risk surveillance side. I think Bob's point is
12 simply it's not so much the specific terms of this
13 proposal as the general increase in number of
14 registered entities, increase in volume, increase
15 in number of products that they carry.

16 COMMISSIONER DUNN: What do we
17 anticipate, increase in FCMs from what we
18 currently have?

19 MR. LAWTON: I'm not sure that we've
20 come up with a number on that. I think that
21 really remains to be seen.

22 CHAIRMAN GENSLER: Yes. I think,

1 Commissioner Dunn, earlier last summer -- and I
2 think this has probably been modified -- last
3 summer we were at about 125 FCMs and staff had
4 said that preliminarily it might grow to as many
5 as 200. And I think that was part of some of our
6 budget work in the fall. But I think it would be
7 good if DCIO sort of now, you know, updates that,
8 particularly as we start to, you know, be more
9 engaged with Congress in our 2012 and even start
10 on 2013 budget submissions for OMB.

11 COMMISSIONER DUNN: Thank you, Mr.
12 Chairman. I thought the figure was 250. It may
13 have been in the 200 range. Thank you.

14 CHAIRMAN GENSLER: Commissioner Sommers?

15 COMMISSIONER SOMMERS: Thank you, Mr.
16 Chairman. To the team, this has been certainly no
17 easy task. I mean, I think that there are
18 legitimate concerns on both sides of this issue
19 with market participants in the swaps market that
20 want to preserve the framework they're used to
21 operating under and market participants in the
22 futures side who want to preserve their futures

1 model of doing business. And I certainly
2 appreciate everything you've done to kind of
3 balance the different interests that have been
4 involved in this rule-making.

5 From the beginning, I, because of those
6 two separate and distinct interests, had hoped
7 that we could preserve some type of optionality
8 because I didn't think that this Commission should
9 be in the business of picking winners and losers.
10 There are people who have frameworks already set
11 up to provide complete legal segregation. And if
12 that's the course we go, they will be a winner in
13 this. There are people who have, you know, of
14 course, the futures model set up. And if we go a
15 different direction, they will be losers. So I
16 was hoping throughout this whole rule-making that

17 we would be able to preserve some type of
18 flexibility and optionality, so I appreciate all
19 the work you've done to include that in this
20 proposal.

21 The question I have with regard to that
22 is the questions that we ask in the proposal about

1 the optionality, I know that you have specific
2 concerns about the bankruptcy code. And in one of
3 the documents we received it says that because the
4 bankruptcy code requires customer property to be
5 distributed ratably we cannot give customers the
6 option to choose. So if you can just quickly walk
7 through what type of optionality, I think there
8 are two different types of optionality we have
9 suggested, and what is in the proposal for
10 optionality.

11 MR. WASSERMAN: So as you quite
12 correctly noted, the concern is the requirement of
13 the bankruptcy code that customer property be
14 distributed ratably. And as the NPRM notes, we
15 have to this point looked at things by account
16 class with different types of products. So, for
17 instance, there is an account class for U.S.
18 exchange-traded futures, there's an account class
19 for foreign futures. We have built just about a
20 year ago an account class for OTC swaps, and
21 that's going to be essentially conformed in this
22 proposed rule-making regardless of which option

1 the Commission were ultimately to choose.

2 But we've not said, for instance, that
3 there be an account class each customer his own
4 account class, and it seems to me that that goes a
5 bit beyond what Congress let us do in the
6 bankruptcy code and in Section 20 of the CEA. But
7 there is mention of one possible approach that one
8 could take, which is if a particular FCM, that
9 legal entity, dealt with DCOs that followed a
10 particular model and only DCOs that followed that
11 particular model, then a ratable distribution
12 would follow that model.

13 And so, theoretically, and essentially
14 the NPRM mentions this is a possibility and seeks
15 comment on it, one could limit by the legal entity
16 -- now, of course, you could have multiple legal
17 entities that are affiliates and one is the legal
18 entity that deals with DCOs who adopt legal
19 segregation with commingling, another deals with
20 DCOs that adopt the legal segregation with
21 recourse or the futures model, and that is a
22 potential way to deal with it. There are, to be

1 sure, concerns in terms of competition and in
2 terms of market structure, but, you know,
3 ultimately that's for the commenters and we look
4 forward to hearing what folks say about the
5 practicality of that.

6 Fairly late in the process we had a
7 commenter mention possibilities, concepts of how
8 one might do this by taking funds out of customer
9 property and essentially leaving it to the DCO.
10 We asked some questions about that. I think we --
11 that concept very much needs further development
12 and it would be helpful to get comment that
13 provides that further development. On the other
14 hand, I think given that this is mentioned in the
15 Notice of Proposed Rule-Making it would likely
16 behoove all interested commenters to give their
17 views on that. I hope that's been responsive.

18 COMMISSIONER SOMMERS: Absolutely.
19 Thank you, Bob.

20 And I think that what I would encourage
21 is all the interested parties to specifically
22 comment on the costs associated with some of these

1 different options and whether or not it satisfies,
2 you know, the intent that we're meaning to bring
3 to this proposal.

4 And again, I wanted to say thank you to
5 this whole team. You've done a lot of thinking
6 outside the box to try to figure out what we can
7 do to solve some of these very complicated issues.
8 Thank you.

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

11 COMMISSIONER CHILTON: Just real
12 quickly, Mr. Chairman. I agree on knowing what
13 the costs are. And as Commissioner Dunn, you
14 know, asks all the time it's also interesting to
15 know what it's going to cost the agency and we
16 need to know what we think it's going to cost
17 consumers. I am interested in what Mr. Wasserman
18 was talking about there at the end about another
19 idea related to taking it out of customers'
20 property, so I look forward to comments.

21 I do think this is a good example of us
22 further fine-tuning where we might be headed.

1 I've been really impressed with the comments we
2 received and visited a bunch of folks around the
3 country on this issue, and it's been very helpful.
4 And this is what the rule-making process is about
5 because we're further defining things and I think
6 we're going to end up at a good place. But these
7 comments have been absolutely critical to us
8 moving forward in the process.

9 I just want to comment the team, commend
10 Bob. And I don't have any questions. Good job.

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

13 COMMISSIONER O'MALIA: Thank you, Mr.
14 Chairman. I think I'd like to follow up on
15 Commissioner Dunn's questioning about
16 understanding kind of what FCMs -- what their
17 exposures are and what customers can expect.
18 Obviously in the futures space we have well-known
19 FCMs. We've got a track record, et cetera. We've
20 got a very good track record in omnibus clearing.
21 And the FCMs and DCOs work really well together.

22 Obviously we're creating a new -- a

1 swaps world is a brand new world and I think
2 customers ought to be a little more informed than
3 the basics of what we've provided in the futures
4 space. We have on our monthly report that is a
5 quantitative analysis of seg funds and Part 30
6 funds and it's Excel spreadsheets saying how much
7 is in each account, but it doesn't give you any
8 qualitative analysis of the risks or the
9 counterparties or anything like that. And I am
10 sensitive to disclosing counterparty risk or, you
11 know, other customer risk in a fund, but I think
12 in the swaps world where we know so little about
13 it and understanding your relationships, we ought
14 to do a better job to educate customers about who
15 they're sharing with.

16 Obviously the team has come up with -- a
17 solution to that is don't expose yourself to any
18 other customers, which is one option, but I think
19 we need to understand what the costs of that are
20 and we have not heard a unanimous cry for total
21 segregation, this legal segregation and we have
22 some people asking for this omnibus model. So I

1 think marrying better information with the
2 possibility of having an omnibus model will
3 certainly give customers better information.

4 You have put some questions in here. I
5 think we can do a better job of really roughing
6 those out. And I will expect, hopefully, in a
7 final rule that we have a better idea of what
8 questions we want to ask and what we can ask of
9 the FCM and disclose to customers. It won't
10 disclose positions, but, at the same time, give
11 them more information going forward.

12 Let me get on to some of the questions
13 that I have here. Can you -- the cost-benefit
14 analysis in the back of this, you use words like
15 "tend" and "likely" and it's a little fuzzy. I'd
16 like to go back a step. What kind of cost did
17 commenters to the ANPR anticipate with a company
18 complete legal segregation model? Because I
19 didn't see that -- I don't think I saw the
20 specific numbers that were referenced in our
21 cost-benefit analysis that were raised in those
22 questions. Were they in there?

1 MR. WASSERMAN: I think they were, but,
2 in any event, yes, I'm pretty sure they were
3 discussed, certainly discussed in the discussion
4 of the comments. And I should note --

5 COMMISSIONER O'MALIA: Well, maybe you
6 could share -- and just summarize those for me, if
7 you will.

8 MR. WASSERMAN: And so there were really
9 two types of costs. One cost is operational
10 costs, essentially doing things under the model
11 that one is not doing today that costs staff time,
12 computer programming, that sort of thing. And the
13 comments indicated that those costs would actually
14 be fairly modest, something on the order of per
15 FCM at one-time cost increase of about 800,000 to
16 \$1 million and a recurring annual cost with a
17 median estimate of about \$700,000. And similar
18 costs in terms of DCOs.

19 There were conflicting discussions with
20 respect to what I would call risk costs. That is
21 to say by essentially removing fellow customer
22 collateral from the equation essentially you're

1 going to be subjecting the DCOs and the other
2 clearing members to increased costs. And there
3 are two ways they can approach that. One is to
4 increase the amount of margin. Each entity -- you
5 know, each customer provides with respect to each
6 position. Another approach is through the
7 guarantee fund. And one could essentially
8 increase the amount in the guarantee fund to meet
9 a potential default or one could do a combination
10 of the two.

11 And so what some folks said is, well,
12 look, first off I should note that the numbers are
13 large because the baseline is large. And so, for
14 instance, ISDA was talking about something on the
15 order of a baseline collateral requirement of some
16 \$500 billion. And they were talking about an
17 increase of some 70 percent of that in the event
18 one goes to individual customer protection. If
19 the DCOs were to take that approach by
20 essentially, say, going from a 99th percentile
21 margin to a 99.9 percentile margin.

22 An alternative approach is through the

1 guarantee fund, and we had baseline estimates for
2 the guarantee funds without this rule of some \$128
3 billion. And this is essentially because more
4 swaps is more business, more risks, and,
5 therefore, that baseline would increase with that.
6 And we've seen estimates of increases in that of
7 some 50 billion to \$128 billion, essentially a
8 doubling.

9 On the other hand, we had -- as I
10 mentioned, one commenter said, wait a minute, how
11 -- the change here is not so great because the
12 change is based on an assumption that you're
13 saying that fellow customer collateral will be
14 there in the event of a default. And there are
15 some kinds of defaults, a very sudden default,
16 where that likely would be the case. But what
17 we've seen also are some other kinds of defaults
18 -- Lehman immediately comes to mind -- where
19 essentially the FCM was on a downward slope for a
20 couple of days before its insolvency. During that
21 time customers are free to, and indeed in many
22 cases maybe have fiduciary obligations to, take

1 their money and move it to another FCM. They have
2 every right to do that. And if they do, that
3 money is not going to be there. So if you set up
4 a default resource scenario that assumes that
5 money is going to be there and it isn't, then you
6 could have a bit of a problem when a default might
7 actually come. And so that suggestion is, well,
8 maybe that's not prudent. In which event if you
9 don't rely on that, it's not a cost.

10 COMMISSIONER O'MALIA: Does this
11 proposed rule- making lean towards using a
12 guarantee fund approach, which poses some risk as
13 you've just identified, or leaning towards more
14 margin? Do you have a personal preference?

15 MR. WASSERMAN: I don't have a
16 preference as to margin versus guarantee fund, and
17 the document does not express preference either
18 way. That would be in the good judgment of the
19 DCOs based on how they would deal with the rules
20 as they are ultimately adopted.

21 COMMISSIONER O'MALIA: Okay. Have you
22 -- has this team or the Office of Chief Economist

1 done an economic cost-benefit analysis on the
2 numbers identified in the -- on the comments in
3 the ANPR?

4 MR. WASSERMAN: Yes. And the
5 cost-benefit analysis in the document is, in large
6 part, based on the comments. I should note one of
7 the things that they pointed out is that to the
8 extent that customers are free to leave before a
9 default, that also affects the benefits because
10 essentially some customers, in other words, might
11 be able to save themselves depending upon how the
12 default scenario plays out.

13 COMMISSIONER O'MALIA: I'm still a
14 little confused because in the cost-benefit
15 analysis in the back it talked about these
16 different scenarios, but it said -- you know, it
17 didn't give hard dollar numbers and it had softer
18 words like "tend" and "likely," and it didn't give
19 me a real good sense of hard economic analysis
20 based on these costs.

21 CHAIRMAN GENSLER: Nancy, do you want to
22 just take it? Because I see you have the papers

1 there.

2 MS. SCHNABEL: Well, there are numbers.
3 It's on page 107 and 109, and those numbers are
4 the same as those up front in the preamble where
5 we talked about commenters giving the risk costs
6 and the operational estimates. So there are
7 numbers. And if there are any other economic
8 analysis that you, I guess, Commissioner O'Malia,
9 wanted to know about, you know, please ask us
10 about it.

11 COMMISSIONER O'MALIA: Yes, I was
12 looking on page 111, 114, and some of these --
13 I'll get back with you on that. I just need to
14 talk with you a little bit more about how rigorous
15 this analysis has been and if we have a good grasp
16 on the likely outcomes of either one of these
17 scenarios.

18 Let me just -- I do want to thank the
19 teams for the flexibility. This is a tough
20 question. We're trying to understand the
21 implications of any decision we make. I differ
22 slightly with the Chairman on the certainty of

1 Congress on this matter and the legal requirement,
2 but it is what it is. And I'm comfortable because
3 I think we do have options to consider going
4 forward and if Congress wants to reflect on this
5 further, I think that would certainly be helpful.
6 But it would -- at least we're not foreclosing
7 some options here and I'm willing to support this
8 going forward. I do want to have a little more
9 discussion about some qualitative customer
10 information that we can talk about in the swaps
11 space going forward and maybe improve upon that
12 and be less asking questions and be a little more
13 forceful in what it is that would inform customers
14 going forward about fellow customer risk.

15 Let me close there and let them vote.

16 CHAIRMAN GENSLER: Thank you,

17 Commissioner O'Malia. Mr. Stawick?

18 MR. STAWICK: Commissioner O'Malia?

19 COMMISSIONER O'MALIA: Aye.

20 MR. STAWICK: Commissioner O'Malia, aye.

21 Commissioner Chilton?

22 COMMISSIONER CHILTON: Aye.

1 MR. STAWICK: Commissioner Chilton, aye.

2 Commissioner Sommers?

3 COMMISSIONER SOMMERS: No.

4 MR. STAWICK: Commissioner Sommers, no.

5 Commissioner Dunn?

6 COMMISSIONER DUNN: Aye.

7 MR. STAWICK: Commissioner Dunn, aye.

8 Mr. Chairman?

9 CHAIRMAN GENSLER: Aye.

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

11 Chairman, on this question the yeas are four, the

12 nays are one.

13 CHAIRMAN GENSLER: I thank you. I thank

14 the team. Now that it is actually passed and

15 we'll be sending it to the Federal Register, I

16 guess I get a chance to do something I'm allowed

17 to do, is to direct the staff to do something and

18 I'll do it publicly.

19 I think within this 60-day comment

20 period I'd like to direct you to have a staff

21 roundtable. I think that this would be a good

22 thing in the middle, maybe like a month into the

1 roundtable, to let people sort of digesting this,
2 but, hopefully, not at the end of the 60 days. So
3 that people can really -- their comments can be
4 reactive also to the staff roundtable. And I
5 would suggest get those who support, those from
6 the buy side and elsewhere that support, those who
7 have reservations, try to explore these cost
8 issues further and, you know, fill this room if
9 you need to because it's a really important issue.
10 But I guess I get under this -- I checked, they
11 said I could direct you to do this. But if you
12 could do that in the middle of the 60-day period I
13 think it'd be very helpful.

14 MR. WASSERMAN: We'll make it so.

15 CHAIRMAN GENSLER: Thank you. With
16 that, I think we'll move to the capital rule.

17 Tom Smith, Thelma Diaz, John Lawton,
18 it's the capital rule, the other half of peanut
19 butter and jelly because you were here as well on
20 the margin rule. I thank you for all of your
21 diligent work and I hand the floor to you.

22 MR. SMITH: Thank you very much. And

1 first I'd like to acknowledge the other members of
2 our team who are not sitting with us: Jennifer
3 Bauer and Todd Prono, Beverly --

4 CHAIRMAN GENSLER: You might come a
5 little closer to the mic or move the mic.

6 MR. SMITH: Yes, and John Paul
7 Rothenberg. Staff requests Commission approval to
8 publish in the Federal Register two documents.

9 CHAIRMAN GENSLER: Why don't you just
10 pull it closer?

11 MR. SMITH: Is that good enough? There
12 we go. The first is the Notice of Proposed
13 Rule-Making titled "Capital Requirements of Swap
14 Dealers and Major Swap Participants." The second
15 is a notice of the extension of the comment period
16 for the Notice of Proposed Rule-Making titled
17 "Margin Requirements for Uncleared Swaps for Swap
18 Dealers and Major Swaps Participants," which was
19 approved by the Commission for publication on
20 April 12, 2011. The extension of the comment
21 period for the margin rules would be published on
22 the same day as the proposed capital rules to

1 ensure that the comment periods for both rules run
2 concurrently for a full 60-day period.

3 The proposed capital rule would
4 implement provisions within Section 731 of the
5 Dodd-Frank Act that direct the Commission to adopt
6 regulations in closing capital requirements and
7 financial condition reporting requirements on swap
8 dealers and major swap participants. The
9 Dodd-Frank Act applies a bifurcated approach that
10 requires each swap dealer and MSP for which there
11 is a prudential regulator to meet the capital
12 requirements established by the applicable
13 prudential regulator. And each swap dealer and
14 MSP for which there is a no prudential regulator,
15 including non-bank subsidiaries of bank holding
16 companies, to meet capital requirements adopted by
17 the Commission.

18 In addition, the SEC is directed to
19 adopt capital requirements for security-based swap
20 dealers and major security-based swap participants
21 that are not subject to prudential regulation.
22 The Dodd-Frank Act also requires a minimum level

1 of coordination and consultation with respect to
2 capital. The regulatory agencies are required to
3 consult at least annually and the capital
4 regulations are, to the maximum extent practical,
5 required to be comparable.

6 Consistent with this provision the
7 Commission has had several meetings with the
8 prudential regulators and the SEC, and has
9 provided the prudential regulators and the SEC
10 with an opportunity to review and comment upon the
11 proposed regulations. In developing the NPR
12 Commission staff also considered the many
13 pre-comment period letters that have been
14 submitted, the issues raised in meetings with
15 outside parties -- all of which are listed on the
16 CFTC website -- and the information obtained
17 during a public roundtable that was jointly hosted
18 by the CFTC and SEC and attended by
19 representatives of each of the prudential
20 regulators.

21 The proposed regulations, to a great
22 extent, draw upon existing Commission and bank

1 capital requirements. The proposed capital
2 regulations are risk-sensitive, meaning that a
3 swap dealer or MSP's capital requirement would
4 increase or decrease corresponding with the level
5 of market and credit risk associated with its
6 swaps transactions. The regulations also would
7 establish a minimum level of \$20 million of
8 regulatory capital that each swap dealer or MSP
9 would be required to maintain. This minimum
10 capital requirement is consistent with recent
11 amendments to the Commodity Exchange Act, where a
12 20 million minimum capital requirement was imposed
13 on futures commission merchants that engaged in
14 OTC transactions in foreign currency. The minimum
15 capital requirement is intended to ensure that
16 swap dealers and MSPs maintain a minimum level of
17 financial resources to meet its financial
18 obligation, including obligations to end users.

19 The proposed regulations effectively
20 impose -- excuse me, the proposed regulations
21 effectively impose capital requirements on swap
22 dealers and MSPs based on one of three categories.

1 First, a swap dealer or MSP that is also
2 registered as a futures commission merchant would
3 be required to comply with existing CFTC FCM
4 capital requirements. The minimum regulatory
5 requirement would increase from 1 million of
6 adjusted net capital to 20 million. An SD or MSP
7 also would require to compute its risk-based
8 capital requirement based upon 8 percent of the
9 risk margin associated with cleared futures and
10 cleared swap positions carried by the FCM in
11 customer and non- customer accounts. The
12 risk-based capital requirement is currently part
13 of the capital rule.

14 Second, a non-bank swap dealer or MSP
15 that also is part of a bank holding company would
16 be required to meet the capital requirements
17 established by the Federal Reserve Bank as if the
18 SD or MSP was a banking entity. The proposal
19 would also establish a minimum regulatory capital
20 requirement of \$20 million of tier one capital as
21 defined by banking regulations. All other swap
22 dealers and MSPs, i.e., those that are not FCMs or

1 banks, would be required to maintain regulatory
2 capital as measured by tangible net equity. The
3 proposal would establish a minimum amount of
4 tangible equity that was equal to or greater than
5 \$20 million plus an additional market risk charge
6 and credit risk charge for the uncleared swap
7 positions. Tangible net equity is defined as net
8 equity as computed under generally accepted
9 accounting principles less intangible assets.

10 SDs and MSPs that use capital models
11 reviewed by prudential regulators or the SEC could
12 request Commission approval to use the same models
13 for computing market risk and credit risk and
14 capital charges. The proposal further provides
15 that the Commission may approve capital models for
16 SDs and MSPs, but do not have models reviewed by
17 the SEC or prudential regulators if adequate
18 resources become available for the Commission to
19 conduct appropriate reviews and continuing
20 assessments of such models.

21 Pending the implementation of such a
22 program, the proposal provides that swap dealers

1 and MSPs that are FCMs would continue to apply
2 existing market risk and credit risk requirements
3 set forth in Regulation 1.17. Other swap dealers
4 and MSPs would use Basel-based, standardized, or
5 grid approach to compute market risk and credit
6 risk capital charges.

7 The proposed financial condition
8 reporting requirements for swap dealers and MSPs
9 are comparable to existing FCM financial condition
10 reporting requirements. SDs and MSPs will be
11 required to maintain current ledgers or similar
12 records which support each transaction affecting
13 their assets, liabilities, income, and expenses
14 and capital accounts. SDs and MSPs also will be
15 required to file monthly unaudited financial
16 reports with the Commission. Each swap dealer and
17 MSP also will be required to file an annual
18 audited financial statement with the Commission.
19 The audited and unaudited financial statements
20 must be prepared using the English language and
21 presented in accordance with generally accepted
22 accounting principles as established in the United

1 States.

2 The Notice of Proposed Rule-Making also
3 includes proposed amendments to CFTC financial
4 form 1FR FCM consisting of a new segregation
5 scheduled for swaps customers' funds. The
6 proposed schedule is consistent in design and
7 format with the existing segregation schedules for
8 Section 4d customer funds and for Part 36
9 (inaudible) funds. The proposed amendments would
10 also revise the provisions governing the required
11 audit scope of the independent public accountant's
12 annual FCM audit to include the new segregation
13 schedule for swaps customers.

14 The proposal also establishes notice
15 filing requirements for swap dealers and MSPs that
16 are comparable to the existing notice filing
17 requirements for FCMs. Such notice provisions
18 include SDs or MSPs being undercapitalized or
19 failing to maintain current books and records.

20 The effective oversight of the
21 implementation and ongoing compliance with the
22 proposed new capital and financial condition

1 reporting requirements would require significant
2 additional resources, including additional
3 staffing resources. In particular, if implemented
4 the proposal might require Commission staff to
5 conduct financial oversight and financial
6 examination of new registrants and potentially
7 review and assess capital models. The Commission
8 requested an additional 60 FTEs for the Division
9 of Clearing and Intermediary Oversight in the FY
10 2012 budget, which represents an approximately 50
11 percent increase over current levels. If
12 received, these additional resources would enhance
13 the division's ability to perform oversight of SD
14 and MSP registrants.

15 That completes the overview of the
16 proposed NPR and we're pleased to take any
17 questions.

18 CHAIRMAN GENSLER: Thank you, Tom and
19 team. With that, I'll entertain a motion to
20 support the staff recommendation on capital.

21 COMMISSIONER SOMMERS: To accept?

22 CHAIRMAN GENSLER: Or to accept. To

1 accept.

2 COMMISSIONER SOMMERS: So moved.

3 SPEAKER: Second.

4 CHAIRMAN GENSLER: Thank you. Tom, I
5 have a number of questions. What I want to focus
6 on is how this is divided up, so I'll start with
7 the traditional group.

8 Futures commission merchants who happen
9 to decide they want to be a swap dealer, their
10 capital regime, is it correct -- would, in
11 essence, with some small adjustments, but would,
12 in essence, be what they currently have? Is that
13 correct?

14 MR. SMITH: That's correct.

15 CHAIRMAN GENSLER: And as I understand
16 it that's a model that means it has to be very
17 liquid and the capital is computed in a way that
18 provides for the liquidity of the futures
19 commission merchant as a member of a
20 clearinghouse?

21 MR. SMITH: That is correct.

22 CHAIRMAN GENSLER: And so we sort of

1 maintain that.

2 MR. SMITH: We maintain that, yes.

3 CHAIRMAN GENSLER: Well, and then the
4 next piece is what if it's a swap deal that's not
5 a futures commission merchant? What we did there
6 was we sort of put it in two different categories?

7 MR. SMITH: That's correct, depending on
8 whether it was part of a bank holding company or
9 any other type of swap dealer.

10 CHAIRMAN GENSLER: So I'm just sharing a
11 little bit of how we got here maybe with the
12 public, but, I mean, they all blur together the
13 numerous meetings I've been in. But as I
14 understand it, swap dealers who were not futures
15 commission merchants, but would be part of a bank,
16 a number of them came in and said we're concerned
17 that you might end up with capital rules that says
18 it's the higher of the CFTC's capital rules or the
19 Federal Reserve capital rules. I mean, that was
20 one of their key, you know, questions.

21 MR. SMITH: That's correct, and they
22 were pointing out that this swap business is done

1 in the bank today in many instances it would
2 possibly be pushed out under Section 716 of
3 Dodd-Frank into a subsidiary.

4 CHAIRMAN GENSLER: Right, which is
5 sometimes known as the Blanche Lincoln Push-Out
6 Provision.

7 MR. SMITH: That's right, yes.

8 CHAIRMAN GENSLER: So where we ended up
9 is, in essence, that if it's part of a bank
10 holding company or if it's part of a systemically
11 -- institution -- I can't remember what SIFI
12 stands for, systemically --

13 MR. SMITH: Systemically important
14 financial institution.

15 CHAIRMAN GENSLER: It's the capital
16 rules as set by the prudential regulators.

17 MR. SMITH: That's correct.

18 CHAIRMAN GENSLER: But we get to see it.
19 We get to see all the modeling. We get to see the
20 monthly reports.

21 MR. SMITH: Yes, they are, in effect,
22 our registrant. And it is our capital rule on

1 financial reporting that they're meeting.

2 CHAIRMAN GENSLER: Technically it's our
3 capital rule, but it piggybacks off the bank
4 capital.

5 MR. SMITH: Yes, our rule defers to --
6 that's right. For the purposes of computing it
7 you refer to the Federal Reserve Board's rules.

8 CHAIRMAN GENSLER: I checked that box.
9 I like those two.

10 Then the other category is the challenge
11 of what if you're a non-bank, non-futures
12 commission swap dealer and that's where we get
13 into firms that have come in -- not a lot of
14 firms, but somewhere, you know, 10 or 15 of them
15 over these months have come in and said, well, if
16 we are a swap dealer we can't imagine using bank
17 capital rules. That's the large focus of the
18 meetings when they've come in and met at least
19 with me.

20 MR. SMITH: That's right and the reason
21 being primarily is that they never were
22 financially oriented institutions. They don't

1 have a balance sheet structure that would be
2 consistent with certainly an FCM or even a bank.

3 CHAIRMAN GENSLER: So where we ended up
4 is they can use tangible net worth. It means they
5 can count their factory, they can count their oil
6 in the ground if they're in the oil business,
7 their customer receivables, et cetera.

8 MR. SMITH: Correct.

9 CHAIRMAN GENSLER: So would they
10 possibly end up with -- I mean it is possible
11 there'd be some regulatory arbitrage that they
12 might have lower capital standards than the bank
13 capital standards would have been?

14 MR. SMITH: I believe so, yes. That'll
15 be a lower standard.

16 CHAIRMAN GENSLER: I'm sorry, so that
17 would be a lower standard --

18 MR. SMITH: The capital on that equity
19 would be a lower standard or an easier standard to
20 meet. Because we're recognizing -- our proposed
21 rules would recognize significantly more types of
22 or classes of assets.

1 CHAIRMAN GENSLER: Right. And one of
2 the issues also is -- and this is a challenge of
3 any regulatory agency setting capital standards,
4 but capital standards help protect the public
5 against a default. Is that right?

6 MR. SMITH: That's one of the things
7 they do, yes.

8 CHAIRMAN GENSLER: What else do they do?

9 MR. SMITH: If it's an FCM it allows --
10 I guess it all can generate from that because it
11 allows the ability to wind down operations to
12 transfer to customer funds to another
13 organization.

14 CHAIRMAN GENSLER: Right, right.

15 MR. SMITH: In the context of a swap
16 deal where you don't have customers it's more
17 counterparty relationships.

18 CHAIRMAN GENSLER: Right. Are you aware
19 of any capital standard for insurance companies
20 which are called reserves, but capital standards
21 or reserve requirements for insurance companies or
22 securities firms or banks where capital is only

1 computed on some of your transactions, but not
2 computed if your counterparty or your insurance
3 client or your securities client is, you know,
4 smaller or something like that?

5 MR. SMITH: No, I'm not.

6 CHAIRMAN GENSLER: So an insurance
7 company, for instance, regulated by a state
8 insurance company would have to have reserves or
9 capital even for their transactions with
10 homeowners insuring their houses or, you know,
11 auto insurance for somebody who has auto
12 insurance. Isn't that right?

13 MR. SMITH: I believe so, yes.

14 CHAIRMAN GENSLER: So I think I support
15 this rule. I think it's going to get a lot of
16 public comment, as it should. I think it's very
17 balanced that we protect futures commission
18 merchants and the liquidity and that that's at the
19 core of lowering risk to clearinghouses. If
20 somebody's not a futures commission merchant and
21 it's part of a bank holding company or a
22 systemically important financial institution we

1 pick up the calculations from the bank regulators
2 so that we don't have sort of a higher than and
3 sort of have regulatory arbitrage. And then if
4 it's not part of a bank holding company, not a
5 systemically important financial institution, of
6 course not a futures commission merchant, it's
7 this tangible net worth approach there may be some
8 regulatory arbitrage. It will be a lower capital
9 standard for those non-bank sort of commercial
10 dealers.

11 MR. SMITH: That's correct. And we've
12 included a question that asks for comment on some
13 financial entities that may fall into that third
14 category.

15 CHAIRMAN GENSLER: Would that be like
16 financial entities like if a high-frequency trader
17 might want to do this?

18 MR. SMITH: Yes, or a hedge fund or
19 something that may -- if it gets caught up in the
20 swap dealer definition, if it's required to
21 register as a swap dealer and is a swap dealer.

22 CHAIRMAN GENSLER: Right. And I'm very

1 sensitive, end users, commercial end users should
2 comment on this, whether a dealer or just end
3 users should comment on this, I'm very interested
4 in their thoughts. Because capital does get
5 priced into transactions. I mean, there's not a
6 doubt. You know, capital is part of how insurance
7 companies price their insurance product, how banks
8 price their loans. But ultimately I support this
9 because capital is a critical feature of
10 supporting the market so that we know that end
11 users, when they enter into a transaction, there's
12 something standing behind the dealer when the
13 dealer enters into the transaction.

14 Commissioner Dunn?

15 COMMISSIONER DUNN: Thank you, Mr.
16 Chairman. If I can follow up a bit on your
17 questioning here. For those SDs and MSPs that are
18 not SIFI or FCM or part of a bank holding company
19 and you're going to base that capital rule on the
20 tangible net equity, how is that going to be
21 determined? How will the CFTC staff go about
22 certifying what that tangible net equity is for

1 that entity?

2 MR. SMITH: There'll be reporting
3 obligations imposed on the swap dealers so we will
4 see monthly and annual certified financial
5 statements. The monthly will be unaudited.
6 Depending on the resources that we have as well,
7 as we do with FCMs today within the Division of
8 Clearing and Intermediary Oversight, we have a
9 program where we may conduct a direct examination
10 of an FCM. That may extend also to a swap dealer
11 or to an MSP. There will be some additional
12 challenges dealing with these specific type of
13 entities. Some of them may be very large energy
14 or agricultural corporations or private companies.
15 And that will be something that will present

16 issues for staff that we'll have to address.
17 We'll have to certainly get up to speed a bit more
18 on how they operate, but I think we'll need to see
19 the landscape of who does register first to
20 identify that.

21 COMMISSIONER DUNN: I like the concept
22 of opening up the margin requirement being done

1 concurrent so folks can look at both that and the
2 capital requirements in there. But I do think
3 this is going to be a considerable challenge to
4 the CFTC staff. For those that are operating
5 under their prudential regulator do you
6 contemplate that we're going to need some
7 memorandums of understanding so that we are privy
8 to all the information that we're going to need?

9 MR. SMITH: We certainly need to have an
10 open dialogue with the Fed and other prudential
11 regulators and with the Securities and Exchange
12 Commission. Whether we need -- I'm not sure of
13 the mechanism in that. That's something that I'm
14 going to take back. I know you raised this with
15 me the other day, Commissioner, and I'm going to
16 look into that with our Office of General Counsel
17 as to what is the best mechanism to have a formal
18 arrangement in place or however we need to do
19 that. But I don't have an answer whether it needs
20 to be an MOU or some other mechanism just to
21 ensure that we can share information with each
22 other about these entities and their models.

1 COMMISSIONER DUNN: Do you in general
2 have an idea how the application of the capital
3 requirements will affect the swap pricing in this
4 new regulatory regime?

5 MR. SMITH: Well, capital is certainly a
6 cost for the swap dealer and for the MSP. And
7 like all costs it has to be absorbed by some
8 party, be it the swap dealer, the MSP itself, be
9 it counterparties, or somehow it has to be taken
10 care of. Whether it will result in direct cost
11 dollar-for-dollar being passed on to end users or
12 to the counterparties, I'm certainly -- I don't
13 know the answer to that, but it is a cost. Some
14 of these entities are not currently subject to
15 capital requirements potentially, so they'll come
16 in and this will be an additional cost for them.
17 But I sort of look at it in the context of general
18 costs that are being absorbed by these
19 organizations. And yes, they will have to be
20 either internalized or passed on in some manner.

21 COMMISSIONER DUNN: When we look at this
22 cost- benefit analysis and what we have for the

1 final rule we will also consider the cost for the
2 Commission for implementation. But on a broader
3 scale, will you be looking at, without having that
4 capital -- that liquid capital available, what it
5 might cost the general public and taxpayers, per
6 se?

7 MR. SMITH: Yes, certainly.

8 COMMISSIONER DUNN: Thank you.

9 CHAIRMAN GENSLER: I just want to ask
10 one question in the middle. The tangible net
11 worth approach, doesn't it allow -- I mean, if
12 somebody's not a bank, that if its factories or
13 receivables that they could be using the factory
14 for other reasons. They might even have the
15 factory securing other loans and so forth. Is
16 that not right?

17 MR. SMITH: That's correct.

18 CHAIRMAN GENSLER: Yes, so it's a very
19 flexible approach.

20 MR. SMITH: Yes.

21 CHAIRMAN GENSLER: And if I have a
22 worry, I have a worry it's too flexible, but I

1 think that it's balanced. I think it addresses a
2 lot of pre-proposal comments.

3 Commissioner Sommers?

4 COMMISSIONER DUNN: The Chairman is
5 suggesting that perhaps we do a (inaudible) of
6 lien.

7 CHAIRMAN GENSLER: I was just noting
8 that we haven't. I mean, one of the questions
9 that I got back in August and September was, are
10 the CFTC going to make us segregate this capital?
11 And it's clear we didn't make anybody segregate on
12 the last category.

13 COMMISSIONER DUNN: No.

14 CHAIRMAN GENSLER: Yes. Commissioner
15 Sommers?

16 COMMISSIONER SOMMERS: Thank you, Mr.
17 Chairman. I think with this proposal it's the
18 same as the other two proposals that we've had
19 before us today. The team has gone through a
20 tremendous amount of work and effort to coordinate
21 and collaborate with other regulators, and I just
22 want to say how much we appreciate your time into

1 this proposal.

2 My concerns with regard to margin are
3 relatively the same -- I'm sorry, with capital are
4 relatively the same as they were with margin.
5 It's with regard to the review of models, the
6 internal models, and the decision that has been
7 made with regard to our limited resources that
8 with absent a prior approval of internal models we
9 may have to have some of these entities follow the
10 Basel standardized approach or I think what you
11 called the grid approach yesterday. And I just
12 want to note that I don't think this is optimal
13 for these people. And if you can tell us who you
14 think may be caught in this area where they
15 wouldn't have internal models that had already
16 been approved.

17 MR. SMITH: The main group will be the
18 entities that are able to use the tangible net
19 equity approach. Most likely they're not going to
20 be a bank and they're not going to be an FCM. So
21 those are entities that will be subject to this
22 requirement to compute their market risk and

1 credit risk using the Basel standardized approach.
2 There could also be some FCMs that don't meet the
3 level set by the Securities and Exchange
4 Commission to use the alternative net capital
5 approach, which is a models-based approach as
6 well.

7 COMMISSIONER SOMMERS: Thank you. And I
8 think my other concern, as I said before, on the
9 margin rule is that as we continue to collaborate
10 with international regulators, I think on these
11 couple of rules in particular it's very important
12 that we're as consistent as possible because, as
13 we all know, capital is a place where if there is
14 any inconsistency it creates a huge opportunity
15 for regulatory arbitrage. So hopefully, as we're
16 all looking forward to applying the Basel
17 standards that we will all continue to be on the
18 same page. Thank you.

19 MR. SMITH: You're welcome.

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

22 COMMISSIONER CHILTON: Thanks, Mr.

1 Chairman. I don't have any questions. I want to
2 commend the team, Tom and everybody, for a good
3 job. I look forward to getting the comments and I
4 think it's a good rule. Thank you.

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

7 COMMISSIONER O'MALIA: Thank you, Mr.
8 Chairman. Thanks to the team, great hard work on
9 this. I know you guys have labored just to
10 explain it to us, so that's been no easy task.
11 Let me ask you some questions.

12 Will end users have to post initial and
13 variation margin to dealers? That's a
14 margin-related question. We think we understand
15 what that one could be.

16 MR. SMITH: And I believe it's pursuant
17 to the credit support agreement that they enter
18 into.

19 COMMISSIONER O'MALIA: Yes, agreed. If
20 an end user does not post initial and variation
21 margin to swap dealer on a swap it enters into
22 with a dealer, then will that swap dealer have to

1 take a risk-based capital charge for that swap?

2 MR. SMITH: Yes, if they don't have
3 collateral. Yes.

4 COMMISSIONER O'MALIA: If the end user
5 posts initial and variation margin to a swap
6 dealer will the dealer have to take a risk-based
7 capital charge for that swap if they post margin?

8 MR. SMITH: If the margin covers the
9 extent of the exposure, no. If the margin is not
10 sufficient, yes.

11 COMMISSIONER O'MALIA: And what is that
12 exposure?

13 MR. SMITH: The current exposure and the
14 --

15 COMMISSIONER O'MALIA: The risk --

16 MR. SMITH: -- potential future
17 exposure.

18 COMMISSIONER O'MALIA: The risk-based
19 capital charge?

20 MR. SMITH: Yes.

21 COMMISSIONER O'MALIA: Okay. So it's
22 the Commission's policy to make -- so they're

1 either going to have to pay a capital charge or
2 going to have to pay margin.

3 MR. SMITH: If there is no margin
4 collected or posted by any end user -- and we'll
5 say if you want to limit it to commercial end user
6 -- a commercial end user with a dealer, they will
7 have a charge in their credit risk charge. Yes,
8 they will.

9 COMMISSIONER O'MALIA: Okay. I think
10 that's what I stated. All right, thank you.

11 So how does that comply with the
12 Lincoln-Dodd letter? Congress clearly stated in
13 this bill that the margin capital requirements are
14 not to be imposed on end users nor can regulators
15 require clearing for end users. How are you
16 taking that into consideration in this rule?

17 MR. SMITH: I think one of the things
18 that we're doing is looking at it from the full
19 perspective of what are these swap dealers allowed
20 to count as their capital. And this rule looks at
21 those swap dealers that are dealing with the
22 commercial end users except that they're a

1 financial company in a very broad way and allowing
2 them to use a significant amount of their assets
3 to meet that capital requirement. So it's sort of
4 a, you know, a balancing of capital and the margin
5 requirements.

6 COMMISSIONER O'MALIA: I appreciate the
7 flexibility you've created with this tangible
8 equity. However, to your point -- to the question
9 you answered previously was if they don't post
10 margin, they're going to post a capital charge,
11 right?

12 MR. SMITH: They're going to incur
13 capital charges because we're required to impose
14 capital requirements on swap dealers and users.

15 COMMISSIONER O'MALIA: This is getting
16 circular, but how did you account -- no, we won't
17 go there. Back to the Dodd-Lincoln letter.

18 All right, moving on to credit rating
19 issues. How do you treat the creditworthiness of
20 counterparties when you apply a credit risk factor
21 charge? If you could explain what that rule
22 provides for.

1 MR. SMITH: Yes. In computing the
2 extent of the credit risk exposure, first you look
3 at what is your current exposure to a
4 counterparty, which is market-to-market of the
5 positions, and you also look at potential future
6 exposure. At that point, under the Basel
7 standardized approach you assign a factor to that,
8 which would be either 20 percent, 50 percent, or
9 150 percent depending upon the credit rating of
10 that counterparty.

11 What we had proposed in this rule is to
12 just use a 50 percent standard and not -- or we
13 have a provision in there that would allow the
14 swap dealer to internally develop what those
15 credit ratings are and they would seek Commission
16 approval or review of those rating approach, and
17 then the resultant number would be 4 percent. So
18 whatever it comes out to at 4 percent is the
19 credit risk charge.

20 COMMISSIONER O'MALIA: Now I'm confused.
21 Four percent or 50 percent?

22 MR. SMITH: Well, it's 8 percent, so

1 it's 50 percent. You look at what your current
2 exposure is and your potential future exposure,
3 add those together, apply this charge which is 50
4 percent, and you --

5 COMMISSIONER O'MALIA: So it's a 50
6 percent haircut?

7 MR. SMITH: No, it's not a 50 percent
8 haircut. There's one more step to the equation.

9 COMMISSIONER O'MALIA: Okay.

10 MR. SMITH: Then the haircut is 8
11 percent of that. So it effectively comes down 50
12 percent of 8 percent is a 4 percent charge on your
13 current and potential future exposures, the
14 aggregate of those. So that would be what a swap
15 dealer would have to have a capital reserve for
16 from a credit risk.

17 COMMISSIONER O'MALIA: My question was
18 the credit risk factor charge, what are we
19 assessing? Because I understand there's the Basel
20 standard and there's this 50 percent standard for
21 how you compute this. And I know we had been
22 discussing back and forth whether we were going to

1 apply the straight 50 percent haircut for the
2 initial evaluation as opposed to the Basel that
3 uses credit ratings to some extent.

4 MR. SMITH: Right. That's right.

5 COMMISSIONER O'MALIA: So let me just
6 deal with that part of it --

7 MR. SMITH: Okay.

8 COMMISSIONER O'MALIA: -- before we more
9 on to this 4 or 8 percent.

10 MR. SMITH: Okay, yes.

11 COMMISSIONER O'MALIA: So in the rule
12 it's 50 percent straight.

13 MR. SMITH: Correct.

14 COMMISSIONER O'MALIA: Regardless of
15 your credit quality.

16 MR. SMITH: Unless you generate that
17 internally within the --

18 COMMISSIONER O'MALIA: The swap dealer?

19 MR. SMITH: Yes.

20 COMMISSIONER O'MALIA: Okay. In the
21 Basel standard, which is what we've used
22 throughout this rule up until this point, is 20

1 percent for investment grade, so it's a 20 percent
2 haircut, 50 percent for junk, and 150 percent for
3 distressed.

4 MR. SMITH: For anything else.

5 COMMISSIONER O'MALIA: For anything
6 else, right.

7 MR. SMITH: Yes.

8 COMMISSIONER O'MALIA: Okay. Now, I
9 know we've discussed about changing whether we
10 were going to use credit rating agencies for
11 company credit quality. I know the statute says
12 not for securities, but it doesn't say that we
13 can't use it for companies.

14 MR. SMITH: No, right now it's stayed at
15 50 percent.

16 COMMISSIONER O'MALIA: Right. And we
17 just ignore the other. Now, what if a company --
18 what if a swap dealer comes up with a model that
19 says, you know, we're actually using credit rating
20 agencies to evaluate the quality of our
21 counterparty and are basing our standard on that?
22 Will we accept it or not?

1 MR. SMITH: We'd have to look at what
2 the whole program is. I don't know at this point
3 in time if it would be part of it.

4 COMMISSIONER O'MALIA: Okay. Well, I
5 have a serious concern about treating everybody
6 the same with this 50 percent rule. And I know
7 you're probably trying to avoid using credit
8 rating agencies, but --

9 MR. SMITH: Yes.

10 COMMISSIONER O'MALIA: -- that's what
11 Basel allows for and we use Basel throughout this
12 entire rule other than this factor here. So I'm a
13 little confused with that.

14 Let me go on to collateral. There's
15 some language about it's in the swap dealers
16 physical possession or control. Does that mean an
17 oilfield if you post that as collateral? Do you
18 physically have to -- is it take title to it or --

19 MR. SMITH: I think to qualify as
20 collateral it would have to have some kind of --
21 you wouldn't want the collateral being used in
22 multiple instances or for multiple obligations.

1 So, generally speaking, there is either a lien or
2 there is some kind of mechanism to ensure that
3 that collateral is unencumbered.

4 COMMISSIONER O'MALIA: But is "physical"
5 the right word for that?

6 MR. SMITH: It can be and I think we use
7 that in the FCM concept where they often post
8 Treasuries and other things with an FCM, so it's
9 borrowing from that concept. It doesn't have to
10 be in the possession, but it needs to be in the
11 possession or control or have some kind of lien.

12 COMMISSIONER O'MALIA: There's a new
13 provision that came in late, this conforming -- on
14 page 63, conforming amendments to delegated
15 authority provisions. This seems to be an
16 amendment to our margin rule in some respects.
17 Not in some respects, you know, with regard to the
18 margin rule, I think it is an amendment to our
19 margin rule. Is that correct? Page 64 and 65.

20 MR. SMITH: I think -- yes, what those
21 are, are there's existing delegations in
22 Regulation 140.91. What we were proposing in this

1 rule was to -- where certain authorities are
2 delegated to the Commission by the rules, the --
3 or under the authority of the Commission they have
4 delegated certain responsibilities to the director
5 of the Division of Clearing and Intermediary
6 Oversight, so we're picking those up. The ones
7 for the margin were in the proposed margin rules
8 with respect to what the rules were and what the
9 Commission's authorities were. The provisions to
10 incorporate the delegation to the Division of
11 Clearing and Intermediary Oversight Director was
12 not included in that rule, so we picked them up
13 here.

14 We're not changing the rules that were
15 put out for a proposal by the Commission with
16 respect to margin. It's the delegation of certain
17 authorities to the division director.

18 COMMISSIONER O'MALIA: Okay. In this,
19 on the margin rule, we had an extensive discussion
20 of modeling margin with Ananda. He was at the
21 table. And it was Ananda's belief that we just
22 had to accept these models and we weren't -- you

1 know, especially for the 716 push-outs. You know,
2 I know -- and you said they didn't have the
3 resources to evaluate the models. Now, I read
4 this and it says -- it contemplates DCIO being
5 able to basically consider what's acceptable
6 margin and what's not and make changes to
7 individual assets or collateral. If we don't have
8 the capability to approve the models, how are we
9 going to evaluate everybody's individual
10 collateral and assets that they're posting? How
11 do we get into that? How are we going to have the
12 resources to do that?

13 MR. LAWTON: I think the concept was
14 that you might have a case where something becomes
15 a distressed asset and we've become aware of
16 something that was fine, was posted as collateral.
17 And because if something happens to the issuer, we
18 become aware of it, we might go into the
19 registered entities or registrants and say we
20 don't think that this is acceptable now. It was;
21 it fit before, but in the news somebody -- it
22 becomes a distressed asset and people across the

1 markets are haircutting these things dramatically.

2 COMMISSIONER O'MALIA: So we would say
3 they can't haircut them as drastically?

4 MR. LAWTON: No, if somebody was not --
5 for example, if somebody was giving a full value
6 to something that we believe should now be
7 haircut.

8 COMMISSIONER O'MALIA: Is this kind of a
9 one-way street that if they're only over-valuing
10 them? What if they're undervaluing them?

11 MR. LAWTON: Yes, I don't think that we
12 would contemplate if somebody was -- I'm sorry,
13 maybe I misunderstand the question.

14 COMMISSIONER O'MALIA: Well, this whole
15 rule seems to say that, you know, we can replace a
16 -- we can require an entity to replace a margin
17 asset posted with the CSE -- which is a swap
18 dealer or a major swap participant -- with a
19 different margin asset. It says we can require a
20 CSE to modify the margin haircut, and I'm just
21 trying to -- I mean, what is our role here? How
22 much interference are we going to have in this?

1 Are we going to -- and how often are we going to
2 look at this and what are the criteria? I mean,
3 I've got a lot of questions about this one and I'm
4 trying to understand. Would it be both ways? If
5 it's too low we would say, you know, the
6 calculation's high; or if it's too high, say it's
7 too low.

8 MR. LAWTON: Again, I think that we're
9 thinking it's in the direction where something is
10 now, we believe, overvalued and, therefore,
11 putting the entity at risk because they're
12 accepting something or valuing something in a way
13 that is not appropriate anymore. And again, I
14 think the notion for delegated authority is this
15 could be in a distressed market situation, perhaps
16 not only is the collateral in a distressed
17 situation, but perhaps the individual dealer is in
18 a distressed situation. And so we want to be able
19 to act quickly.

20 COMMISSIONER O'MALIA: Well, since we've
21 authorized this vast authority without much
22 limitation can I talk you into maybe creating some

1 thresholds or some flexibility on end user capital
2 requirements? Maybe substituting our decision for
3 what a bank may assess a small end user. Would
4 you be interested in that?

5 The silence is deafening. I think
6 there's a typo in this, on page 65, the second
7 line. "The Commission is proposing to delegate
8 authority with respect to," blah, blah, blah,
9 "which would authorize a Commission." Don't you
10 mean the Commission is not delegating, the
11 Commission is delegating DCIO. Line 2, page 65.
12 Is that a typo?

13 CHAIRMAN GENSLER: Unanimous consent to
14 fix the type? No objection, it's fixed. Good
15 catch.

16 COMMISSIONER O'MALIA: I read this
17 stuff. I have no further questions. Thank you.

18 CHAIRMAN GENSLER: I thought I'd reply
19 to a question you gave the staff. How I comport
20 with the Dodd- Frank letter -- not the
21 Lincoln-Dodd letter is this rule does not impose a
22 charge on the end users. I do appreciate that end

1 users doing swaps with a bank where the federal
2 prudential regulators are setting capital or
3 dealing with a non-bank where the SEC or we're
4 doing capital, that capital is priced into the
5 swap. But there's no capital being assessed or
6 imposed directly on the end user; it's part of
7 that business. So as it relates to the letter
8 itself I think -- and I know we have a difference
9 here, but, I mean, I think that it does comply
10 with that letter.

11 We're not doing margin. That's the rule
12 we did two weeks ago. Congress said they're not
13 having clearing. That's all right, too. And on
14 capital, I think the capital that the dealer has
15 to have we've taken a very balanced -- my word
16 might even be light -- approach, but they're not
17 systemically relevant because they're not SIFIs
18 and they're not part of bank holding companies.
19 So I think this tangible net equity approach where
20 they can using the factory for other reasons --
21 and the handful of people that have been in have
22 said if we don't have to segregate it and we can

1 use tangible net equity so we can use the factory
2 for other purposes, we think that that might work.
3 Might. They'll see the proposal and then they're
4 comment.

5 COMMISSIONER O'MALIA: Thank you for
6 clarifying that.

7 CHAIRMAN GENSLER: Mr. Stawick?

8 MR. STAWICK: Commissioner O'Malia?

9 COMMISSIONER O'MALIA: No.

10 MR. STAWICK: Commissioner O'Malia, no.
11 Commissioner Chilton?

12 COMMISSIONER CHILTON: Aye.

13 MR. STAWICK: Commissioner Chilton, aye.
14 Commissioner Sommers?

15 COMMISSIONER SOMMERS: Aye.

16 MR. STAWICK: Commissioner Sommers, aye.
17 Commissioner Dunn?

18 COMMISSIONER DUNN: Aye.

19 MR. STAWICK: Commissioner Dunn, aye.
20 Mr. Chairman?

21 CHAIRMAN GENSLER: Aye.

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

1 Chairman, the yeas are four, the nays are one.

2 CHAIRMAN GENSLER: I thank you and we'll
3 accept that vote and, along with the others, be
4 forwarding it to the Federal Register.

5 Let me just see whether I'm supposed to
6 now or -- there was this vote on extending the
7 other comment period. Am I going to do that now?

8 COMMISSIONER O'MALIA: Just read.

9 CHAIRMAN GENSLER: All right. I'm
10 supposed to just read. As we noted two weeks ago,
11 when the Commission proposed the margin rule, it's
12 our intention to ensure that the comment periods
13 for proposed margin and capital rules end on the
14 same date. To that end, consistent with the draft
15 Federal Register release that the Office of
16 General Counsel circulated, do I hear a motion to
17 extend the comment period for the proposed margin
18 rule to end the same day as the comment period for
19 the proposed capital rule that we just considered?

20 COMMISSIONER O'MALIA: Mr. Chairman, I
21 have an amendment I'd like to offer to this, if I
22 may. I have an amendment and if it's appropriate

1 now, then I'd like to do it now if we need --

2 CHAIRMAN GENSLER: This is not the

3 30-day piece.

4 COMMISSIONER O'MALIA: Okay.

5 CHAIRMAN GENSLER: This is just to make
6 margin and capital coterminous.

7 COMMISSIONER O'MALIA: No complaints.

8 CHAIRMAN GENSLER: Okay. Do I hear a
9 motion?

10 COMMISSIONER SOMMERS: So moved.

11 COMMISSIONER O'MALIA: Second.

12 CHAIRMAN GENSLER: If there's no
13 discussion, Mr. Stawick could you call the roll?

14 MR. STAWICK: Commissioner O'Malia?

15 COMMISSIONER O'MALIA: Aye.

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

18 COMMISSIONER CHILTON: Aye.

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

21 COMMISSIONER SOMMERS: Aye.

22 MR. STAWICK: Commissioner Sommers, aye.

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 question the yeas are five, the
8 nays are zero.

9 CHAIRMAN GENSLER: Okay, thank you. We
10 will have a separate vote after the fourth one on
11 this whole 30-day concept.

12 Thank you so much, Thelma and Tom.
13 John, you get to stay at the table, I think,
14 right? Changing seats.

15 I did notice a bunch of other alums
16 here, you know, Jim Newsome, Brad Berry. I mean,
17 I noted David and there are so many people here,
18 so I didn't want to leave you out. And there's
19 probably Graham -- I mean, there's too many.
20 There's a lot of -- Dan Waldman comes back every
21 time. Alison, there's Alison Lurton. There are
22 probably people I'm just not seeing. My eyes are

1 blurry.

2 John Lawton, Peter Kals from the
3 Division of Clearing and Intermediary Oversight,
4 there's Nadia, the Division of Market Oversight,
5 David back at the table again from the General
6 Counsel will present the staff report proposed
7 rules concerning amendments to adapt certain CFTC
8 regulations to Dodd-Frank. I don't know who I'm
9 turning to, but the team.

10 MR. LAWTON: Good afternoon. The
11 Commission has before it amendments to numerous
12 regulations across its Rule Book to bring them
13 into conformance with the requirements of the
14 Dodd-Frank Act. In some cases the changes are
15 purely ministerial. For example, deleting
16 references to derivative transaction execution
17 facilities is a category of trading platform that
18 was eliminated by Dodd-Frank. In other cases the
19 changes, while technical, did require the exercise
20 of a judgment in drafting. For example, modifying
21 various definitions to accommodate swaps in the
22 Rule Book. Finally, in several instances the

1 changes are substantive in nature. For example,
2 modifying certain recordkeeping requirements and
3 aligning them across futures and swaps.

4 With regard to the cost to the staff,
5 staff believes that implementation of these
6 particular rules would actually not require
7 additional resources. Staff believes, in fact,
8 that by clarifying and harmonizing various rules
9 across the Rule Book that should facilitate
10 oversight of the markets and reduce the need for
11 interpretative guidance going forward.

12 To provide a bit more detail I'm going
13 to turn it over to my colleagues. First Peter
14 Kals of DCIO, then Nadia Zakir of DMO, and then
15 finally Dave Aron of OGC.

16 MR. KALS: The Dodd-Frank Act amended
17 the Commodity Exchange Act's definitions of
18 "futures commission merchant" and "introducing
19 broker" to permit them to trade swaps for
20 customers. Accordingly, the proposed rule-making
21 amends regulations applicable to FCMs and IBs so
22 that they cover swaps analogously to futures.

1 Definitions. Staff has proposed
2 revising the definitions of "customer," "customer
3 funds," and "commodity interest" so that customers
4 of FCMs and IBs include swap customers and so that
5 the transactions they handle include swaps
6 transactions in addition to futures transactions.

7 Recordkeeping. We've proposed revising
8 fundamental recordkeeping rules so that FCMs and
9 IBs keep records of swaps transactions similarly
10 to how they presently maintain records of futures
11 transactions. For example, we've proposed
12 amending Regulation 1.31 so that swap records must
13 be maintained not only for five years, which is
14 the current retention period for futures records,
15 but also for the life of the swap because swaps
16 tend to have longer terms than futures. This
17 would require FCMs and IBs to maintain swap
18 records for the same amount of time as the
19 Commission recently proposed for swap dealers and
20 major swap participants.

21 Bunched orders. Under current
22 Regulation 1.35 FCMs and IBs must keep records

1 identifying each customer whose order is submitted
2 to a designated contract market. However, if an
3 FCM or IB receives several orders for the same
4 contract -- a bunched order -- from an eligible
5 account manager, such as a commodity trading
6 advisor, the FCM or IB need not include in its
7 trading records the identity of each customer. In
8 order for the FCM or IB to avail itself of this
9 exception the eligible account manager's
10 post-trade allocation scheme must be fair so that
11 the manager doesn't give preferential treatment to
12 certain customers if the FCM or IB can't fill all
13 of the bunched orders at the best available market
14 price.

15 Staff has proposed amending the bunched
16 orders provision so that swap orders can be
17 bunched analogously to futures orders and can be
18 submitted to a swap execution facility in addition
19 to a DCM. Staff has proposed provisions specific
20 to bunched orders for swaps executed bilaterally.
21 Whereas eligible account managers must allocate
22 bunched orders that have been cleared as soon as

1 necessary to ensure that clearing records identify
2 each customer, which would have to happen sometime
3 before the end of the day on which the order is
4 executed, bunched orders executed bilaterally must
5 be allocated to individual customers by the end of
6 the day on which the order was executed. The
7 preamble of the proposed rule seeks comment
8 whether it be possible for market participants to
9 bunch swap orders as proposed.

10 Finally, in amending the bunched orders
11 provisions in Regulation 1.35 staff has proposed
12 adding FCMs and IBs to the list of eligible
13 account managers. We understand that these
14 brokers have the ability to bunch orders and,
15 therefore, they should be permitted to do so
16 provided they comply with all of the existing
17 rules as well as other regulations that prohibit
18 these brokers from trading ahead of their
19 customers. As a result, FCMs and IBs would not be
20 able to bunch customer orders with their own
21 proprietary orders.

22 MS. ZAKIR: Good morning, Mr. Chairman

1 and Commissioners. In addition to establishing a
2 comprehensive regulatory framework for swaps and
3 security-based swaps, Title VII of the Dodd-Frank
4 Act also created a new type of regulated
5 marketplace and registered entity called the swap
6 execution facility, or SEF. The Dodd-Frank Act
7 established a new regulatory framework for SEFs
8 similar in many respects to the regulatory
9 framework for designated contract markets. In
10 particular, the regulatory framework for SEFs
11 under the Dodd-Frank Act includes a number of
12 self-regulatory responsibilities that are similar
13 to the self-regulatory obligations of DCMs.
14 Accordingly, the amendments to the Commission's
15 regulations proposed today would add SEFs to
16 certain regulations that currently applied to
17 designated contract markets.

18 As an initial matter, staff is proposing
19 to amend the definition of "self-regulatory
20 organization" in Regulation 1.3(ee) to include
21 SEFs. The addition of swap execution facilities
22 to the self-regulatory organization definition

1 would, for example, require SEFs to comply with
2 Regulation 1.59 which requires self-regulatory
3 organizations to submit rules to the Commission
4 that prohibits certain conduct by their employees.

5 Staff also is proposing several new and
6 revised definitions under Part 1 for terms that
7 are newly defined or have revised definitions
8 under the Dodd-Frank Act. Such terms include
9 "swap execution facility," "swap data repository,"
10 "floor broker," and "floor trader," to name a few.

11 Staff is proposing also to amend
12 Regulation 1.35 to add SEF participants who have
13 trading privileges to the list of persons that
14 must comply with the basic recordkeeping functions
15 that are currently applicable to members of
16 designated contract markets, FCMs, intermediary
17 brokers, and retail foreign exchange dealers.

18 The proposed revisions to Regulation
19 1.39 would extend the requirements applicable to
20 the simultaneous execution of buy and sell orders
21 of different principals to staff participants with
22 trading privileges.

1 Staff also is proposing to extend
2 Regulation 1.67, which currently applies designed
3 contract markets to SEFs, thereby requiring a SEF
4 to notify an FCM or other registrant upon learning
5 that a member of such facility or market violated
6 a rule resulting in financial harm to a customer
7 and requiring the FCM or registrant to then notify
8 the customer.

9 Staff is further proposing to revise
10 Part 7 which currently sets forth contract market
11 rules altered or supplemented by the Commission
12 pursuant to Section 8(a)(7) of the Commodity
13 Exchange Act. Staff proposes to revise parts of
14 and to include the rules of any registered entity,
15 including SEFs, that the Commission may alter or
16 supplement in the future.

17 In order to implement the grandfathering
18 and phase-out of exempt markets under the
19 Dodd-Frank Act staff also is proposing an
20 amendment to Part 36 governing exempt markets.
21 The revisions eliminate cross references to
22 sections of the Commodity Exchange Act that are

1 eliminated by the Dodd-Frank Act. While
2 eliminating the cross references, the proposed
3 revisions incorporate the relevant substantive
4 provisions of the Commodity Exchange Act
5 applicable to exempt markets that will continue to
6 operate during the pendency of the grandfathering
7 period as permitted by the Dodd-Frank Act.

8 Finally, staff is proposing revisions to
9 Part 140 and 145 pertaining to governing
10 organizations, functions, and Commission
11 procedures, and Commission records and
12 information. The proposed revisions largely add
13 SEFs and swap data repositories to the provisions
14 that are currently applicable to other registered
15 entities, including, for example, the Commission's
16 delegation of authority to divisions within the
17 Commission to publish in the Federal Register and
18 to disclose confidential information.

19 This concludes my presentation and I
20 look forward to answering your questions. Thank
21 you.

22 MR. ARON: I just have a few preliminary

1 remarks. I just want to say it's great to be back
2 here. It's even more fun the second time around
3 at the agency. And Peter stole one or two of my
4 bullets, so my presentation will be even shorter
5 than it otherwise was.

6 And lastly, I didn't actually draft the
7 proposed changes to 1.31 and 1.35, so my able
8 enforcement colleagues may jump in in response to
9 some questions that I anticipate on possibly the
10 oral recordkeeping rule and otherwise.

11 So 1.31 is the Commission's general
12 recordkeeping rule, 1.35 is its transaction
13 recordkeeping rule. Our general approach and what
14 we're recommending today was to conform to the
15 December 9th swap dealer and MSP recordkeeping
16 rule -- which I note was a five-nothing vote -- to
17 conform in some respects to international
18 standards.

19 The overview of the 1.31 changes are
20 first that all persons who are subject to our
21 recordkeeping rules would be required to keep
22 those records in original format for paper or

1 native file format for electronic records. And
2 I'll come back to what "native file format" means
3 in a minute. And I understand that enforcement
4 already expresses a preference for those formats
5 in their record production requests currently, so
6 it won't be a complete surprise or change.

7 Production of records must be in a form
8 for proposing -- or recommending the proposed --
9 that they be in a form specified by the
10 Commission. And Federal Rules of Civil Procedure
11 already require that with respect to federal
12 proceedings currently.

13 Next, we would propose that record
14 keepers maintain records of swaps and related
15 sport and forward trades until, as Peter
16 mentioned, expiration, termination, or transfer
17 plus five years, for the reasons Peter mentioned.

18 And lastly, the record keepers would be
19 required to permit inspection not only by us and
20 DOJ, but also the applicable bank regulators; and
21 for security-based swap agreements, only the SEC.

22 So native file format briefly is the

1 format in which the electronic file was originally
2 created. And this is important because saving a
3 file in that format ensures it will store all the
4 data that were created with the program. Other
5 formats may be compatible, but they might not save
6 all the information. So if you save a Word
7 document as a plain text file, it removes the
8 formatting. We don't want changes like that.

9 So moving to 1.35, the recordkeeping
10 obligations would extend to -- I think Peter
11 mentioned this as well -- swaps executed by FCMs,
12 IBs, and SEF members on SEFs. The rule applies
13 now to non-swaps and only on DCMs.

14 Next, the oral recordkeeping proposal.
15 It would expressly require FCMs, retail forex
16 dealers, IBs, and DCM, SEF members to keep records
17 of all oral and written communications that lead
18 to commodity interest or cash commodity trades:
19 Commodity interests, you know, swaps, futures,
20 futures options, commodity options. And the
21 rationale behind our recommendation is that where
22 oral communications are used to form trades, the

1 Commission has historically had a more difficult
2 time enforcing the Commodity Exchange Act in our
3 regs, and particularly where we must establish a
4 threshold knowledge or intent level of
5 sustain-and-action. And as a consequence
6 enforcement success is often directly correlated
7 to the existence of a high-quality voice
8 recording, so we're trying to increase the
9 efficiency and get better results.

10 So that's kind of a quick and dirty and,
11 you know, ready for some questions.

12 CHAIRMAN GENSLER: With that, the Chair
13 will entertain a motion to accept the staff
14 recommendation to issue the rule concerning
15 amendments to various regulations.

16 COMMISSIONER SOMMERS: So moved.

17 COMMISSIONER O'MALIA: Second.

18 CHAIRMAN GENSLER: I have just a couple
19 questions. I support this, but I particularly
20 want to ask a question about bunched orders and
21 then maybe on this recordkeeping.

22 And again, I'm relating this because so

1 many meetings that I've been in, asset managers,
2 particularly asset managers who use subaccounts --
3 a subaccount might mean that they're managing for
4 many different pension funds' money -- have raised
5 the bunched order flexibility that they have in
6 the futures world and have asked that they have a
7 similar flexibility in the swaps world if they're
8 traded on a swap execution facility or brought to
9 a clearinghouse. So my question, Peter and John
10 and the team, is do you think this addresses --
11 and I know, John, you've been in some of these
12 meetings -- does this address the issue that many
13 of these asset managers have raised?

14 MR. LAWTON: Yes, we believe that it
15 does. We've talked to a number of people and I
16 think the people are certainly interested in
17 reviewing this and seeing whether they believe it
18 can work for them. And I think it ties to the
19 Part 39 straight through processing rule that the
20 Commission proposed recently that the asset
21 managers had a concern about that rule because
22 they don't necessarily know at the time a trade is

1 executed who is the ultimate beneficial owner of
2 all the pieces of the trade. And we believe that
3 that issue was raised in the futures world in the
4 past and that the bunched orders rule seems to
5 address it. And we're trying to establish and
6 analogous procedure for swaps.

7 CHAIRMAN GENSLER: So, I mean, we could
8 get in a debate whether this is a conforming rule
9 or not a conforming rule. It's not ministerial,
10 as you said, but it is, in essence, taking is it
11 1.35 as it applies to futures and allowing
12 basically the flexibility that these pension funds
13 and asset managers could use a similar approach to
14 swaps?

15 MR. LAWTON: Right. And I think that
16 one issue that people will discuss is what should
17 be the deadline for getting your allocation done.
18 And I think we'll get some comment on that because
19 it may be that different asset managers have
20 different capabilities as to how quickly they can
21 do it.

22 CHAIRMAN GENSLER: Right. So I think

1 this helps lower risk to the market as it brings
2 things into clearing and swap execution
3 facilities, but actually addresses a legitimate
4 concern that asset managers had without clarifying
5 it. Because if the Commission didn't clarify it
6 they do our bunched order rules for futures apply
7 to swaps, and this is what this proposal's saying.

8 MR. LAWTON: Essentially, yes.

9 CHAIRMAN GENSLER: Yes. And then when
10 recordkeeping and reporting, I guess David and
11 maybe -- I see Vince there as well from the
12 Division of Enforcement, you said that this is,
13 again, you know, whether it's -- it's not
14 ministerial whether it's conforming, but, in any
15 event, this is consistent with what we did in a
16 rule in the fall, a proposed rule in the fall, for
17 swap dealers' recordkeeping, is that correct?

18 MR. ARON: That is actually, isn't it?
19 The oral --

20 CHAIRMAN GENSLER: Vince, come up to the
21 table if you want.

22 MR. LAWTON: Right. There was one of

1 the business conduct rules for swap dealers had a
2 similar provision and so that was just proposed.
3 It's out there as a proposal for swap dealers and
4 MSPs, so this would apply a similar requirement to
5 FCMs and IBs.

6 CHAIRMAN GENSLER: Is that right?

7 MR. MCGONAGLE: Yes, that's right. And
8 so it captures language that says each transaction
9 record shall be maintained as a separate file
10 identifiable by transaction and counterparty as
11 well as the length of time, say, in particular for
12 audio which is a new proposal for 1.35, that it be
13 for five years. And so currently, this proposal
14 tracks the prior language that was used for the
15 swaps rule.

16 CHAIRMAN GENSLER: And it's still -- you
17 know, it was out for comment, but if we do vote in
18 a few minutes to extend everybody 30 days, that
19 would be extended as well, so it'd be helpful.

20 Do you know what the international
21 regulators do, the FSA, for instance? What do
22 they do in this area?

1 MR. MCGONAGLE: So with respect to audio
2 recordings, there's been conversation in the
3 regulatory community, even internally within CFTC,
4 for several years about whether the recordkeeping
5 obligations should extend to audio. And
6 commencing in 2008, the UK FSA commenced a
7 comprehensive market study with respect to audio
8 requirements and imposed a rule that had a
9 retention requirement of six months. It was
10 basically focused on communications, say, at
11 certain dealers, that those communications be
12 maintained for a period of six months, and

13 entertained a number of comments from various
14 industry sources in determining whether to roll
15 out that rule. It had a very long tail with
16 respect to the implementation in the proposal, was
17 out there for several months. And then when the
18 proposal was picked up, implementation period
19 extended thereafter for several months.

20 But the FSA takeaway was that in large
21 part for their community audio was already being
22 captured. And so to the extent that for the large

1 firms they were already doing it, FSA didn't see
2 that there was large additional costs imposed.

3 That's not to say, however, that those
4 commenters who submitted to UK FSA agreed. I
5 mean, they took the position that there would be
6 costs associated with respect to audio
7 requirements. The UK FSA ultimately disagreed in
8 terms of whether the costs should outweigh the
9 benefit and ultimately promulgating the rule. And
10 the UK FSA is also coming out with a new proposal
11 which will be effective in the fall with respect
12 to cell phone communications and the data capture
13 for those conversations.

14 CHAIRMAN GENSLER: And is it correct, I
15 gather, for the Division of Enforcement you're
16 recommending this for at least two reasons. One,
17 it makes futures commission merchants have to be
18 consistent with swap dealers? Is that --

19 MR. MCGONAGLE: That's correct, Mr.
20 Chairman.

21 CHAIRMAN GENSLER: And then the second
22 reason is you think it'll be -- facilitate this

1 agency's transparency and ability to police the
2 markets?

3 MR. MCGONAGLE: So the benefits that we
4 see are for market protection, deterrence. The
5 communications? We're neutral as to the
6 communications, so they may be inculpatory or
7 exculpatory. But the fact of the matter is, is
8 that people communicate about their transactions
9 through writing and orally. We have a very good
10 program in place for the capture of written
11 records, written communications, and this would
12 capture oral communications that relate to the
13 transactions that we're most interested in.

14 CHAIRMAN GENSLER: Okay, thanks.
15 Commissioner Dunn?

16 COMMISSIONER DUNN: Let me follow upon
17 that because, correct if -- the proposed rule
18 regarding oral communications requires that a
19 registrant would actually record all oral
20 communications that could lead to an executed
21 transaction. Is that correct?

22 MR. MCGONAGLE: Yes. Commissioner, the

1 operative language is: All oral and written
2 communications provided or received concerning
3 quotes, solicitations, bids, offers, instructions,
4 trading, and prices that lead to the execution of
5 transactions and the commodity interest or cash
6 commodity whether communicated by telephone,
7 voicemail, facsimile, instant messaging, chat
8 rooms, electronic mail, mobile device, or other
9 digital or electronic media.

10 COMMISSIONER DUNN: Well, on the oral
11 side, I wonder when does the tape have to go on?
12 I'm in Chicago, so naturally I'm going to give a
13 little push for the Bulls since they won last
14 night. Say you've called up your friend and you
15 started talking about the Bulls game last night
16 and that evolved into something that potentially
17 leads to a transaction. At what point do they
18 have to turn on the tape or is it supposed to be
19 on all the time?

20 MR. MCGONAGLE: So my first answer is
21 the conservative one, which is basically, you
22 know, I'm interested in comments -- we'll be

1 interested in comments concerning how people are
2 already taping in the community. My expectation
3 is that the tape's going to be running. And in a
4 number of cases where we've obtained audio
5 recordings it's because people are speaking on a
6 taped line. And so they're having a conversation
7 at a desk where they're most likely to be
8 conducting business that's relevant to our
9 jurisdiction. So I think it's a situation where
10 they would not be able to toggle on and off during
11 their communication, that it would capture for the
12 entirety of the day those individuals that are
13 engaged in transactions that would be subject.

14 So, you know, we do pick up
15 conversations and this has happened in the past
16 where people will say whatever they say on the
17 phone, some of which won't be susceptible or, you
18 know, privacy issues or talking about their
19 day-to-day life, and intermixed with that will be
20 transactions or communications about transactions.
21 So that's a long way of saying that I don't know
22 that finding a bright line will be easy to do. It

1 would be easier, I think, if you had a taped line
2 and people conducting business just conducted
3 their business on that taped line.

4 MR. ARON: If I could just add a little
5 something. In connection with the FSA study they
6 found that 80 percent of the covered phone lines
7 were already being recorded and it's not that
8 unusual on Wall Street for traders to be recorded.
9 You often hear the beep in the background when
10 you're talking to a trader. So we'll find out in
11 response, you know, to what the commenters say if
12 maybe it's changed. But if it's not, it shouldn't
13 be all that unusual.

14 COMMISSIONER DUNN: All right. Thank
15 you.

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

18 COMMISSIONER SOMMERS: Thank you, Mr.
19 Chairman. I don't have any questions, but just
20 want to state two objections to these conforming
21 amendments.

22 The first being that I think it's

1 premature to have conforming amendments to conform
2 to proposals that we haven't finalized yet. And
3 the second one is the inclusion of issues that I
4 believe are important issues, but substantive
5 issues being put into a proposal that is supposed
6 to be conforming.

7 I don't have any questions. Thank you.

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

10 COMMISSIONER CHILTON: I have no
11 questions. Support it. Thank you.

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

14 COMMISSIONER O'MALIA: On the recording
15 and the recordkeeping, the amendment would require
16 that recorded communications be identified by
17 counterparty and transaction. How does this
18 differ from current storage practices of
19 electronic communications? And the second part of
20 this, can this kind of tagging be accomplished
21 automatically, you know, without human
22 intervention, so, you know, we're not going to

1 have to sort this thing out?

2 MR. ARON: I'm not really sure about the
3 technology, but, I mean, obviously when you just
4 set your phone line to be recorded it will all be
5 there. And presumably, you know, just manually it
6 can be done by simply somebody stating at the
7 beginning of a conversation who they're talking
8 to, you know. I don't know if we thought about
9 that specifically, but just off the top of my
10 head.

11 COMMISSIONER O'MALIA: Well, this goes
12 to kind of the larger conforming to our other
13 major rule-makings about counterparty IDs and
14 legal entity identifiers. If we're going to try
15 to sort all these communications out by those

16 transactions we're going to have to have a way to
17 manage that without saying -- you know, speaking
18 into the phone line and then requiring us to sort
19 that out. That's not a winner for us. Does
20 anybody have any thoughts on that, how we're going
21 to sort that out or how they're going to sort that
22 out so we don't have to?

1 MR. MCGONAGLE: Well, certainly the
2 industry that is using audio now, they're
3 capturing the information in a way that is
4 somewhat searchable because they want to go back
5 and confirm the nature of the transaction. So,
6 you know, from enforcement's perspective our
7 ability to do the audit trail without -- you know,
8 to focus on communications of interest and filter
9 out those communications that we're not interested
10 in, it is important. But I think here in
11 particular as it relates to audio how those
12 communications are tagged by transaction and
13 counterparty will be a key area for comment, so we
14 can see what people are able to do currently for
15 their audit trail as it relates to audio
16 communications because I think it's different for
17 the electronic -- you know, the e-mail and chat
18 rooms, things like that.

19 MR. KALS: Also, if I may add, some
20 market participants have already commented on some
21 of your questions with respect to the swap dealer
22 recordkeeping rule. And I know generally that

1 staff is considering those comments already.

2 COMMISSIONER O'MALIA: Can you
3 characterize those for me?

4 MR. KALS: I don't have specifics about
5 those.

6 COMMISSIONER O'MALIA: All right. Thank
7 you.

8 CHAIRMAN GENSLER: I do know,
9 Commissioner O'Malia, I asked just back here,
10 there's about 20 comments on that original rule,
11 but no summary of it.

12 COMMISSIONER DUNN: Mr. Chairman?

13 CHAIRMAN GENSLER: Yes.

14 COMMISSIONER DUNN: Mr. Chairman?

15 CHAIRMAN GENSLER: Yes.

16 COMMISSIONER DUNN: Just to follow up on
17 Commissioner Sommers' comments, will this comment
18 be held open until all other rules are completed?

19 CHAIRMAN GENSLER: Well, I think this
20 would be held open for, you know, the 60 days, but
21 it's my -- it's not my anticipation that any of us
22 are going to be thinking about this. It's going

1 to be an earlier rule we finalize. So just like
2 we have discretion to consider late comments as
3 late comments come on this, you know, we'd have
4 the discretion to take those comments in.

5 COMMISSIONER DUNN: Thank you for that
6 clarification.

7 CHAIRMAN GENSLER: Mr. Stawick?

8 MR. STAWICK: Commissioner O'Malia?

9 COMMISSIONER O'MALIA: Aye.

10 MR. STAWICK: Commissioner O'Malia, aye.
11 Commissioner Chilton?

12 COMMISSIONER CHILTON: Aye.

13 MR. STAWICK: Commissioner Chilton, aye.
14 Commissioner Sommers?

15 COMMISSIONER SOMMERS: No.

16 MR. STAWICK: Commissioner Sommers, no.
17 Commissioner Dunn?

18 COMMISSIONER DUNN: Aye.

19 MR. STAWICK: Commissioner Dunn, aye.
20 Mr. Chairman?

21 CHAIRMAN GENSLER: Aye.

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

1 Chairman, on this question the yeas are four, the
2 nays are one.

3 CHAIRMAN GENSLER: The ayes have it, so
4 the staff recommendation is accepted. I do ask at
5 this point for unanimous consent to allow staff to
6 make technical corrections to the documents voted
7 on today prior to sending them to the Federal
8 Register.

9 I guess not hearing any objections, the
10 technical corrections are done.

11 As I noted when we opened the meeting we
12 have now substantially completed the proposal
13 phase of our Dodd- Frank rule-making. We do have
14 the Volcker Rule. We're bound to find some other
15 things that we'll think are appropriate to
16 propose. Testing and supervision, we've had a lot
17 of discussions and I'm very much looking forward
18 to staff recommendations on that.

19 COMMISSIONER O'MALIA: What about
20 portfolio margining?

21 CHAIRMAN GENSLER: I'm with you on that
22 one. Commissioner O'Malia and I have been like --

1 COMMISSIONER O'MALIA: Let's write one.

2 CHAIRMAN GENSLER: Yes. Terrific. We
3 need to work on that one, so I agree with
4 Commissioner O'Malia on that.

5 But to continue to give potential market
6 participants the opportunity to evaluate the
7 entire mosaic of rule-makings the Commission will
8 vote to reopen and extend the comment period. I
9 know Commissioner O'Malia has an amendment to
10 what's been circulated here. But let me say I
11 think this time will allow the public to submit
12 any comments they might have after seeing the
13 whole mosaic.

14 And for the rules which the comment
15 period is closed, we've had the discretion. Those
16 late filers have been put up on our website and so
17 forth, but this is a more formal way to say, in
18 essence, take the month of May and have people
19 reflect and comment on these things.

20 But I think I need to have a motion on
21 extending the period for 30 days and then
22 Commissioner O'Malia can do the amendment. But do

1 I hear a motion first on the Federal Register
2 release that was distributed around to the
3 Commissioners' offices?

4 COMMISSIONER O'MALIA: So moved.

5 CHAIRMAN GENSLER: Maybe I'll second it.
6 And then I know that you had an amendment that you
7 wanted to make.

8 COMMISSIONER O'MALIA: Yes. Mr.
9 Chairman, I move to amend the proposed rule by
10 inserting language in the summary dates and
11 supplementary information sections. It would
12 request comment on the proposed sequencing of
13 considering final rules promulgated under
14 Dodd-Frank. I've circulated a draft that includes
15 that language.

16 Now, Mr. Chairman, we had talked earlier
17 on today about a more specific proposal. Now,
18 thanks to questioning by Commissioner Sommers and
19 Commissioner Chilton and General Counsel
20 Berkovitz' answers I have found a solution that
21 will not force everyone to take the proposal --
22 the very specific rule-making proposal that I was

1 seeking comment on, but I can submit that as part
2 of or my comments as an amendment to the rule. So
3 I am only asking that the language simply says:
4 The Commission is also requesting comment on the
5 order on which it should consider the final
6 rule-making made under the Dodd-Frank Act.

7 Now, I will, in my concurring statement,
8 put forward a very specific list that wouldn't
9 have passed because under the short timeframe I
10 don't think I'd give it enough time for our
11 Commissioners to review that. So I will put
12 forward that. I will hope that the public will
13 comment on that proposal and make suggestions
14 based on that. And if it's completely wrong, I
15 won't be offended. But we would like to have the
16 public's input, the market's input as to what the
17 proposed sequencing going forward is while we have
18 this extra 30 days or so to develop this
19 rule-making.

20 This does not at all satisfy my other
21 concern that we ought to also put forward an
22 implementation schedule and put that so the public

1 can comment on that. I think making full
2 transparency of how we're going to implement these
3 and over what period of time will be essential to
4 developing budgets, developing priorities, and
5 hiring, et cetera. So I guess I'm scratching one
6 part of the itch, but I'll be back.

7 So I appreciate the Commission's
8 tolerance of my amendment at this late date. And
9 I appreciate the willingness of staff to kind of
10 work this out as well.

11 CHAIRMAN GENSLER: It'd be my honor to
12 second your amendment.

13 COMMISSIONER O'MALIA: Thank you. I
14 appreciate that.

15 CHAIRMAN GENSLER: The original proposal
16 being moved and seconded and the amendment moved
17 and seconded, are there questions for Commissioner
18 O'Malia on his amendment or any comments by
19 Commissioners? I want to talk about
20 implementation phasing, but it's not a question.
21 So I just want to see, Commissioner Chilton or
22 Commissioner Dunn, who are in Chicago?

1 COMMISSIONER CHILTON: Well, I have some
2 questions, Mr. Chairman, but perhaps I want to
3 hear your comments first.

4 CHAIRMAN GENSLER: Okay. All right. So
5 on implementation phasing, I think we've benefited
6 by that all of our rules have asked about
7 effective dates. And we've benefited that
8 Congress has actually given the SEC and CFTC some
9 flexibility on effective dates. The staff is
10 having a roundtable -- two days of roundtables
11 next week. It's anticipation that before the
12 roundtables they're going to put out a set of
13 concepts. Whether it'll be 10 or 12 or 14
14 concepts, it's still sort of in discussion with
15 the SEC. These will be at the staff level. They
16 don't implicate the five of us or their five
17 Commissioners. And I think it will be very
18 helpful to get the public comment on these dozen
19 or so concepts and get those questions out. We
20 have a public comment file that I think is open
21 till June 10th or something as well.

22 Implementation phasing is a very

1 important role that we play to help lower the
2 cost; to get the job done, as Congress has asked
3 us, but try to take that cumulative cost and, you
4 know, sort of phase it over time. When does a
5 clearinghouse sort of be open for business, have
6 its Rule Book in place? When does a SEF or a swap
7 data repository sort of be open for business and
8 have its Rule Books in place? That can be
9 different than, for instance, when the clearing
10 mandate actually takes place and so forth.

11 So I think that we'll get a tremendous
12 amount of public input through putting out these,
13 what I'll call concepts, getting the input next
14 week. No doubt the concept will change, we'll all
15 deliberate a bunch, and continue to get good
16 feedback from the public.

17 I think this specifically about how we
18 phase our final rule-making, it is helpful to hear
19 from the public, but a lot of that, I think, is
20 going to be when the staff can adequately
21 summarize the comments, when we have sufficient
22 time to deliberate, and, of course, when we

1 consult with other regulators. And I think that
2 there's some rules that, frankly, we'll be able to
3 move sooner because they're less controversial.
4 But we still might say the effective date is six
5 months or nine months later, or it might be an
6 effective date that's conditional upon another
7 rule being finalized. So I wouldn't want to be
8 constrained if we happen to have consensus and we
9 can move a final rule because that helps lower
10 market uncertainty, even if we delay the effective
11 date. And I look at the two can be detached.

12 But I turn it to Commissioner Chilton
13 because I thought you had something you wanted to
14 add and I didn't want to front-run what I thought
15 you wanted to add.

16 COMMISSIONER CHILTON: Well, no,
17 actually it was helpful hearing what you were
18 saying, Mr. Chairman. But I did have a question
19 then, in that same line, for Mr. Berkovitz.

20 Nothing in the original 30-day comment
21 period which enumerated several rules, there's
22 nothing in that language that would require us to

1 extend the comment period on rules that are not
2 enumerated. Is that correct?

3 MR. BERKOVITZ: That's correct,
4 Commissioner. Only the specific rules that are
5 enumerated in the Federal Register Notice would
6 the comment period be officially reopened or
7 extended.

8 COMMISSIONER CHILTON: Okay. And then
9 the second question, because I generally think
10 that this idea of sequencing that the Chairman
11 talked about in February and Commissioner O'Malia
12 is trying to move forward is a good thing in
13 concept, but I had significant problems with the
14 original amendment that Commissioner O'Malia had.
15 But the concept, I think, is a good one and I
16 don't want to, you know, mess that concept up. So
17 my question, Mr. Berkovitz, is what essentially
18 the Chairman, I think, was saying there, but just
19 to confirm, there is nothing in the language of
20 Commissioner O'Malia's that would restrict the
21 Commission from implementing or passing final
22 rules that are within the constructs of the Act.

1 Is that correct?

2 Let me say it again. Nothing within
3 Commissioner O'Malia's language would restrict the
4 Commission's ability to operate within the
5 constructs and timetables of the Act. That
6 doesn't mean we're going to meet all the
7 deadlines; we've talked about how we're not. But
8 I just want to ensure that just because we're
9 asking for the sequencing that, as the Chairman
10 suggests, if we have the wherewithal with a number
11 of votes to go forward on something, we're not
12 required to wait for these things. We can still
13 do what Congress told us to do. Is that correct?

14 CHAIRMAN GENSLER: Commissioner Chilton,
15 Mr. Berkovitz is just making sure. He had seen
16 the language, but with your question he just wants
17 to refresh his look.

18 COMMISSIONER CHILTON: That's fine with
19 me. I want to be sure. I want to be deliberate.

20 MR. BERKOVITZ: That's correct,
21 Commissioner. The amendment would not restrict
22 the Commission's discretion or ability in terms of

1 the sequence of the final rules. This notice
2 would not do that.

3 COMMISSIONER CHILTON: Okay. Well, I
4 think it's a helpful thing, Commissioner O'Malia,
5 in general, again, how you've amended your
6 amendment. I think it's helpful.

7 I don't have any other questions, Mr.
8 Chairman.

9 COMMISSIONER DUNN: Mr. Chairman? I've
10 got a question and it's a follow-up on
11 Commissioner Sommers' concern about legal
12 certainty in the swaps with the repeal of certain
13 provisions of the Commodity Futures Modernization
14 Act. Will we address that particular concern
15 before that?

16 CHAIRMAN GENSLER: Commissioner Dunn,
17 I'm going to hand it over to Dan Berkovitz, but it
18 is my hope that we would, that the five of us
19 through our staffs and through our good counsel of
20 our general counsel, but as well as the heads of
21 the Division of Market Oversight and heads of DCIO
22 have some recommendations. The issue before us,

1 Dan, if you can comment, is that under Dodd-Frank
2 on July 15th, I think it's exactly in 12 weeks and
3 1 day or so, but that there are certain
4 self-executing provisions of Dodd-Frank. And as
5 we move through our rule-writing in the summer and
6 what well will be into the fall to finalize rules,
7 how the market addresses that.

8 So it's my hope that we'd have
9 recommendations from staff and we would address
10 ourselves to it, but, Dan, do you want to take the
11 question?

12 MR. BERKOVITZ: Yes, that's correct, Mr.
13 Chairman. The staff and my office and general
14 counsel's office and then the divisions have been
15 working to look at the various requirements which
16 would come into effect and the provisions that in
17 existing law which would no longer be in effect as
18 of the effective date, and to prepare a briefing
19 for the Commission, and the options and our
20 authorities for addressing that. We'll be
21 prepared to brief the Commission on that shortly.

22 CHAIRMAN GENSLER: The emphasis was on

1 "shortly," right, Dan?

2 MR. BERKOVITZ: Very shortly, Mr.
3 Chairman, yes.

4 CHAIRMAN GENSLER: Not hearing any
5 further questions, Mr. Stawick, you'll have to
6 figure out how to call the roll or do I --

7 MR. STAWICK: You may do it by voice
8 vote, Mr. Chairman.

9 CHAIRMAN GENSLER: Okay, I'm allowed to
10 do it by voice vote. All right. So do I do a
11 voice vote on the amendment first?

12 MR. STAWICK: Yes.

13 CHAIRMAN GENSLER: All right. So if I
14 could have all those in favor of Commissioner
15 O'Malia's amendment say aye.

16 GROUP: Aye.

17 CHAIRMAN GENSLER: Those opposed to
18 Commissioner O'Malia's amendment?

19 COMMISSIONER SOMMERS: No.

20 CHAIRMAN GENSLER: The ayes appear to
21 have it. And now I'll move to the amended motion
22 on the 30-day extension. All those who are in

1 favor say aye.

2 MR. STAWICK: This one, Mr. Chairman,
3 this is the actions under the previous unanimous
4 consent request.

5 CHAIRMAN GENSLER: Right. So, Mr.
6 Stawick, will you call the roll and the amended
7 motion?

8 MR. STAWICK: Commissioner O'Malia?

9 COMMISSIONER O'MALIA: Aye.

10 MR. STAWICK: Commissioner O'Malia, aye.
11 Commissioner Chilton?

12 COMMISSIONER CHILTON: Aye.

13 MR. STAWICK: Commissioner Chilton, aye.
14 Commissioner Sommers?

15 COMMISSIONER SOMMERS: No.

16 MR. STAWICK: Commissioner Sommers, no.
17 Commissioner Dunn?

18 COMMISSIONER DUNN: Aye.

19 MR. STAWICK: Commissioner Dunn, aye.
20 Mr. Chairman?

21 CHAIRMAN GENSLER: Aye.

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

1 Chairman, on this question the yeas are four, the
2 nays are one.

3 CHAIRMAN GENSLER: Thank you, Mr.
4 Stawick. The ayes having it. That, too, will be
5 sent to the Federal Register. And throughout the
6 summer and into the fall the Commission will hold
7 meetings like this one on some regular basis, but
8 we haven't set a schedule yet as we work through
9 some final rules. Right now we sort of have a bit
10 of a natural pause.

11 I think the next you'll have is some
12 staff roundtables, very important staff
13 roundtables next week on implementation phasing,
14 staff roundtables on segregation of cleared swaps,
15 maybe some others. But as we are able to move
16 towards some final rules in the next couple or
17 several months, we'll be doing as we always do, is
18 posting the public and putting out Federal
19 Register releases for meetings like this to do our
20 business in public and do final rules.

21 With that, if there's not further
22 Commission business I'd entertain a motion to

1 adjourn the meeting.

2 COMMISSIONER SOMMERS: So moved.

3 COMMISSIONER O'MALIA: Second.

4 CHAIRMAN GENSLER: All in favor?

5 GROUP: Aye.

6 CHAIRMAN GENSLER: All right. Any
7 opposed? It appears unanimous. I thank you all.
8 I thank all the staff. I thank the public for
9 being with us for these 14 meetings and being with
10 us on all their comments going forward.

11 (Whereupon, at 1:13 p.m., the
12 PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Stephen K. Garland, 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.

Notary Public, in and for the District of Columbia
My Commission Expires: May 31, 2014