UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

OPEN MEETING ON THREE FINAL RULE PROPOSALS, ONE PROPOSED RULE AND A DELEGATION OF AUTHORITY ORDER

Washington, D.C.

Wednesday, January 11, 2012

PARTICIPANTS:

Commission Members:

GARY GENSLER, Chairman

BART CHILTON, Commissioner

MARK WETJEN, Commissioner

JILL E. SOMMERS, Commissioner

SCOTT D. O'MALIA, Commissioner

Staff:

DAVID STAWICK, Office of the Secretariat

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Presentation No. 1: Final Rule on Protection of Cleared Swaps Customer Contracts and Collateral: Conforming Amendments to the Commodity Broker Bankruptcy Provisions

BOB WASSERMAN, Division of Clearing and Risk

LAURA ASTRADA, Division of Clearing and Risk

MARTIN WHITE, Office of General Counsel

Presentation No. 2: Final Rule on Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties

PHYLLIS CELA, Enforcement Division

TED KNELLER, Enforcement Division

CHARLES MCCARTY, Enforcement Division

PARTICIPANTS (CONT'D):

Presentation No. 3a: Final Rule on Registration of Swap Dealers and Major Swap Participants:

BARBARA GOLD, Division of Swap Dealer and Intermediary Oversight

CHRIS CUMMINGS, Division of Swap Dealer and Intermediary Oversight

ELIZABETH MILLER, Division of Swap Dealer and Intermediary Oversight

GARY BARNETT, Division of Swap Dealer and Intermediary Oversight

Presentation No. 3b: Delegation of Authority Order on Performance of Registration Functions by National Futures Association with Respect to Swap Dealers and Major Swap

BARBARA GOLD, Division of Swap Dealer and Intermediary Oversight

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Presentation No. 4: Proposed Rule on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, And Relationships with, Hedge Funds and Private Equity Funds:

STEVEN SEITZ, Office of General Counsel

GARY BARNETT, Division of Swap Dealer and Intermediary Oversight

P R O C E E D I N G S

(9:33 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 final and proposed rules under the Dodd-Frank Act.

I'd like to welcome members of the public, market participants, members of the media, as well as those listening to this meeting on the phone and watching this webcast, the first of our meetings in 2012.

I'd first like to wish everybody a happy New Year, and like to thank Commissioner Sommers, Chilton -- is Bart on the phone?

COMMISSIONER CHILTON: I'm here, Mr. Chairman.

CHAIRMAN GENSLER: Great. Commissioner O'Malia, Commissioner Wetjen for their significant contributions to this entire process as we move along, and I thank all of the members of the hardworking CFTC staff that are so dedicated to this mission.

This is our 23rd open meeting of the commission to consider Dodd-Frank rule-making, and today we'll consider staff recommendations on segregation of customer funds for cleared swaps, a business conduct standards rule, which helps on sales practices -- what we call external business conduct rules. Thirdly, registration of swap dealers and major swap participants.

And in addition, we will be voting on a delegation order to a registration authority to the National Futures Association. Those would be finals that we would look at.

Lastly, we'll vote on a proposed rule on proprietary trading provisions, which is best known as the Volcker Rule.

Today's segregation rule is an important step that staff is about to describe in protecting customers and reducing risk of the swaps market -- segregation of customer funds at the core foundation of customer protection in the futures and swaps marketplace.

The rule further protects customers by ensuring that futures commission merchants and clearing organizations segregate customer collateral supporting cleared swaps. It prohibits clearing organizations from using the collateral of non-defaulting, innocent customers to protect themselves and their clearing members.

So in essence, this rule builds upon what we have in the futures world by saying that a clearing organization cannot use non-defaulting customers' money to fill the hole of a defaulting customer's money. But I know that Bob and Laura and Martin will give us a better explanation.

For the first time, customer money must be protected all the way down to the clearinghouse on an individual basis. We've received tremendous amount of input on this rule, starting really shortly after the President signed the Dodd- Frank Act, but it's included two staff roundtables, as well as through comments on not only the proposal but something earlier called an "Advance Notice to Proposed Rule Making."

This rule builds on the customer protections included in the clearinghouse rules that we voted out in October. Most importantly, what we finalized in October included a provision that said that clearinghouses had to take customer money and keep it on a gross basis, not net one customer against another -- or more precisely, not let the futures commission merchants net that money against each other.

What we are continuing to gather thoughtful input on how we might build upon today's proposed final rule. And I've asked staff to carefully analyze proposals from market participants, and to make further recommendations on further safeguarding client collateral on an individual basis. And there have been numerous letters even in the last week, in the last month about some thoughts, and I've asked staff to consider those and give the best thoughts to those and bring back recommendations to this commission.

I've also requested staff to report to the commission on whether it would be appropriate to eventually consider segregation protections for futures that are similar to those that we hope to adopt today for swaps. And I've asked the staff to put together public roundtables, maybe more than one -- thank you, Bob and Laura, in advance -- on these potential customer protection initiatives.

The commission has made significant progress on three critical aspects of reform: Transparency in the marketplace, lowering risk to the public and enhancing market integrity.

Today, we turn to a new topic, which is the swap dealers themselves, and we'll consider registration of those swap dealers and external business conduct standards as well. This is just the first step. There will probably be, if I count right, five or six other rules that we'll consider throughout the rest of this year. But it starts us on a fourth and critical area of reform.

The external business conduct rule will establish and enforce robust sales practices in the swaps market. The registration rule will allow the commission to monitor the swap dealers and major swap participants for compliance, but it will be in partnership with the NFA, because I hope that we would also vote out a delegation order to them as well.

We'll also talk a bit today about the Volcker Rule. And if I'll just close on this hopefully, but putting out to comment the Volcker Rule proposal, it will be consistent with what the bank regulators and the SEC did in -- I think it was October. This joint rule proposal that they put out actually is under the Bank Holding Act, and what we will vote on today will be our part of this. I know the proposal will get a lot of comments, and I very much look forward to the public comments on this important rule.

I'd like to take a moment, though, also to discuss a possible schedule for considering final Dodd-Frank rules. I stress this is just a possible schedule because we're human. We're five Commissioners, and we're all going to have a lot of input, but just as I did in September, I put something out there so the public could at least know something about our internal deliberations.

So a more complete, tentative list will be up on our website today, but in addition to the three rules that we're consider today to finalize in the first quarter of 2012, I'm hopeful we can finalize both of the joint rules with the SEC on definitions. That's the entity and product definitions.

Other potential final rules for consideration relate around the end user exception and certain internal business conduct rules, and possibly core principles on designated contract markets.

In addition, I would be hopeful that we can put out some new proposals. One area that we've talked about in December collectively that is repropose a block rule, and also that we would explicitly seek public comment on some of the international aspects, or what's called the extraterritoriality applications of Dodd-Frank's Title VII.

One area that's also come up, and I know the press has written a little bit about it, is I'm hopeful that working with regional transmission organizations and rural electric cooperatives and municipal power authorities; that they will actually file petitions with us for what's called 4C exemptions. This is highly dependent upon when they come to us, but the best news right now is that the regional transmission organizations are close to filing something that we would put out to public comment and get the public's input on these possible exemptions.

As with the first 22 final rules, the CFTC's working to complete these remaining rules thoughtfully, not against a clock. It's based on thousands of public comments, more roundtables to come and lots of meetings.

But in brief, I wanted to thank everybody from this commission and the staff for what we've accomplished. It's really remarkable. To promote transparency, we've completed rules on large trader reporting, on the swap data repositories and then just in the end of December, on the actual data that goes to these data repositories, as well as realtime reporting to the public.

To lower risk to the public, we've been successful in completing rules on risk management of clearinghouses and enhanced customer protection on the investment of customer funds. And to enhance market integrity, we've finished rules giving the commission authority to prosecute wrongdoers against recklessly manipulating the markets. Whistleblower office -- not only did we finish the rules, but the office is now operationally up, and I want to welcome Vincente Martinez to the CFTC, who's running that office, and we finalized position limit rules on aggregate speculative positions.

These final rules represent a substantial down payment on making the marketplace safer and more transparent.

And with that, I think I'm going to turn it to Commissioner Sommers.

COMMISSIONER SOMMERS: Thank you, Mr. Chairman, and as always, thank you to the four teams that have worked so diligently to get the rules that we are considering today before us. They're enormous, complex rules, and we much appreciate all the hard work and dedication that you put into getting these rules to a place that is reasonable. So thank you all very much.

Today, we are considering a Volcker Rule proposal and final rules relating to the registration of swap dealers and major swap participants, external business conduct standards and segregation of collateral for cleared swaps.

The Volcker proposal and the external business conduct rules are lengthy and extremely complex, and I do not think we've taken sufficient time to fully consider all of their implications. This is due in part to the fact that much of our time over the past few weeks has been taken up with considering a host of policy issues regarding how to best address segregation and bankruptcy issues for both futures and swaps, and whether we should forge ahead with final rules that fail to include futures.

I am troubled that this is the path the commission has chosen. I'm also very concerned that in just two weeks, we will again be voting on rules that are both massive in length and extremely complicated without taking sufficient time to consider all of their implications.

I have been advised that on January 25, the commission and the SEC will vote to finalize joint rules defining the terms swap dealer and major swap participant, and that the CFTC will also vote on internal business conduct standards and final rules for CPOs and CTAs. I don't believe this schedule is workable.

As we vote on the Volcker Rule proposal today, I can't help but question the timing of this vote and why the commission did not join the other agencies in their proposal back in October. It certainly should not have come as a surprise to us last summer and early fall that the other agencies were getting close to being ready to issue their proposal.

Moreover, we had a CFTC team dedicated to the Volcker Rule -- a team that was coordinating with those other agencies. Had we planned better, we could've joined the October proposal.

Unfortunately, we are proposing rules that are virtually identical to the other agencies' proposed rules well after they have been widely criticized, and after many have called for those agencies to start over -- including Paul Volcker.

What will we do if they repropose their rules? Will we be prepared to withdraw our proposal and join a reproposed Volcker Rule with the other agencies? It seems as if we have put ourselves on a separate track, which I fear will needlessly complicate an already convoluted and likely unworkable set of rules.

Today, we're also voting on registration rules for swap dealers and major swap participants. I would've preferred to vote on these registration rules, along with the entity definitions and had hoped that the comprehensive rules relating to the extraterritorial application of Dodd-Frank would have been considered ahead of both of those.

Instead, we are continuing with the piecemeal approach. And while I and many market participants have been eager to take up the issue of extraterritoriality, the critical issue remains unaddressed.

As I have said many times over the last year, a logical plan for sequencing and implementing rules is critical if we expect the transition to this new regulatory regime to be smooth. We must consider comprehensively what sort of implementation and compliance schedule is truly realistic, given the realities of the markets we regulate.

We have already learned that the final rules we adopted for large trader reporting of swaps are unworkable, which required staff to issue broad, market-wide no action relief. Market participants were telling us all along that our requirements and deadlines were not workable, but we went ahead nonetheless.

I suggest we learn from that experience, and pay closer attention to what market participants tell us about legitimate compliance challenges and obstacles.

I also have serious concerns regarding the business conduct rules we are finalizing today. It is clear that Congress intended for us to implement increased protections for special entities. However, shortly after our proposed rules were published, special entities began to tell us that the protections we proposed were not protections at all. We heard over and over again from special entities, right up until last week, that our rules would not provide additional protections, but would actually harm them by making it more difficult for them to enter into arm's length transactions with swap dealers.

As I listened to these special entities tell me how our so-called protections would actually harm them, I could not help but think of President Reagan and his statement that the nine most terrifying words in the English language are, "I'm from the government, and I'm here to help."

I will be voting against the business conduct rules. Finally, I'm very concerned about voting today on the segregation rules. The final rules provide swap customers with protections from fellow customer risk -- protections that do not apply to futures customers.

During the discussions over this issue over the last year, we focused almost exclusively on the need to alleviate the risks that swap customers posed to their fellow swap customers with accounts at the same FCM. We did not focus on the risk customers face due to the actions of the FCM.

Given recent events, we need to rethink this approach so we can provide adequate protections in a comprehensive and coherent way, to swaps customers and futures customers.

I do not accept this piecemeal approach

to customer protection as a step in the right direction.

Thank you, Mr. Chairman, and thank you again to all the teams today.

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

COMMISSIONER CHILTON: Thanks, Mr. Chairman. I'm going to commend you for what you've done. I understand that Commissioner Sommers has some concerns. I think a lot of them have some merit, but we shouldn't let the perfect be the enemy of the good, and as you've discussed, we've got a panoply of accomplishments so far on this legislation with all the rules.

We're seven months behind the schedule that Congress gave us, and I appreciate the forthrightness that you've undertaken to get us going down the road. We're late on a lot of things, but that doesn't mean that we haven't made important progress, and I thank you for your leadership and all the help of the staff.

Sometimes you need to see what things

look like when they go really wrong, in order to appreciate how good you have it when things are going right. And we've seen a few things that have gone really wrong in the past couple of months, and it's made us think about how good we actually had it.

And I'm talking about something Commissioner Sommers referred to, and that's about MF Global, and how for so many years, we had the confidence that customer funds were very well protected by the Federal Commodities Segregated Account Statutes and Regulations. But MF Global was really sort of a slap in the face, wakeup call for us all, and it hit the very heart of who we are as regulators and who we are as an industry -- and most important, it's now a constant sort of clanging bell for me that we have to see what we need to do in order to ensure that customer funds -- taxpayers' money, that is -- are taken care of, first and foremost, before anything else.

We're in the middle of this path. Everybody knows that. We're in the process. Our investigators are trying to track down the money, and we're pursuing it, along with other civil and criminal authorities, all the available enforcement avenues.

At the same time, I think we need to look at what we can do to change our oversight system. Commissioner Sommers mentioned one thing there, but treating customers' monies the same in the swaps and the futures world. But we need to make sure that this doesn't happen again -- or at the very least, make sure that we're not making it easier for our customers to get ripped off.

I've spoken about a couple of things I think we need to do, and I appreciate, Mr. Chairman, that you have asked for suggestions, that we're holding roundtables. But I think the clock is ticking, and we're moving as forthrightly as we can.

But a couple of things I've talked about that I think we should do, and that I hope people will consider. One is an insurance fund in the derivatives space. And that would be similar to

SIPC in the securities area and similar to the FDIC and the banking industry.

The second thing is we scaled back our 1.25 Reg in early December, but I actually think we might need to go further than that. I do think we need to go further than that, and pull back on the type of investments that brokers can use to invest customer money. Since 1968, the commission has sort of gone down a slippery slope and allowed more and more things to be used, and I think we should, out of an abundance of caution, pull that back.

And then another thing is -- and I think most of my colleagues met with some of the folks that were in a couple of weeks ago. Some of them had some European counterparts, and they've got customer choice there. And customers can choose whether or not they want to opt out of any investment whatsoever using segregated funds. And I think that deserves our consideration.

And separately, but it's similar, there's also this idea of a guaranteed customer account. So you could still opt out, but there would also be a guaranteed customer account, which would in essence provide another alternative, perhaps even a third party to the FCM, to keep the funds segregated and safe.

And finally, as Commissioner Sommers said, I think it makes sense for us to consider this concept of regularizing the treatment of futures and swaps segregated funds so that we could more fully protect customers.

So anyway, I don't think we have a whole lot of time to waste. I do appreciate the fact that everybody's working hard. There's not much more you can get out of people than we're getting, Mr. Chairman.

But we're doing the LSOC Rule today, and I fully support that. But I think the lessons that we've learned so far from MF Global teaches that we don't have the luxury of time in making additional progress to protect customers. We need to do more, and we need to do it now, and I know that you feel that way too, Mr. Chairman, and I look forward to working with you and all my colleagues.

Thank you very much.

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

COMMISSIONER O'MALIA: Thank you, Mr. Chairman. That it was all very complicated -- Michael Lewis wrote this in his 2010 book, "The Big Short: Inside the Doomsday Machine." He was writing about how customers were sold publicly traded credit default swaps by Wall Street firms that were kept in the dark about the nature and the value of these investments.

It was complicated because no one would want to believe that the customers were being duped into paying to essentially take out the garbage of the housing bubble.

Fortunately, today's rule makings seek to require dealers to be more accountable to their customers and offer improved protections of segregated funds by FCMs.

I'd like to thank the four teams

responsible for today's three final and one proposed rule. Combined, these documents total over 1,000 pages -- a massive amount of work for the commission to review and to provide comment, and I commend the staff for their patience and willingness to work with the commission on very short time tables.

As is made clear in the book "The Big Short," many customers were not provided a full picture of the risks and various products, including specifically mortgage-backed securities, let alone the inherent conflicts of interest when dealers took positions opposite their customers.

Today, final rules relating to external business conduct standards present an informed integration of the statutory language, Congressional intent, existing statutory and regulatory and self-regulatory requirements for market professionals, securities law and industry best practices.

The final rules do not preserve many of the unworkable proposals, such as the best execution and the prohibition against trading and front-running, which were not at all supported in the comments.

As well, there are multiple modifications to the proposed rule, to, where possible and appropriate, avoid creating trading delays or barriers between swap dealers and major swap participants and their counterparts. One significant manner in which this is all accomplished is by allowing in many instances the demonstration of and compliance with the rules on a relationship basis through disclosures and counterparty representations through documentation. To the extent that they can standardize it, good luck, but that is provided in the rule.

Rules also provide safe harbors for swap dealers, from acting as an advisor to a special entity, and for dealers and MSPs to meet the requirement. They have a reasonable basis to believe that the special entities' representations meet the statutory specified qualifications to be a counterpart.

The final rule also confirms through a statement through the Department of Labor, the commission's external business conduct rules will not cause a swap dealer or MSP to become an ERISA fiduciary under existing law or in subsequent regulations, which I strongly support.

I believe, with the modification, the commission has endeavored to be responsible through the provision of guidance in appendix A to the subpart, and staff has assured me that the market participants may seek additional guidance from the commission staff if the rules are unclear or onerous. And I'm reminded of part 20, large trader reporting, when we thought we had it right and it was still confusing. So I'm pleased that we will offer some flexibility to help people develop the appropriate standards.

I also support the final rule making on the protection of cleared swaps, customer contracts and collateral, because I believe it's the most effective way to achieve customer portability.

However, as Commissioner Sommers noted, this rule making does not address, much less solve, MF Global. The rule making, properly understood, is simply a first step in the commission's reconsideration of the customer segregation regime for both futures, who bore the brunt of the MF Global failure, and cleared swaps customers.

I've drafted a separate statement on this final rule making and its significant limitations in an effort to inform the public and to prevent inaccurate perceptions of the proposal we have offered today.

In addition, I do not support the commission's version of the Volcker Rule. It is an unworkable solution that is entirely too complex and provides the commission with little to no means to enforce or to deter violations of this rule. Volcker Rule sets in motion what Sheila Bair, the former Chairman of the FDIC, aptly described as a 300 page Rube Goldberg contraption of regulation proposed by federal agencies.

As many commenters, including foreign banks and end users, allege, the rule may have unpredictable consequences for swaps liquidity. I've drafted a separate statement on this as well, that all you can find on my website, on the commission's webpage.

With regard to registration swap dealers and MSP, the commission is finalizing a final rule that requires SDs and MSPs to become and remain members of a registered futures association. To implement this regulation regime, the commission has delegated to the NFA the authority to perform the full range of registration functions and requires the NFA to monitor compliance of applicants and persons registered as SDs or MSPs. This is consistent with the current regulatory practice for futures, and wisely builds on the existing registration experience of the NFA.

The delegation will avoid the costly investment of taxpayer dollars to recreate NFA's registration system at the commission, and will allow the resources to be better employed at the commission's other -- towards the commission's other oversight responsibilities.

The following rule is an improvement over the proposal, and revised in two significant ways to address the concerns of commenters.

First, the following rule has been revised to make clear that the provisional registration will be granted upon filing of one's application and not upon NFA's review and approval of the application document. This will allow market participants to continue to conduct business while the NFA reviews their applications and is not burdened by arbitrary timelines.

The firms won't be forced to expend considerable amount of resources complying with the regulations, and must be given adequate time to do so.

Second, the rule allows for phased implementation of the business conduct rules, and I ultimately hope for all commodity exchange 4(s) rules to have the same flexibility.

Specifically, dealers will have 180 days after the effective date of that regulation or the date on which SDs or MSPs are required to apply for registration pursuant to regulation 310, the mandatory compliance reporting date -- registration date, actually.

Although this solution allows market participants more time to demonstrate compliance, it will still require market participants to track multiple rules to determine which 4(s) requirements they do or do not need to demonstrate compliance in order to comply with the NFA registration. Only the government could think it wise to pass over a simple, clear-cut bright line rule and instead adopt a cumbersome, complex set of timing rules on various separate rules.

The piecemeal approach makes it even more important that the commission issue a schedule outlining the order of rules to be considered and an implementation timeline for all of the rules. More transparency into scheduling and implementation will accelerate compliance and ensure those who have to register can do so in full knowledge of when the deadlines will occur.

Let me close again by thanking the staff who have worked very hard to prepare and negotiate over 1,000 pages of rule makings before the commission today. I think in terms of pages, this might be our biggest day, which is not our proudest moment. It's ridiculous to do 1,000 pages in one day. It's just not possible to get it right, and we should take a more measured approach on considering the number of rules we consider in any one meeting.

I do appreciate you circulating that timeline. It's something I've asked for, and it's essential, and I greatly appreciate that. Don't misread my frustration with the volume that we've had to achieve today, and I'd like to see that we make sure that we do a regular number of rule makings so we can get it right.

CHAIRMAN GENSLER: Just to address it -- I think -- and I'm -- so much depends on people not at this dais. I mean, their staffs, the SEC, other regulators and so forth. But that schedule, if we were to finalize these three finals today, list 11 things for the first quarter. So that would be eight other final Title VIIs. Now I am hopeful that we do these two proposals, the block rule and the extraterritoriality, and there's one non-Title VII, that CPO document that we've all had for about a month and a half.

And depending upon people's reactions -- so that might be two a meeting or something. There might be one meeting that will have to be three a meeting, but I think that would get us through the quarter.

But of course, we never know because maybe we're not able to get something from a staff recommendation up to the commission itself.

COMMISSIONER O'MALIA: We can do this now or do it later, but if you want to talk about your schedule and I'll comment on this. But there are a number of things that are not on this list that we know are pending -- OCR, colocation, things like -- I'd like to see. Commissioner

Chilton lists several things he wants -- no-year FCM, 30.7 seg requirements, how that money's held. We've talked about that. Are we going to consider that as part of a customer protection post-MF Global? Joint several liability for APs, which we discussed here, that was not able to get into this rule that you said we're going to immediately proceed to.

What are we going to do about the Volcker Rule? And this is coming back. This rule is so bad, it really merits re-proposal. So that's got to fit into all of this, and that does have a hard July 12 deadline, I understand.

So we've got some roundtables we've got to do, and these are just the things that, as I was scanning the rules, what's -- these are Dodd-Frank rules.

There are other rules that we need to do as well, and MF Global is going to force us to consider other rules as well.

So let's put this out, but let's put the full picture out, and then let's look at how many rules we are going to be doing in a day and see what we can get done.

CHAIRMAN GENSLER: I'm going to hand off to Commissioner Wetjen, but I totally agree. This is a critical time for this agency. We have so much that the people really want us to do -- to complete Dodd-Frank in a thoughtful, balanced way so that there's less risk and more transparency in the markets, while at the same time, there's significant non-Dodd-Frank matters to enhance customer protectors -- whether through rule making, roundtables or even some of the issues that Commissioner Chilton raised would probably take the work of Congress, as well as some of the key rules that you mentioned around ownership and control and colocation and so forth.

Commissioner Wetjen?

COMMISSIONER WETJEN: Thank you, Chairman Gensler. Thank you also to the professional staff for your hard work on the recommendations for us today. I appreciate all of your hard work on these rules. I also appreciate your dedication to getting these regulations right, and that you have remained open to public input and feedback from my office and others.

Clearly, there's a critical component -- the Dodd- Frank Act's regulatory regime for swaps and one of its primary means of reducing systemic risk in the financial markets.

Today, we are considering final regulations that will take important first steps to ensure that customer collateral is appropriately protected throughout the swaps clearing process.

The commission previously requested comment on a number of clearing models, each with certain customer protections and operational costs. After considering these models and engaging in detailed discussions with the public, I am confident that, at present, the legal segregation with operational comingling model sets forth the most cost- effective framework to protect customer collateral for swap transactions.

The LSOC model substantially reduces

fellow customer risk. Derivatives clearing organizations will be prohibited from accessing non-defaulting customer collateral in the event of a double default of a customer and its FCM clearing member.

In the event of such a default, moreover, LSOC facilitates the movement of positions and related collateral. Each DCO will have customer information on a customer by customer basis, and thus will be less reliant upon the defaulting FCM for that information.

To be clear, certain risks remain under the LSOC model. First, although fellow customer risk is significantly reduced, it is not completely eliminated. In the event of a double default, customers continue to face the risk that substantial variation margin will not be credited and imported immediately with non-defaulting customer collateral due to payment-netting practices.

Second, excess collateral in the FCM's customer account is always exposed to operational risks, including risks of fraud or misappropriation.

But no regulation -- indeed, no segregation model in itself -- will, in every case, prevent the willful misappropriation of customer funds. That is why I've asked the staff to consider whether additional or other collateral protections could further reduce risks to customer collateral.

For instance, I am eager to further discuss the merits of a guaranteed clearing participant relationship that would permit a customer to hold its collateral in a third party custodial account with a guarantee from its FCM clearing member. Commissioner Chilton mentioned this in his statement.

In the meantime, today's final regulations take the initial step of clarifying that customer collateral may be deposited at the election of the FCM and its customers and a third party safekeeping account. As indicated, the staff is planning two roundtables to seek public input concerning other potential measures to provide further protections for customer collateral.

I look forward to working with the staff on these important ongoing initiatives.

One of the issues we need to explore is whether similar protections for customer collateral in the futures markets would be appropriate. That's clearly a concern shared by my fellow Commissioners.

This should not, however, prevent us from taking important first steps to protect swaps customer collateral now. I therefore will be supporting the staff's recommendations.

We are also considering final regulations to establish external business conduct standards, which require a very delicate balance.

If our rules prove unworkable or raise unacceptable legal risks, then swap dealers and major swap participants may choose not to do business with some counterparties, especially special entities as defined by Dodd-Frank. This could deprive swap market participants of the liquidity they need to manage the risks.

I commend the staff for their diligent efforts and thoughtful consideration of the strong views expressed by those on all sides of this debate. The staff has fairly considered conflicting viewpoints in crafting a rule that, in their professional judgment, protect counterparties from abusive practices.

I support the staff's recommendations because, in my judgment as well, they take a reasoned approach consistent with the statute.

On the one hand, the rules implement a robust, investor protection regime as directed by Congress, especially with respect to special entities that the public depends on for stewardship of retirement benefits, public funds and endowments.

On the other hand, the rules set standards that are reasonably tailored to the manner in which the swap markets operate, and thus, market participants should be able to comply without undue regulatory risks and costs.

I appreciate the willingness of the staff to accommodate changes throughout the rule making process. These changes have improved the final regulations.

For example, the revisions made to develop safe harbors with respect to ERISA plans supported by my office and others reflect sound public policy in light of the established regulatory structure under ERISA and the high fiduciary standards already imposed.

I also support the shift in the final rules from proposed requirement -- that swap dealers provide a scenario analysis for high-risk, complex swaps. Rather than leaving difficult determinations as to what constitutes high-risk or complex to the dealer, the final rules permit a counterparty to opt in by requesting a scenario analysis for any swap together with disclosure, the material assumptions and limitations of the analysis.

Where, however, a counterparty performs

its own analysis and does not elect to obtain one from the dealer, we will not prescriptively mandate that one be provided anyway.

The final rule will build strong, new investor protections into the swap marketplace. It includes robust disclosure requirements that ensure counterparties require information sufficient to assess the nature and the extent of the material risks of a swap.

And the final rules contain a strong independence test to ensure that where a special entity has a qualified independent representative to act in its best interests, that representative is truly independent of the swap dealer or major swap participant on the other side of the transaction.

Finally, while I support this rule, our work in this area will not end here. The staff continues to work with the SEC, the Department of Labor, the National Futures Association and the Municipal Securities Rule Making Board to harmonize, where appropriate, our respective rules.

Equally important, some commenters have suggested that a registration and testing regime for independent representatives be created. The staff is exploring whether such a regime is feasible.

Today's registration process rules leverage the commission's existing framework by delegating to the National Futures Association full registration authority. The NFA will be responsible for reviewing applications and confirming initial compliance with commission rules.

Importantly, the commission will maintain the authority to review the NFA's performance and conduct onsite examinations of swap dealers and major swap participants.

I will be supporting these rules because they establish an appropriate process for provisional registration while the new regulatory framework comes into effect.

Finally, we are also considering a

proposal to implement what is commonly known as the Volcker Rule. Among other things, the Volcker Rule generally prohibits banking entities from engaging in short-term proprietary trading for their own accounts, and from owning or sponsoring hedge funds or private equity funds.

The commission's proposal includes questions concerning the applicability of certain provisions to CFTC- regulated entities, including FCMs, DCOs, swap dealers and major swap participants.

This proposal is an important step towards finalizing the Volcker Rule and providing much-needed regulatory certainty to the public and the banking community.

The commission's issuance of this proposal, together with the recent extension of the comment period by the other financial regulatory agencies, will afford the public an appropriate opportunity to review and comment on each agency's Volcker Rule.

I would like to thank the staff for

their hard work and coordination with other financial regulators. I will be supporting this proposal, and I look forward to the comments.

Again, I want to thank the staff for its hard work, and I appreciate having all the briefings and discussions we've had over the last couple of weeks.

Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Wetjen. And I think with that, the staff will make presentations concerning their recommendations on final rules for Dodd- Frank. And following each of the discussions, the commission may take a vote on the recommendations as presented.

To that end, I ask unanimous consent that all final votes conducted in this public meeting should be recorded votes, and the results of these votes be included in their relevant Federal Register releases.

Not hearing any objection, thus so ordered. Mr. Stawick, do you mind telling me why

I couldn't just do that for all Dodd-Frank, and I wouldn't have to do it each meeting?

MR. STAWICK: I cannot tell you why you can't do that for all other meetings.

CHAIRMAN GENSLER: All right.

MR. STAWICK: I think you can --

CHAIRMAN GENSLER: So maybe if I could just ask unanimous consent, then, for the remainder of our meetings, we'll always do recorded votes, and then I won't have to ask that each time.

So without objection -- okay. That's out of the script now.

At this time, I'd like to welcome Bob Wasserman and Laura Astrada from the Division of Clearing and Risk, Martin White from the Office of General Counsel to present the staff's recommendation concerning the final rule. Though there are only three people at the table, that did not really go to the extent of all the people from the Office of the Chief Economist, from the Office of General Counsel's Office, Division of Clearing, to the Division of Swaps and Intermediary Oversight, all the Commissioners' offices, even the Division of Market Oversight, if I can recall some meetings.

So I thank everybody. But Bob and Laura and Martin --

MR. WASSERMAN: Thank you, Mr. Chairman. I'm Robert Wasserman, of the Division of Clearing and Risk, and I am lead for the segregation bankruptcy team. I'd like to express my deep appreciation to my deputy, Laura Astrada, sitting to my right, and Martin White, of OGC, sitting to my left, as well as other members of my team -- my DCR colleague Alicia Lewis, Jennifer Bauer of Swap Dealer and Intermediary Oversight, and David Reiffen and Todd Prono, of the Office of the Chief Economist. This work could not have happened without their assistance.

This final rule represents a culmination of a year and a half of extensive public consultation, including dozens of meetings with representatives of DCOs, FCMs on the buy side, an advance notice of proposed rule making, a notice of proposed rule making and two public roundtables.

Section 724 of Dodd-Frank requires FCMs and DCOs to segregate the cleared swaps collateral of swaps customers. The final rule before you for consideration implements this provision. The rule also implements certain technical amendments concerning time periods and bankruptcy from some earlier legislation.

Segregation rules are designed to navigate through three concerns. First, customers, many of whom insist upon individual collateral protection with respect to their uncleared swaps, are concerned about fellow customer risk, the risk that a DCO would need to access the collateral of non- defaulting cleared swaps customers to cure an FCM default.

Moreover, some firms have expressed concern about the impact of such a loss of collateral on portability -- that is, the ability to transfer customer positions from a failing firm to a stable one, and the importance of avoiding disruptions that might be caused by a forced liquidation of customer positions.

Second, some firms and clearinghouses expressed concern about the costs of changing from a model where customers are protected on an anonymous basis -- that is, as a group -- to a model where customers are protected individually.

Third, we must operate within the limits of the bankruptcy code -- in particular, section 766(h) of the bankruptcy code requires pro rata distribution of customer property.

And the model that staff is recommending has been referred to as complete legal segregation or legally segregated but operationally comingled or LSOC.

These rules permit operational comingling, allowing FCMs and DCOs to keep the cleared swaps collateral of a firm, swaps customers together, just as is done today under the futures model. This avoids the administrative costs of managing, accounting for and reconciling collateral transfers between FCMs and DCOs for what may be thousands of customers on an individual basis.

The rules require legal segregation. They oblige firms to transmit information defining the cleared swaps portfolios of their customers up to the DCO at least once a day. The DCO will use this information to calculate the collateral associated with each customer's portfolio of cleared swaps.

The rules also allow DCOs to permit or to require excess or additional collateral for individual customers' portfolios, while tracking that collateral as attributable to the individual customer.

In the event the FCM clearing member defaults to the DCO, the rules require the DCO to treat these portfolios individually, using only the collateral attributable to a customer whose portfolio reflects losses to meet those losses.

The remaining collateral will be available to support a DCO's transfer of customer portfolios to one or more transfer FCMs, will be returned to the bankruptcy trustee for distribution to customers.

This model does not achieve perfect protection of customer collateral. Risks remain -- in particular, operational risk and investment risk. However, staff believes that this rule making strikes the best balance between achieving the goals of swaps customer collateral protection and fostering portability at a reasonable cost, all within the bounds of the bankruptcy code.

We realized that there are some market participants -- they've been referred to, of course, this morning -- who seek perfect protection of collateral, even at significant added cost. You have set us the challenge of working with these market participants and FCMs and DCOs to devise additional measures to achieve such protection consistent with the goal of risk management and the constraints of the bankruptcy code. You have also charged us to examine additional protections for futures customer collateral.

We intended to meet these challenges with dispatch, and to properly provide you with proposals.

Thank you.

CHAIRMAN GENSLER: Thank you, Bob. With that, I will entertain a motion to consider the staff recommendation on segregation of cleared swaps.

COMMISSIONER SOMMERS: So moved.

COMMISSIONER O'MALIA: Second.

CHAIRMAN GENSLER: With that, I intend to support this, I think, very critical rule -- this Congress-mandated. Customers dealing in swaps should get the full benefit of segregation, and we had to do a rule. And I think this is an important step forward in protecting customers and reducing risk in the swaps trading.

I think at the core, what it does is it ensures that at the clearinghouse, if one customer default brings down a futures commission merchant, a clearinghouse can't tap into another customer's funds to cover that. Is that right, Bob and Laura?

MR. WASSERMAN: Yes.

CHAIRMAN GENSLER: So it increases the protection under our rules and under the bankruptcy code. Is that right?

MR. WASSERMAN: Yes.

CHAIRMAN GENSLER: Yeah. And so I support it. I know that there are some -- some of the letters that we've received recently that have asked us, can we do something with regard to third party custodial accounts, individual segregated accounts, guaranteed accounts? They seem to have different names by different models.

But I do have a question about an interpretation that the CFTC put out in 2005 called Interpretation 10-1. And two questions. Why have commenters raised this with us, in simple plain English? And does it apply to swaps?

MR. WASSERMAN: So back in 1984, we had permitted certain third party custodial accounts to be used for futures. Of course, this was before swaps were subject to our jurisdiction. In the early 2000s, some problems were seen with this.

As a result, in 2005, essentially we pulled back from that 1984 interpretation. What the commission is doing in the preamble to this rule is making clear that that 2005 action does not apply to swaps, and so swaps customers would be able to use third party custodial accounts under the same conditions, under the same limitations as are set forth in the 1984 original Interpretation 10.

CHAIRMAN GENSLER: So as I take it that third party custodial accounts as they existed from 1984 to 2005 were no longer allowed for futures, and the commenters asked, but did that speak to swaps? And we're saying in the preamble, no, it doesn't prohibit it in swaps -- at least, along the conditions that were set back in that 20 year period.

MR. WASSERMAN: Yes.

CHAIRMAN GENSLER: But some commenters

have asked us to go a bit further -- that even if they, on a optional basis, wanted to go directly and set up -- there's so many titles of these things -- but individually segregated accounts or quit individual clearing accounts or guaranteed accounts, I think they're sometimes called -- you'll conduct a roundtable and do your best to come back with recommendations to the commission as to what is achievable, that best protects customers and is within our laws.

MR. WASSERMAN: Exactly.

CHAIRMAN GENSLER: Great. So once again, I support this rule. I think it's a very critical rule. It is only to swaps. It is not yet to futures, and it shouldn't be confused that way, but I've asked staff to consider what would be appropriate -- what timing and to do a roundtable, and it might be subject to as much public comment as this was because this had enormous input from the public.

But I think this is an important step forward, where swaps customers in essence will get greater protection than if we had just gone with what's called the futures model. So I thank you.

COMMISSIONER O'MALIA: Mr. Chairman, can I -- on that question you asked regarding the 2005 ruling, can I ask a follow-on?

CHAIRMAN GENSLER: Absolutely, as long as Commissioners don't mind the out of order. Sure, yeah.

COMMISSIONER O'MALIA: Bob, can you tell us what the bankruptcy treatment will be if we get rid of the 2005 for swaps? What does the 1984 bankruptcy treatment provide in pro rata distribution?

MR. WASSERMAN: And as noted in the 1984 interpretation, we basically said that we were concerned that persons making use of such accounts would mistakenly expect special treatment in the event of a bankruptcy. And so indeed, the pro rata distribution would continue to apply, regardless of the use of a third party account.

CHAIRMAN GENSLER: I take it, Commissioner O'Malia, what some people have raised and what hopefully staff can work on is, is there a way to both comply with Dodd-Frank section 4(d) -- is it F -- 4(df) and the bankruptcy code, but get the protections they would like through these individual accounts?

COMMISSIONER O'MALIA: Won't that require an act of Congress?

CHAIRMAN GENSLER: I don't know.

MR. WASSERMAN: And I think that we can work with folks, and I think through some combination of this, make it so that they are not acting through FCMs but rather are guaranteed by FCMs in what would be a direct relationship with a clearinghouse, at which point then they would fall outside the definition of customer property, and that's how one works around 766(h).

CHAIRMAN GENSLER: All I'm asking is that you get a lot of public input. And of course, anything -- even if we were to consider something, it would come back to this commission. It would be subject to notice and comment, and if it needs an act of Congress, then obviously we probably should figure that out with the public input that we get.

COMMISSIONER O'MALIA: Right. Well, we are running out of time. I mean, if customer protection actually hinges on bankruptcy reform, then Congress needs to get on with it.

CHAIRMAN GENSLER: Which means, I guess -- is another spur to figure this out soon.

MR. WASSERMAN: Yes, as I said, with dispatch.

CHAIRMAN GENSLER: Thank you, Commissioner O'Malia. Commissioner Sommers?

COMMISSIONER SOMMERS: Thank you, Mr. Chairman, and thank you again to this team for all your hard work.

I have a couple of different questions that hinge a lot on how protections could extend to futures, and while I understand you are working on solutions that may extend to futures, can we expect that what may extend to those customers is the same solution that we're voting on today -- that we would just simply extend this LSOC model to futures?

MR. WASSERMAN: I think in light of recent events, we're going to be considering a number of things. I think that I would certainly not say that the consideration would be limited to extending LSOC to futures.

COMMISSIONER SOMMERS: Okay. So in light of potentially going further or doing something different, is it prudent to require DCOs to set up operationally the systems to allow them to implement LSOC by November 8 of this year if that is not what is going to be the eventual solution?

So I guess what I'm saying is, if we go further and allow either optionality or some sort of completely segregated -- legally segregated -- account, should we be, at this point, finalizing a rule that sets up a different system and asking people to go to the expense of setting that up when we may not use that?

MR. WASSERMAN: I think it's at the last point where there may be a bit of distinction because I think what we're dealing with here is LSOC is essentially the baseline that would be available for swaps customers. To the extent we're looking at additional matters for certain swaps customers, those would be over and above LSOC, which is that baseline, and those would be specific to those individual customers.

I think there will be a lot of swaps participants who might not participate as much, who might not have as extensive accounts, for whom LSOC is where it stops because to do an individual relationship would be simply not cost beneficial given the nature of their relationship. And I think that might well be by number a very large number of the swaps participants.

So what we're talking about in terms of individual customer protection, I think, or individual client protection or however it gets structured and denominated, is something that would be for a relatively small but very important sliver. That doesn't mean that LSOC is going to be thrown away -- rather, that's what's going to be there as the baseline for, I think, by number, the majority of swaps customers.

COMMISSIONER SOMMERS: Which sort of leads me back to my first question about futures. Will that end up being --

MR. WASSERMAN: Well, my second point is --

COMMISSIONER SOMMERS: Okay.

MR. WASSERMAN: Right now, we have the futures model, and that plumbing, if you will, is there for futures customers. What will be happening between now and November 8 is the building and the testing and the implementation of LSOC for swaps customers. By implementing that for swaps customers, you're basically setting up the framework that would then, assuming the commission were to adopt LSOC for futures customers, could then be extended to the futures customers.

So we have an existing futures model. We will have an LSOC model, and then essentially you'd be building off of that. And so it's not that any of this is going to be just simply thrown away, but rather what you have is a building up.

COMMISSIONER SOMMERS: Okay. So my next question relates to in the interim, those people who have swaps accounts and can take advantage of LSOC -- if they would like to take advantage of the type of netting efficiencies you would receive of having your futures and your swaps in the same account, will they be able to put their futures in their swaps account?

MR. WASSERMAN: We have a process for putting futures in a swaps account, basically under section 4(d), and essentially those have been referred to as 4(d) orders. And historically, in a number of cases, have granted such orders.

Moreover, as part of the DCO rules that were enacted back in November, we have a provision -- I believe it's 39.15 -- under which the DCO can request and by rule and providing certain information approval for comingling between futures and swaps. This would be generally done based on particular contracts, at the request of the DCO, as opposed to an individual customer's account by account.

COMMISSIONER SOMMERS: So this would have to be something that the DCO would initiate with us, not necessarily something a FCM or customer would initiate with the DCO.

MR. WASSERMAN: Historically, that's the way it's proceeded.

COMMISSIONER SOMMERS: Okay, okay. So again, I think just to point out -- and for the sake of beating this too much, this will be my last question with regard to futures.

MR. WASSERMAN: Please.

COMMISSIONER SOMMERS: If somebody who has a swaps account is able to put their futures in their swaps account and take advantage of greater customer collateral protection, I fear that the only people that are left out are those who do not have swaps accounts.

MR. WASSERMAN: Again, I think this is done more on a product by product basis, and generally, these rules -- putting futures in the swaps account generally has happened -- well, it hasn't happened yet, of course, but comingling, rather, in the same account has happened with products that are risk-related.

COMMISSIONER SOMMERS: Right.

MR. WASSERMAN: And so for instance, when you have a futures product --

COMMISSIONER SOMMERS: Right.

MR. WASSERMAN: -- and a swaps product that are -- and so I'm not sure that what you're suggesting --

COMMISSIONER SOMMERS: Right.

MR. WASSERMAN: -- would be as likely to happen --

COMMISSIONER SOMMERS: Well --

MR. WASSERMAN: -- but obviously --

COMMISSIONER SOMMERS: So I guess what you could assume is that for products like commodities, there may not be the offsetting swaps position in commodities yet or -- right?

MR. WASSERMAN: Yeah.

COMMISSIONER SOMMERS: More likely not for those accounts, instead of for financial futures, interest rates --

MR. WASSERMAN: Yeah.

COMMISSIONER SOMMERS: Thank you so much.

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

COMMISSIONER CHILTON: I don't have a question. I just wanted to make a quick statement, and then thank this team.

But we continue to see a lot of the same people at the table here, who are really the stars of the agency. Bob Wasserman in particular has been a real star. He's worked extra hard on the MF Global circumstance, leaving his family during the holidays and being up in New York, and we thank you, Bob, and appreciate all the work that's going on -- not just the people at the table, but the people behind them -- but particular Bob. You've done a great job on this one, on the other things you've worked on.

Again, I don't have any questions. Thank you, Mr. Chairman.

MR. WASSERMAN: Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. That is true. Bob and Laura and Martin -- I mean, everything that you're doing is very significant for the public.

Commissioner O'Malia?

COMMISSIONER O'MALIA: This was kind of a tough rule for me. And Bob, we've gone round and round on this one, but I do appreciate the time you've spent. And Laura and Martin, all the work you've done on this rule.

And Commissioner Sommers points out a significant flaw in this -- that it is one piece to a real customer protection regime. And it's not only segregation. There are many other kind of reforms that we really have to consider, and have to do so in a timely fashion, to really implement true customer protection, not just in segregation.

This is, when you look at MF Global,

really a small part because what we're doing today doesn't even affect what happened at MF Global.

So I was weighing the process issue versus the rule issue. And I decided I'd vote yes on this only because of the rule and only because it offers better customer portability and a customer to customer relationship. The operational risks exist. The bankruptcy challenges exist. We've got two trustees. We've got a trustee not in the FCM model, but we're balancing that against -- and in any trustee situation, we're always going to find a pro rata situation that's going to limit our ability, despite what our part 190 rules say about moving and porting positions. You get into that trustee business, everything stops.

And I know they're trying to be careful, and I know they're trying to look out for customers, but we can't promise more than we can deliver on these things, and we should be very clear about what this rule delivers.

I have a bunch of questions along these

lines, and so just be patient with me, and the shorter the answers, the quicker it'll go.

And we're applying just this LSOC model -- and I believe it's a complete misnomer to call it complete legal segregation. I think we continue to confuse the issue, but let's just stick with LSOC.

First of all, it does not apply to futures customers at all, correct?

MR. WASSERMAN: Correct.

COMMISSIONER O'MALIA: In many ways, the operational structures that this final rule making creates is modeled on the future segregation structure, correct?

MR. WASSERMAN: Correct.

COMMISSIONER O'MALIA: So would it be fair to say to the extent that future segregation structures may have vulnerabilities, this rule making may share in such vulnerabilities?

MR. WASSERMAN: Correct.

COMMISSIONER O'MALIA: If the commission were to reconsider such aspects of the future segregation structure, would the commission need to make similar changes in this final rule making -- if we were going to fix more broadly the operational risks?

MR. WASSERMAN: This is when I'll have to do more than one word. I would say that I think if we consider doing added things in futures, I would expect we would continue doing those same added things in swaps. My point being that we would be building on the structure rather than ripping the structure out.

COMMISSIONER O'MALIA: So an intermediary may be making technological investments is directed in this final rule making only to be potentially redirected -- and potentially even this year.

MR. WASSERMAN: That's where I'm pointing out that I think these would be -- they might well be making additional investments. I don't believe that they would be essentially building something up only to rip it out and put something different in its place. I would see this as something additional.

COMMISSIONER O'MALIA: Okay, thank you. To highlight some of the operational limitations --

What is operational risk and what is investment risk?

MR. WASSERMAN: Operational risk in this context essentially comes from the operations of the entity, and one thing that is included in this context is from people misusing funds -- whether intentionally or accidentally.

And investment risk -- as you know, we have our Rule 125 and this parallels 125. And while Rule 125 -- the commission has since -- recently, of course, tightened up to reduce the investment risk, investment risk remains in anything really other than cash.

COMMISSIONER O'MALIA: So is it fair to say that even for cleared swaps customers, this rule making does not mitigate operational risk, nor does it mitigate investment risk?

MR. WASSERMAN: I think that would

probably be a bit too far. It does mitigate it to the same extent that these rules that we have -- which, in fairness, while there have been failures, they do tend to work mostly and most of the time.

And so to the extent we have segregation rules in the futures models, we are having much the same in this model. To the extent we have limitations on investments of customer funds, in the futures model, there will be exactly the same in this model. And so it is mitigated but not perfectly so.

COMMISSIONER O'MALIA: Do you want to elaborate on the customer to customer relationship, in terms of what that protects -- in terms of portability?

MR. WASSERMAN: I'm not sure I understand the question. Sorry.

COMMISSIONER O'MALIA: What does this operationally provide for -- protections -- you want to elaborate on the -- you indicated that there are operational protections this does provide for. What are they?

MR. WASSERMAN: Essentially, this requires FCMs to treat customer funds as belonging to the customers. And so for instance, it is an FCM's responsibility -- and of course, we have capital requirements and supervision requirements over FCMs to make sure that they are fulfilling their responsibilities, and that they have the wherewithal to do so.

And so if one customer loses money, it is the FCM's responsibility to have that money in segregation in advance so that at each point, the FCM has enough money to meet its obligations to all those customers with positive balances, and that they're not using one customer's money to margin guarantee or secure, as the statute has it, another customer's positions.

And so it is the FCM's responsibility to use their own capital to do this, and we have capital rules to make sure they have the wherewithal to do that.

COMMISSIONER O'MALIA: As I understand

it, fellow customer risk, as defined in this rule making, does not extend to any collateral that an intermediary holds outside of the DCO. So any excess collateral that a cleared swaps customer may provide to its intermediary is not protected. Is that correct?

MR. WASSERMAN: One of the changes we made as a result of a comment is that excess collateral can be sent to the DCO, but to the extent you're asking if there's collateral that is held at the FCM, is that subject to operational risk? And the answer is, of course, yes.

COMMISSIONER O'MALIA: Okay. In the DCO core principles rule making, we state that a DCO must require its clearing members to collect excess collateral. Do we have a conflict here? I mean, we obviously have operational risk. In another rule making, we put a premium on excess collateral.

So how do we solve this? I think that to some of Commissioner Sommers's concerns, that's another step that we have to think about. But we've identified a weakness, obviously.

MR. WASSERMAN: I'm not sure I would agree, and here's why. First off, as I mentioned, excess -- the requirement under the DCO rule making is that they must collect collateral in an amount greater than that which would be required from the FCM acting, in other words, as a direct clearing member.

It is possible that this excess collateral would be staying at the FCM. It is also possible that the FCM, under this rule, would be sending that higher level of collateral, that excess collateral, to the DCM.

And so no, there's not an inherent conflict. Moreover, again, I think in light of recent events, we're going to be looking at how the seg system works and whether there are additional things that should be put on top of the rules we currently have.

And so I think that part of that process would be addressing this, but also, as I say, that excess collateral could be sent to, could be required by, the DCO.

COMMISSIONER O'MALIA: Yeah. I get the importance of having excess and protection. That mitigates risk. That's a cushion. Everybody understands that. But we also have to be honest. We have to put in place the proper protections to ensure that's taken care of.

Obviously people have, including myself, have agreed that the rule making needs to be adopted now because swaps are being cleared now. The company collateral is therefore vulnerable to fellow customer risk.

I'm trying to understand, in some respects, the timing of this. The Chairman and I have talked about at this dais when the clearing mandate begins. And how does this work with a seg rule that it becomes operational in November, and we potentially could have a mandatory clearing requirement in third quarter, end of second quarter?

How do we rationalize and bring this together? Will we have protections in place? Are we going to force them to go to a -- whatever's existing in a DCO today and then change again in November?

MR. WASSERMAN: And so we already do have some protections for cleared swaps now, as you quite rightly said. I am focused on these requirements, and we're implementing this at the implementation date of November 8 -- is the same time at which the gross margining requirement under the DCO rule becomes effective, and thus because this rule requires gross margining to work, that's when this becomes effective.

My familiarity with all the implementation issues is a little bit thin, and so I'm not sure I'm the best guy to answer those questions.

COMMISSIONER O'MALIA: Well, I agree.

CHAIRMAN GENSLER: May I --

COMMISSIONER O'MALIA: Please.

CHAIRMAN GENSLER: Sure. I think you raise a very good point. I see Sarah Josephson here, who's been sort of --

COMMISSIONER O'MALIA: So this is Sarah's fault?

CHAIRMAN GENSLER: No, no.

COMMISSIONER O'MALIA: Okay.

CHAIRMAN GENSLER: Actually, I think it works. I think it works because we haven't yet gotten a comment summary up to Commissioners on the comments from the implementation phasing, but as you recall, the clearinghouses start the process. They haven't kicked it off yet, so I don't know when that 90 day process will start. So part of it is when does that start.

The first bucket or the first group was dealer to dealer, and I guess the high activity hedge funds. So we would have to think through -- and I don't know what the commenters have said there to here. So I think your question is a very good question that needs to be joined when we start to look at those comments. If that first bucket -- in essence, if that first bucket is before November 8, then it is -- but most of that bucket is dealer to dealer, which wouldn't be in

-- because this is customer money.

MR. WASSERMAN: Yeah, this would not affect dealer to dealer.

COMMISSIONER O'MALIA: Well, obviously if we're going to explain where we are going with cleared customer money, then that's going to dictate obviously a big change in the industry. They're going to have to adopt this. They're not going to want to adopt multiple proposals -- I mean, to Commissioner Sommers's point -- so we just have to be clear and get the phasing right so everybody understands.

We did say, I believe, in that rule making that people who want to clear earlier can do so if they want, and that may include customers.

CHAIRMAN GENSLER: That's right.

COMMISSIONER O'MALIA: What does their universe look like?

CHAIRMAN GENSLER: Right. But that was voluntary, rather than mandatory.

COMMISSIONER O'MALIA: But --

MR. WASSERMAN: And there is, under our 2010 cleared OTC rule, there is protection for that collateral if the DCO rules require segregation. And so in this case, if customers voluntarily choose to clear -- and of course, by doing so, mitigating counterparty risk -- their customer collateral would be protected, assuming the DCO -- I know for instance CME has implemented just such a rule, and so collateral for cleared swaps at, say, the CME or anyone else, any other DCO which adopts a requirement for segregation -- and that's what would be in effect prior to November 8. That collateral would be protected as part of the cleared OTC account class.

COMMISSIONER O'MALIA: So what is the process for -- if they clear under that rule and then have to come in compliance with an LSOC rule, what is the process for -- what do they have to do to switch segregation regimes?

MR. WASSERMAN: There's not a whole --

COMMISSIONER O'MALIA: And if you get out of the position?

MR. WASSERMAN: I don't -- no, forgive me. This is -- these rules apply to the FCM, and this tells the FCM and DCO, this is what you must do with customer collateral. And so a customer who has cleared swaps, say, on November 7 and through November 9, there is nothing they will need to do.

What the FCM will need to do is on November 7, prior to November 8, they would be subject to the DCO rule. The DCO rule -- my understanding of the CME rule, having worked with them a bit on it, is it is very analogous to what we have under the futures model and, as we discussed earlier, the cleared swaps rule, in terms of the basic requirements, is also analogous.

In short, they would need to do certain additional things in terms of providing information about portfolios of positions to the DCO, and the DCO would be receiving that, and tracking it and making calculations on November 8 that they wouldn't be making or wouldn't be required to make on November 7.

But essentially, what you're talking about is a model that, in terms of its implementation, I think would be very similar from the seventh to the eighth. There would just be some additional things in terms of information flow that would be going up.

And then what could be done with that information in the event of a default? That's what would change November 8 versus November 7.

COMMISSIONER O'MALIA: Just one final comment. To the extent that we're going to continue to make changes to this -- let's not do it in a piecemeal approach. Let's try to get our ducks in a row on customer protections across FCMs, DCOs, et cetera, to understand what the full universe looks good, as opposed to rushing ahead and providing third party while we leave futures customers in third place, which is kind of where Bob pointed out.

We've talked about providing complete legal segregation or third party segregation.

Well, that's all well and good to direct the staff, but what about the futures customers?

And to further -- let's talk to the Hill about it because I remember when this first came up. It was because we were doing it because of the magic letter S -- whether it was customer or customers. Obviously there was a strong -- I think we put out a memorandum justifying why we had no other choice but to do it because of the magic S or the lack thereof. Let's make sure that the Hill is -- that this time, we're clear about what the Hill expects for this, and we engage with them as we look for -- because these are --

CHAIRMAN GENSLER: Gary Barnett, don't leave.

COMMISSIONER O'MALIA: So --

CHAIRMAN GENSLER: I was just going to say -- no, Gary -- so just -- Gary Barnett is part of this too. You should be -- you can leave in 30 seconds, but your staff at the Division of Swap and Intermediary Oversight also should be involved and engaged in these roundtables and so forth because I agree with, I think, what Commissioner O'Malia is saying -- is that we want to look at this customer protection thing thoughtfully, hear from the public, hear from the Hill in a thoughtful way, across these divisions and these topics.

The only thing is, it may well be that something becomes ripe and all five of us say, well, no, this is something that we can do, and there might be other things that need statutory changes that would take longer.

COMMISSIONER O'MALIA: And that's why we have to engage the Hill -- because we could come up to significant bankruptcy rule changes. On pro rata distribution, pointing out the 1985 and 2005 guidance -- that we may not be able to give them the protection they think they want in bankruptcy. And obviously the MF Global trustee issue is pointing out where we're stuck with bankruptcy.

CHAIRMAN GENSLER: Mr. Barnett, you can leave now. Thanks. Thank you.

Commissioner Wetjen?

COMMISSIONER WETJEN: I'd just like to point out, it's a number of tough acts to follow -- some very good questions.

COMMISSIONER O'MALIA: I've been there.

COMMISSIONER WETJEN: Does that mean you have sympathy or that you don't have sympathy?

COMMISSIONER O'MALIA: Not anymore.

CHAIRMAN GENSLER: He might have advice, though. You always want to have a good line about Macy.

COMMISSIONER WETJEN: Thanks again to the team for your work on this rule.

One thing I still have on Commissioner O'Malia is that I'm younger than he is. But my shorter time on this Earth, I've already discovered that life is a series of tradeoffs a lot of times, and in each of these rules, I think we've had to make some.

And one of them is with respect to FCMs and the risk management processes. And one of the things that has come up in my discussions is that when there is exposure to fellow customer risk, it actually has a good effect on FCMs because it forces them to be more careful and to develop better risk management processes, knowing that they might not attract customers without those processes in place.

So we're trying to do away with a lot of the fellow customer risk here with LSOC, but what kind of an effect is that going to have on the FCMs' risk management processes? And clearly the rule has made a judgment about that, and has decided to go the direction of the LSOC anyway, but I wondered if you'd just provide some comments about why we've gone in the direction we've gone in. Why do those --

MR. WASSERMAN: And I guess I would answer that -- as some of the customers have pointed out, what this will do is enhance the incentive of the DCO, who is now closer to the risk to risk manage their FCM members. Now of course, DCOs are already responsible for risk managing their members. They already have programs in place. They are, in fact -- first off, because they're more concentrated, this is essentially their main job. They have departments devoted to this in a better position.

And most importantly, this information about fellow customers -- that if I go to an FCM and I ask about my fellow customers, there's a limit to how much information they can give me because of issues with confidentiality. The DCO, on the other hand, is a market neutral, and a self-regulatory organization. So they can go to the FCM and ask very specific questions about specific fellow customers about whom the DCO is already getting information on.

And so the DCO, I think, is well-positioned to make sure that its member FCMs have excellent risk management.

COMMISSIONER WETJEN: Thanks for the explanation. Commissioner O'Malia had talked about a number of different risks that remain, even with LSOC. And one of them that caught my attention relates to the payment processes that clearing organizations use.

And so in the event of a double default of an FCM and a customer, you could still have a situation where a DCO is going to have to net payments to defaulting customers with payments -- I should say payments from defaulting customers with payments owed to non-defaulting customers.

Could there have been a way for the rule to address that? And if so, why haven't we done that here? As I understand, it could very well be a situation that it's not really resolvable. But I wondered if the staff had considered this particular risk.

MR. WASSERMAN: There are some additional things that DCOs will be able to do. Right now, the rule requires, based on our assessment of where the state of the art was at the time we were looking at this and is now, requires information to essentially go up once a day -- no less frequently than once a day.

But that's no less frequently. And so it is currently open to DCOs to require that their members provide that information more frequently

-- or indeed, as I understand, some DCOs may be looking at requiring that each transaction be associated with a particular customer so that the DCO could essentially do this on a quasi-realtime basis.

And so even within the rule as it's structured, DCOs could, by requiring that information, more frequently lessen the risk that you're referring to. And it may be the case that as the state of the art develops, we realize that in fact this is really the practice that folks are doing -- in which event we might then change the rule to require that.

But at the present time, looking at where we are, we didn't yet require it, and so that, to a certain extent, limits the protection. But it limits the required protection. Again, a DCO is perfectly free, even today, to start requiring that their members provide that information on a realtime basis. And so that would then reduce that risk.

COMMISSIONER WETJEN: Thanks, Bob. I

had a question about third party safety accounts, but the Chairman had already covered that, and also one about the interplay with the bankruptcy code and our rules, which Commissioner O'Malia had touched on, but the one other thing I wanted to mention or ask about -- and it relates to one of Commissioner Sommers's questions.

We had heard from some commenters as recently as yesterday about the kinds of effects LSOC would have on the futures space. And I'm wondering if the staff had considered that, and what sort of discussions you might have had.

For example, I think -- as I understood one of these comments, with the perceived greater protections of LSOC and swaps, you might actually drive a lot of trading volume to swaps and away from futures, and that could have a number of different pricing consequences for the futures markets, for participants who are more comfortable using futures, have been using them for a long time and otherwise would plan to continue to do so.

So I'm wondering what kinds of discussions the staff had about this particular problem -- if that's something that's come up before.

MR. WASSERMAN: I think the answer is that -- of course, with the swaps and the futures markets sort of moving closer together, to the extent that you have liquidity going to the swaps markets, you might well have customers following that liquidity.

And so to the extent you have particular contracts in the futures markets that lose liquidity because of a corresponding contract in the swap market, then you might find customers following that liquidity to the swap market.

To the extent you have the same contracts or similar contracts, then you might well have DCOs essentially putting in rules under that 39.15 that I mentioned, whereby essentially there would be moving the futures collateral into the swaps account, and the approach we take in the rule is that if you have futures in the swaps account, then the customers would -- and the collateral would -- enjoy the protections of the swaps account.

It also works the other way around, and so if you put swaps in the futures account, then you would have those protections.

And so I guess there's a number of ways of looking at it. And finally, as I pointed out, we are going to be looking with great dispatch at what else we can do for the futures customers and the futures accounts.

COMMISSIONER WETJEN: When I read these comments -- I mean, I think felt some of the same things, had some of the reactions I'm hearing that Commissioner Sommers had, which is you have -- I don't want to use this in a pejorative sense, but perhaps less sophisticated market participants who could be left disadvantaged somehow by this process.

I don't think, based on your answer and some of the other discussions we've had, I don't think it's a reason for us to not move forward with LSOC today, especially given the fact we already have swaps being cleared. But I do think it's a legitimate issue, and something that we should all be mindful of.

MR. WASSERMAN: Clearly, and we are limited today because under the Administrative Procedure Act, the commission can only adopt --

COMMISSIONER WETJEN: Right.

MR. WASSERMAN: -- what was proposed or a logical outgrowth. But certainly we're going to be looking at a lot of these things very quickly, to see basically what more we can do.

COMMISSIONER WETJEN: Thank you. Thanks, Bob.

CHAIRMAN GENSLER: Thank you, Commissioner Wetjen. If there are not further questions, then Mr. Stawick.

MR. STAWICK: Commissioner Wetjen?

COMMISSIONER WETJEN: Aye.

MR. STAWICK: Commissioner Wetjen, aye. Commissioner O'Malia?

COMMISSIONER O'MALIA: Aye.

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

CHAIRMAN GENSLER: So now we know what those two beeps were on the phone. I thought it was Commissioner O'Malia's sort of thing to keep your answers short, but it apparently cut Commissioner Chilton off.

MR. STAWICK: Commissioner Sommers?

COMMISSIONER SOMMERS: No.

MR. STAWICK: Commissioner Sommers, no. Mr. Chairman?

CHAIRMAN GENSLER: I'm going to do two things for you, Mr. Stawick. I'm reading a proxy -- this is to certify that the undersigned, Mark Chilton, he's left a proxy in support of the final rule on protection of cleared swaps customers, contracts and collateral on conforming amendments, commodity broker, bankruptcy provision.

This is so the public knows. This was left in case there was some problem with the telephones.

MR. STAWICK: Commissioner Chilton is noted as voting aye. Mr. Chairman?

CHAIRMAN GENSLER: Aye.

MR. STAWICK: Mr. Chairman, aye. Mr. Chairman, on this question, the yays are four, the nays are one.

CHAIRMAN GENSLER: I thank you, Mr. Stawick. The ayes have it. The staff recommendation is accepted, given that the majority has passed it.

So I thank you, Mr. Wasserman, Ms. Astrada, Mr. White. You have a lot of work still do to, obviously to get this in the Federal Register, but also on the roundtables, and to give thoughtful consideration to all that the five Commissioners have asked you to give thoughtful consideration to -- because we all asked you a lot. But thank you.

The second group that's going to come up to the table, I think, is a group to discuss rules on external business conduct -- Phyllis Cela, Ted Kneller, Charles McCarty, all from the Division of

Enforcement, to present the staff's recommendation concerning a final row of business conduct standards.

Charles, you and I both, think, twinged and I couldn't help it. No, it's not Pat McCarty here today. Pat's back there, is he? Where is Pat? There you are, man. My twin doesn't do that to me. God help us when he does.

All right. It's over to you.

MS. CELA: Okay. Thank you, Mr. Chairman. I'm joined today by Ted Kneller and Barry McCarty.

Ted is our specialist in special entity issues, and Barry has been working hard and specializing in the disclosure issues.

Good morning, and before presenting an overview of the final rules, I'd like to acknowledge the rest of the team as well -- Katie Driscoll, Michael Solinski, Todd Prono, Peter Sanchez, and colleagues in OGC, Mark Higgins and Rob Schwartz.

We have worked closely with our

counterparts at the SEC, and I would like to acknowledge Lourdes Gonzalez, the team leader there.

In the course of preparing the final rules, we received very helpful comments from numerous stakeholders through letters and consultations, and also from staff at fellow regulators, in particular the Department of Labor.

Section 731 of the Dodd-Frank Act adds section 4(sh) to the Commodity Exchange Act, and requires the commission to promulgate rules to establish business conduct standards for swap dealers and major swap participants dealing with counterparties generally.

In addition, Dodd-Frank requires the commission to promulgate rules to implement special protections for special entities, including governmental entities, public and private pension plans, and endowments.

The final rules are informed by statutory language in section 4(sh), Congressional intent, existing requirements for market professional under the CEA and commission regulations, securities law, SRO requirements, industry best practices, comment letters and consultations with stakeholders and regulators.

Generally, the rules require swap dealers and major swap participants to engage in fair dealing, make disclosures of material information and undertake due diligence concerning their counterparties.

Major swap participants are excluded from some of the due diligence requirements based on the nature of their swaps business.

The rules were designed where possible to avoid creating trading delays, imposing market entry barriers for counterparties and chilling communications between swap dealers or major swap participants and their counterparties.

For example, where appropriate, the final rules allow compliance on a relationship basis by including the prior disclosures and counterparty representations in master agreements.

Also, certain rules provide safe harbors that mitigate compliance risk. The release states that in exercising its prosecutorial discretion for violation of these rules, the commission will consider whether the swap dealer or major swap participant complied in good faith with its policies and procedures.

There are two broad categories of rules. First, rules that apply to deals with virtually all counterparties. And two, rules that apply to dealings with special entities.

In response to commenters' concerns, the release confirms that the external business conduct standards rules do not cause swap dealers or major swap participants to be advisers or otherwise owe fiduciary duties to counterparties solely by virtue of compliance with the rules.

In addition, the rule provides an exclusion from the commodity trading adviser definition for swap dealers whose advice is solely incidental to their business as a swap dealer.

We also understand from the Department of Labor that compliance with the final business conduct standards rules alone will not cause a swap dealer or major swap participant to become an ERISA fiduciary under existing ERISA law.

We are continuing to discuss with SEC staff the treatment of swap dealers and major swap participants under the municipal adviser definition as the SEC continues to consider final registration rules for municipal advisers.

The rules will apply to swap dealers and major swap participants when they know their counterparties prior to entering into a swap. Often these will be uncleared bilateral swaps.

The disclosure and due diligence requirements will not apply to swaps initiated on a designated contract market or a swap execution facility where the swap dealer or major swap participant does not know the identity of the counterparty prior to execution.

The general provisions contain prohibitions against fraud, manipulation and abusive practices, incorporating the statutory text from new section 4(sh)4.

The final rule adds an affirmative defense to fraud violations that are based on the business conduct standards rules.

The final rules also protect confidential counterparty information, but do not adopt the proposed freestanding trading ahead or front running rule.

The rules require disclosure of material risks and characteristics of the swap, and the material incentives and conflicts of interest of the swap dealer or major swap participant in connection with the swap.

Unlike the proposed rule, only swap dealers will be required to provide a scenario analysis, and only upon request for swaps that are not made available for trading on a SEF or a DCM.

The final verification of eligibility rule includes a safe harbor to facilitate compliance. For uncleared swaps, swap dealers and major swap participants must provide a daily mark, which is defined as the mid-market mark of the swap.

Swap dealers and major swap participants will be required to communicate to counterparties in a fair and balanced manner, based on principles of fair dealing and good faith. The final rules also include an institutional suitability rule that applies when swap dealers make recommendations to counterparties.

The final suitability rule is harmonized with the SEC and FINRA requirements, and includes safe harbors that rely on the exchange of particular representations by the parties.

The adopting release also includes an appendix to the rules providing guidance to swap dealers that make recommendations under the suitability rule and the special entity adviser rule.

The final rules referring the definition of special entity for certain municipal special entities and employee benefit plans -- a swap dealer will act as an adviser to a special entity when it recommends a swap or trading strategy involving a swap that is tailored to the particular needs or characteristics of the special entity. The adopting release confirms that the best interest duty is not a fiduciary duty under this rule.

The final rule includes two safe harbors -- one for ERISA plans and the other for all special entities. For ERISA plans, a swap dealer will not be acting as an adviser to a special entity if the plan represents that it has an ERISA fiduciary coupled with several other representations.

Under the second safe harbor, the swap dealer will not be subject to a best interest duty if it does not express an opinion as to whether the special entity should enter into a recommended swap, and then the special entity represents that it will not rely on the swap dealer, will rely on advice if it's an independent representative and the swap dealer discloses that it is not acting in the special entity's best interests.

Swap dealers and major swap participants that offer to or enter into a swap with a special entity other than an ERISA plan must have a reasonable basis to believe -- excuse me -- that the special entity has a representative that meets certain criteria, including independence from the swap dealer or major swap participant.

The rule includes a safe harbor for the swap dealer or major swap participant where the special entity and representative represent that they have complied in good faith with policies and procedures reasonably designed to ensure that the representative satisfies the applicable criteria.

For ERISA plans, a swap dealer or major swap participant will have a reasonable basis to believe that the plan has an independent representative if that representative is an ERISA fiduciary.

The final special entity rules also adopt pay to play restrictions for swap dealers when dealing with governmental special entities. This rule is harmonized with existing security-side rules for investment advisers and municipal securities dealers.

The final rules do not include the proposed swap execution standards rule, and should the commission determine to consider such a rule in the future, it will repropose the rule.

Thank you, and I am happy to try to answer any questions. Sorry for the length.

CHAIRMAN GENSLER: Thank you, Phyllis, Ted and Barry. I don't know why I say Charles. Is that --

MR. MCCARTY: It's my first name.

CHAIRMAN GENSLER: Your first name.

COMMISSIONER WETJEN: It always throws me off, Mr. Chairman.

CHAIRMAN GENSLER: What's that?

COMMISSIONER WETJEN: When everyone calls him Barry, and then you see Charles.

CHAIRMAN GENSLER: Yeah, I know -- and then I started to think it's triplets.

All right. With that, I'll entertain a motion to accept the staff recommendation on external business conduct.

COMMISSIONER SOMMERS: So moved.

COMMISSIONER O'MALIA: Second.

COMMISSIONER WETJEN: It's exacerbated by the fact he looks so much like his twin.

CHAIRMAN GENSLER: Yeah.

MS. CELA: Maybe we should bring him to the table.

CHAIRMAN GENSLER: I don't know. No, I don't think -- I'd probably break all sorts of federal laws, and it would set a precedent with my twin that just --

I support the final rules to establish business conduct, and I have a longer statement for the record, but this final rule implements important features that Congress was addressing. I think Commissioner O'Malia captured colorfully in terms of referring to various popular books about Wall Street, that Congress really wanted to address protections for counterparties, and in particular, special entities -- municipal governments, pension funds that are entrusted with trillions of dollars of assets on behalf of people's retirements, and I think this rule takes a balanced approach to it.

I'm just going to mention three things. One is I think it's very important. It was a Congressional mandate, but I think we've got it right in the rule. The counterparties will get a daily what's the value of this outstanding swap, and I think that's particularly important for a lot of municipals and pension funds, but also small banks, small end users, midmarket companies that would not necessarily know what's the value of that -- or at least what does their dealer think the value is on those bilateral swaps. And they'll get it midmarket before the profits or the charges that would be there. I think it's very critical.

Two, I think it does help protect against fraud and other abuses in the market, but it has a balanced approach with three or four or five places probably in the rule where there's safe harbors, where there's affirmative defenses -- I mean, that we really worked with the pension fund community, the ERISA plans particularly, where ERISA has a fiduciary's -- and there's a whole Congressional mandated process that I think this finds the balance.

Maybe it is just one question that will come out of it, but I take that it that ERISA plans will be able to access this market as they have in the past, though with additional protections. Is that correct, Phyllis?

MS. CELA: Yes, yes.

CHAIRMAN GENSLER: It's a big yes. All right, good. And thirdly, I think -- though it doesn't usually get a lot of notice in this, I think it's really important that we, like the Securities and Exchange Commission and the Municipal Securities Board, have brought pay to play prohibitions as well -- that a dealer in dealing with a municipal or state government that's entering into swaps, that we have similar rules. I think it's not the heart of this rule, but I think it's a really critical piece for the integrity of these markets, and to protect the taxpayers of those various municipal and state folks that enter into swaps.

So I support the rule. With that, I'm going to turn to Commissioner Sommers.

COMMISSIONER SOMMERS: Thank you and, again, thank you to this team for all of your hard work. These are very challenging issues, and I think we all understand how complicated it's been to get to the right place on these, but I have a number of different questions that highlight some of my concerns.

The first question may just be a clarification. It was with regard to a change that was made last night to the safe harbor and to the first part of the safe harbor for ERISA plans. And we added in the language that I think brings consistency to where this same language was used in other places in the rule -- the language that was added was complied in good faith.

And that same language is used in a number of different places, but it brought to light a question with regard to the way it's worded, saying that the ERISA plan represents in writing that it has complied in good faith with written policies and procedures reasonably designed to ensure that any recommendations the special entity receives from the swap dealer materially affecting the swap transaction is evaluated by a fiduciary before the transaction occurs.

So does that -- the way the words are on the page make this backward-looking to where it would have to be on a transaction by transaction basis?

MS. CELA: So I take the tense issue. I think that's a good catch, and I actually think that it would be -- if it's going to be in counterparty relationship documentation, it probably should be forward-looking so it should say that it will comply.

COMMISSIONER SOMMERS: Bart, is that you?

MS. CELA: Commissioner Sommers, I think it should be forward-looking.

COMMISSIONER SOMMERS: So I think it's

used --

MS. CELA: That it will comply in good faith.

COMMISSIONER SOMMERS: It's used in other places so it may be language that needs to be changed in other places as well, as long as in all the other places, you don't intend for it to be on a transaction by transaction basis. I don't know what the intent is.

MS. CELA: We will go through and make sure in each place whether they are saying something about something they've already done, and the way the reliance on representations works is that you can make a representation today, and you can have it renewed with each swap, assuming that there are no changes in the circumstances of the parties.

So the fact that it would say something in the past tense -- is renewed, as if it were new again, with respect to a subsequent swap so it may be okay, but we will flyspec.

COMMISSIONER SOMMERS: Okay.

MS. CELA: This one, I think, feels to me like it should be forward-looking.

COMMISSIONER SOMMERS: Okay, thank you. The next part that I had a question about was the addition -- this is on page 187 -- the addition that we made to the preamble with regard to the non-ERISA plans, and saying that they can have representations included in their relationship documentation that says that swap dealers will represent that they will not express an opinion, and that they are allowed to do that if they want to in their relationship documentation, but that does not avail them of some sort of safe harbor to get them out of the other requirements.

MS. CELA: The way it works is, if what the swap dealer -- I could imagine this situation. Swap dealer makes a determination that it doesn't want to be acting in the best interests. It doesn't want to be held to that standard so it wants to train around a standard that would cause sales staff not to use certain opinions, subjective opinion language.

So in shaping the relationship between the parties -- and the relationship documentation is the place where parties do that -- it would certainly be a fair thing. It's not mandated in the rule, but we wanted to clarify that it certainly would be permitted in the rule for them to say, our communications to you are not going to express an opinion about whether you should enter into any particular swap.

Now at the end of the day, if they have a rogue salesperson, somebody who acts outside of that training, it will not protect completely the dealer from responsibility for having that best interest standard applied to whatever opinion was expressed by the person who's working for or on behalf of the dealer.

But we thought that it would be helpful to the parties to say, when you're listening to what we are saying, we are not going to the place where we're making a subjective recommendation to you to do a certain thing that you should do this. In that place, you should consult your independent representative, who you must have under paragraph five --

COMMISSIONER SOMMERS: Right. So under that example, if you assume that it is represented in their relationship documentation that the swap dealer will not express an opinion and a swap dealer does express an opinion, then does the relationship documentation that says it will not -- it's voided and all the best interest duties kick in.

MS. CELA: I think it's really a facts and circumstances case, frankly. When you get into litigation -- I don't know whether we're talking here about private litigation or we're talking about enforcement action -- the place where I'm comfortable because can't really affect private litigation.

But in the enforcement context, we have said, throughout this document, on your behalf -- hopefully you'll accept it -- that when the enforcement division evaluates a non-scientor of these rules to make a judgment -- whether it's appropriate in any particular case -- to bring an action for a strict liability provision, it will consider whether or not the swap dealer has acted in good faith, in compliance with reasonably designed policies and procedures.

From our perspective, it does two things. It's not a "gotcha" enforcement regime, and yet it is a force for good in a way. It incentivizes the swap dealer to have robust policies and procedures, and to engage in a compliance regime with respect to those, so that when the time comes and if it comes, they have a basis to say, you should look at us in that light, as opposed to a person who has acted intentionally or without policies and procedures.

COMMISSIONER SOMMERS: Okay. Well, I do continue to think that this opinion versus recommendation place for non- ERISA plans is an issue, and I wonder why non-ERISA plans are not able to rely on the same sort of safe harbor that ERISA plans can rely on. If they are representing that they have a qualified, independent representative and they don't, then that would be a problem. But many of these plans do, and do not rely on opinions from swap dealers.

So I'm not sure why we would not let them rely on that safe harbor, but if you can explain that --

MS. CELA: This is a place where we were -- our approach to this was that where the statute spoke specifically about a particular issue, we felt more constrained in our discretion, and this is one of those places.

In fact, you could take the view that rule making wasn't required here. You didn't even need to say that there are rules about what it means to act as an adviser and a swap dealer would be essentially left without any guidance about what would cause them to have to act in the best interest, including what the best interest duty is.

So we thought there was a significant amount of compliance risk in that place, and that we looked for ways to cabin the risk without gutting the effect of the provision.

The provision says that there will be a time when a swap dealer will act as an adviser. It seemed to us, based on what we had heard from commenters -- and I fortunately or unfortunately actually had worked on the Bankers Trust case in the middle '90s and Gibson Greetings and Procter & Gamble, and the issues there were all about at what point did the swap dealer assume advisory duties with respect to the counterparty.

And even though there was nothing in writing that said that somebody was acting as an adviser, there were claims. The commission made a claim that Bankers Trust was acting as an adviser subject in that case to 4O, which is our fiduciary essentially -- fiduciary duty obligation with respect to fraud for pool operators and trading advisers.

So we were told that there is a place where people are trained to not venture into that space unless it's understood and there is a real understanding between the parties about the nature of the relationship, and the dealer is prepared to take on those additional duties. That was the baseline.

So for us, it seemed to be, based on what we were told in our consultations, that the line they train around are these subjective opinions -- that you could make all kinds of recommendations more objectively stated. It could be based or tailored to the needs of a particular counterparty, but what the swap dealer would say in that case would be more along the lines, I understand your risk to be this. This is a swap that would accomplish that risk reduction. Whether or not you should enter into this, based on your circumstances, you should consult your adviser who you are paying to do that kind of work. I'm not acting in your best interest.

So we think it allows for the making of the recommendations. Now this is such a long answer, but in the last places where we distinguish between the ERISA plans -- in the case of ERISA, there is a full-blown federal regulatory scheme. DOL is the principal regulator. Under ERISA, they have rules specific to ERISA fiduciaries, what the requirements of ERISA fiduciaries are.

We had heard a lot, as you did too, about the risks of not simply relying on the ERISA law, with the potential that we would create potentially inconsistencies, unintended consequences. So in that one narrow space where we had another federal regulatory scheme that we could rely on comfortably -- and in consultation with the Department of Labor, we said, okay, here and in the paragraph five provision, if there is an ERISA fiduciary on the scene, then that will be the safe harbor for ERISA plans.

For all others, which frankly are governed by very many approaches to fiduciary status -- common law, state law, local law -- there isn't a coherent, single scheme to which we could have deferred.

And so in that way, we felt like this was an appropriate line, giving meaning to the statute, without unduly creating an impossible situation for the counterparties who want to transact.

Sorry for the long answer.

COMMISSIONER SOMMERS: That's okay. Thank you. I appreciate that, and I think that many people who are listening probably appreciate that comprehensive answer. So thank you for that.

The other couple of questions I have are with regard to how this will actually work, and why the rules apply when these transactions are on trading facilities and cleared. So these disclosure requirements -- and I think in a number of different places, it talks about the section not applying with respect to transactions that are initiated on a designated contract market or initiated on a SEF if the swap dealer or major swap participant do not know the identity of the counterparty to the transaction prior to execution.

So if they do know the identity of their counterparty prior to execution in a RFQ-type model, how will this type of disclosure regime work?

MS. CELA: Right. How it will work -- ultimately, in practice, I think it will depend upon the evolution of communications systems and the technology on the platforms, and their functionality, et cetera.

But our choice for drawing the line there again was another place where we felt there was very limited discretion for the commission given the way the disclosure provision is written in the statute. It talks about disclosure of material risks. There is no out. There is no limitation on when that happens.

There is another provision that discusses special entity provisions and references transactions on the SEF or DCM where the swap dealer doesn't know the identity of its counterparty.

But for example, the SEC interpreted that language to apply only to the acts as an adviser and independent rep provisions, and not to apply to disclosures. So if I'm correct, I think the SEC's view is that disclosures are made whether you know your counterparty or not.

And so we thought that we could use the language in the statute to allow for easier and more effective and less compliance risk, and what we imagined -- again, looking at the SEC's release and talking to others who are familiar with how these things can work, the SEF environment will be an electronic environment for the most part. They could develop functionality to put out disclosures for transactions that are permitted to trade on that SEF. They could be given to the SEF by the swap dealer so that the swap dealer can use a sort of substituted compliance to make it happen that way, or the swap dealer could put all the disclosure information that it thinks is relevant to the types of swaps that it enters into, whether in the SEF environment or in the bilateral environment, and put them in a place -- and as long as either they're directed by the SEF or through the response to the RFQ, the counterparty will know where to look. We are not anticipating this be a stop the music kind of disclosure.

The other thing is that it is our understanding that for transactions on SEF, it's likely too that the participants on those platforms will have counterparty relationship documentation with other participants in that marketplace. They may not know who they're transacting with at any particular moment, or they may only know about it just before execution.

But they would be able, in that counterparty relationship documentation, to include the kinds of disclosures that you're talking about.

So we think that where there's a business opportunity and a way to do this, it may very well be in the interests of both the SAF -- for the sake of drawing liquidity into the marketplace, and to have the dealer have a facilitating way to comply. So we're expecting those functionalities to develop.

COMMISSIONER SOMMERS: I guess my

concern is that it doesn't limit participation on the SEFs to only people that the swap dealer has this type of documentation with --

MS. CELA: Right.

COMMISSIONER SOMMERS: -- and so the swap dealer feels safe in saying, I know that anybody I may execute a transaction with on this SEF, I'm already papered with so I'm not running the risk of having to --

MS. CELA: Right, right.

COMMISSIONER SOMMERS: -- one second before execution --

MS. CELA: Right.

COMMISSIONER SOMMERS: -- find out that this is somebody I don't have disclosure documentation with, and now we have to --

MS. CELA: Right. So the guidance in the release is explicit on this point -- that the swap dealer would be able to work with --

COMMISSIONER SOMMERS: Right.

MS. CELA: -- the SEF or --

COMMISSIONER SOMMERS: Right.

MS. CELA: -- the DCM to develop this functionality.

COMMISSIONER SOMMERS: Right.

MS. CELA: We would consider that substitutive compliance and not an invasion, and so we actually think it would be an interesting business model, to see how that might look.

COMMISSIONER SOMMERS: The next question I have is with regard to the scenario analysis.

MS. CELA: Yes.

COMMISSIONER SOMMERS: And it talks about how the swap dealer or major swap participant, prior to entering into a swap with a counterparty -- I'm sorry. I should read this verbatim or else I'm going to mess it up.

Prior to entering into a swap with a counterparty other than swap dealer or major swap participant -- security- based swap dealer or a major security-based swap participant, that is not made available for trading.

So if we finalize a rule like we have proposed, that the SEF can make the determination that everything they list is made available for trading, do we really want to hinge the scenario analysis on that fact -- that everything that's listed on a SEF is considered made available for trading and the scenario analysis then is not required?

MS. CELA: The proposed rule had a more prescriptive approach to this, and was definitionally challenging. People were concerned about that, and we agreed, and made it more of an optional rule.

COMMISSIONER SOMMERS: But the optionality only kicks in on the made available for trading.

MS. CELA: If it's not made available --

COMMISSIONER SOMMERS: Right.

MS. CELA: -- for trading. Right. So the idea is -- in the bespoke area, for example -- in the area where it's likely to be bilateral, subject to extensive negotiation, that's when --

COMMISSIONER SOMMERS: I guess my point here is a SEF -- if our proposal is finalized as proposed, there could be a number of very illiquid bespoke swaps that are listed on a SEF, and because the SEF believes it's in their best interest to deem them made available for trading, it seems to be an odd quality to tag this with.

MS. CELA: So for us, it was really a balancing of burdens. This is a discretionary rule, in the sense that Congress didn't direct us to provide for scenario analysis as scenario analysis.

So in justifying the discretionary rule, we tried to figure out where a line might be where we were very comfortable imposing this burden, this cost on dealers, to have to respond to such a request.

Nothing in the rule, as we say in the adopting release -- nothing in the rule would preclude parties from negotiating the receipt of such scenario analysis separate from Judy under (inaudible) rule.

And in fact, what we were told during our consultations -- which is why we thought this was an appropriate rule at all -- was that it is routine business practice when a counterparty asks for scenario analysis, that it is provided, and it's often provided without any cost to the counterparty -- at least, any separate payment.

So I think what we were feeling comfortable with was that in the places where it was likely to be the most helpful, it would be required at the option of the counterparty. In other places, it would be the subject of negotiation.

This was one of those where we were hearing concerns about cost and burden. We thought it was a valuable rule, and came to this ground, this line for us.

COMMISSIONER SOMMERS: Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. I think Commissioner Chilton is back on.

COMMISSIONER CHILTON: Yeah, I'm here, Mr. Chairman.

CHAIRMAN GENSLER: Good.

COMMISSIONER CHILTON: Sorry about the technical issues, and I'm glad you had my proxy. I do support all the rules.

I don't have any questions on this one. Thank you.

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

COMMISSIONER O'MALIA: Thank you, Mr. Chairman. Thank you to the team.

Can you tell me -- given that swap dealers and MSPs will be commission registrants, who will be responsible for direct oversight of compliance with the rules today -- NFA or the CFTC? And how will compliance with these rules be monitored?

MS. CELA: I think we should probably have Mr. Barnett at the table, as we had Ananda the last time.

CHAIRMAN GENSLER: Is Gary Barnett in the room? Gary, you've been invited to the table by Phyllis, to talk about these sort of collaboration -- assuming that later today we might actually delegate to the NFA, what we might delegate to the NFA.

Red button.

MR. BARNETT: Okay. In response to the question, the part that gets delegated is just registration and determining that there's compliance at a time of registration.

In terms of overall oversight, what typically happens is that the NFA would adopt rules that are as tight as or tighter than our rules, and then they would require their members to comply with those rules.

And then we would oversight the NFA's oversight of its members, and in doing so, occasionally we would go in and do direct review of the compliance of its members.

But that's the basic methodology, and it does allow us to leverage the reach of the NFA.

COMMISSIONER O'MALIA: Thank you. Followup on Commissioner Sommers's questioning regarding a SEF -- I support the rule, but with all good rules, they can go too far, and some of my concerns, which I think have been addressed here, are what will happen on anonymous transactions, and creating some burden that can't be fulfilled in a non-exchange kind of environment.

This rule, I think, appropriately understands that this is still a principal to principal market, while the Volcker Rule totally misses that slight nuance, but nonetheless, I think you guys have probably done it better than -- certainly better than that rule.

But I do have some concerns about this, to make sure that we don't create an expectation and a burden that just can't be fulfilled, due to the on-screen nature of these things.

And one of the concerns is the voice broker relationship. And we have no idea whether that's going to be allowed or not in the SEF proposal, and trying to draft rules.

Do you have any sense of what kind of relationship -- it's kind of a middle ground. You're kind of negotiating trades but it's going to be on-screen. How do we -- what is the burden in your rule for that kind of relationship, if it's allowed?

MS. CELA: These rules apply to swap dealers and major swap participants when they know their counterparties. So I'm not sure that I could answer your question because I'm not sure of what interface would occur through the voice broker.

If through the voice broker, the swap dealer or major swap participant comes to understand and know who that counterparty is going to be, in the same way that we talked about in the SEF environment, it would seem to me that that voice broker could play a role in helping the swap dealer to comply, either upfront or on a transaction basis.

But really, I'm a little uncomfortable here because I'm not sure that I -- I know that I don't know the environment well enough to give you an answer you could rely on.

COMMISSIONER O'MALIA: Great, thank you.

Can you explain why the best execution standard was dropped from this rule?

MS. CELA: There were a lot of comments, as you would imagine, on the best execution rule. That rule depended upon more of an understanding of the kinds of things that you just asked me about, that remain -- in my mind anyway -- still fuzzy and unclear, and haven't fully been developed.

So as I recommended that we defer consideration of this, for me, it was that I didn't feel like I understood well enough what the communication schemes were that would cause a dealer to be able to get the necessary information or how transactions would occur.

But that will be happening. We will get clarity around that, and if and when the time comes that we know what that looks like, then it would be perfectly appropriate for the commission to repropose the rule in light of those requirements, and then get fresh comment on it.

COMMISSIONER O'MALIA: While I do

appreciate the fact that we didn't overreach on something we had no understanding of how the market will transact -- so I definitely support that.

MS. CELA: Well, at least as with respect to me. I'm sure there are others who probably know better, but I didn't.

COMMISSIONER O'MALIA: Today's rules defer all discussion on the international reach of the rules until the commission addresses extraterritoriality issues in a separate release.

What does the 4(sh) of the act say with regard to extraterritorial reach of the external business conduct rules?

MS. CELA: The business conduct standard rules apply to swap dealers and major swap participants, with respect to counterparties.

The definition of counterparty is not limited by geography, and neither is the definition of swap dealer defined in terms of territory.

So read as it is, if you have a swap

between a swap dealer -- somebody who would be within the meaning of a swap dealer and somebody who would be within the meaning of a counterparty, on its face the rules would apply.

But there is the extraterritoriality provision in Dodd-Frank. I couldn't recite it to you at the moment, but there is a test in there with respect to which kinds of activities or conduct would cause the commission to have an interest, something that would affect the commerce of the United States or something along those lines.

And so while the statute in this place doesn't speak to territoriality, if you couple that with the extraterritorial provision, it would be understood that you'd have to make the case for transactions that have foreign components to have to understand what the reach of these rules will be in any particular circumstance.

COMMISSIONER O'MALIA: Do you have any sense of any other international jurisdictions that are proposing such a rule or have rules in place similar to this?

MS. CELA: What we do know is that in the EU, for example -- we know that in the EU, there are comparable or there are business conduct standards rules that address many of the issues that we have here. What their extraterritorial effect is, that I couldn't respond to.

Substantively, they accomplish several of the things that we are doing.

COMMISSIONER O'MALIA: Cost benefit analysis -- the commission has certified the rule as a major rule under the Congressional Review Act, and OMB has concurred. But we never received any data from anybody so I'm not exactly sure how we arrived at an over $100 million economic impact. How did we arrive at it? This is a little thin on the numbers.

MS. CELA: I think this may be one where we may want to ask OGC to join, but what we did appreciate was that because we didn't have the data -- the data were not easily susceptible to gathering and hadn't been offered to us -- that we couldn't rule out the fact that it could have, and rather than undersell the rule, we thought it was better to declare it and then have it considered that way so that we weren't undercounting. It was important not to undercount or mislead.

COMMISSIONER O'MALIA: The large trader reporting rules -- we thought we had it figured out. Put it out, people had number questions. I think we put out a 150-page count -- 150 plus page guidance to help clarify that. Your rule is infinitely more complex than that reporting requirement. It is what it is.

Will we provide additional guidance or clarification or flexibility for firms that are confused, unclear, have questions? How will we deal with this when they come pounding on our door?

MS. CELA: So the issues around -- which we felt that there was the most concern was in this recommendations area, and the safe harbors that would apply in the suitability space and in the acts as an adviser to special entities place.

We did prepare a separate appendix that will be included in the part 23 rules so that anybody that's going to the rulebook will also have a few pages of explanation.

There is a routine process at the commission for relief. So if it turns out that there is a particularly aggrieved party as a result of these rules, whether it's on a implementation basis or it's a unique business practice that they would like to get some comfort on, I am certain that process could be used to provide additional guidance.

And I would assume that if the staff is permitted and encouraged by the commission, we would be very happy to take people through these rules and forms that are comfortable, to try to give some texture to the words.

CHAIRMAN GENSLER: Let me just jump in and clarify. You are absolutely permitted -- the staff on every rule team as we finalize these things is encouraged to help market participants, subject to staff resources. We are an agency that is limited in resources, but to help market participants understand that which these rules mean.

COMMISSIONER O'MALIA: That's all I have. Thank you. Thank you to the rule team.

CHAIRMAN GENSLER: Thank you, Commissioner O'Malia. Commissioner Wetjen?

COMMISSIONER WETJEN: I think my fellow Commissioners and I -- I think all of us have had tours of duty in the public sector, in the private sector and we've all interacted with a number of different people -- a lot of very talented people, impressive people.

But I just wanted to start by saying that I've found that Phyllis and her team have been very, very professional and impressive, and in all these different areas where I've worked in my short career, I've not seen it surpassed by what I've seen with this team.

So I just want to make sure I publicly acknowledged how impressed I've been with this team and appreciate all the hard work on this.

MS. CELA: That feels like a star. Bob Wasserman was a star so --

COMMISSIONER WETJEN: We talk about starting a rookie of the year award or something. Maybe we should have a veteran of the year award too, possibly.

But Phyllis, you and team and I, we had some good discussions about this rule, and I think you could sense that when I first came to our discussions, I had some pretty serious concerns about it, but I was very reassured after we talked, and we talked about the know your customer requirement, we talked about the scenario analysis requirement. It was also talked on here by Commissioner Sommers. The best execution requirement, which was dropped. Commissioner O'Malia just mentioned that. Suitability, counterparty eligibility, and of course, the safe harbors for the special entities.

So all of these were very significant issues, and I was, again, very, very relieved once we had a visit and I got to understand better how those issues were treated in the final rule -- that this would be a very workable set of standards for the dealer community.

While I'm thinking of it, Commissioner Sommers mentioned this issue about opinions, and specifically mentioned some of the preamble language and how the dealers could, in fact, include some language in their representations, that they would not be rendering opinions.

And you and I had a very good discussion about this, and if you'll permit me to elaborate a little bit -- what I took from our discussion is that this language, while not exonerating for a swap dealer, could be very, very useful in a number of different respects, and at a minimum, if there were some sort of litigation where a judge was having to determine whether the standard was met or not, certainly this would be a mitigating circumstance if they had a document that included a written representation that they were not rendering opinions.

You had mentioned earlier in your

discussion about that doesn't take away from the fact you could have other facts that could, in fact, show an opinion was given. But certainly, that would be a mitigating factor, to have that language in a master agreement.

And it also would have the very desired effect, I think, of helping the dealer community train their staff. I think you touched on that as well a little bit earlier.

So while not exonerating, I agreed with you in our discussion that it would be probably a useful guiding principle included in the preamble. So I was supportive of that language.

In a cost benefit discussion of the rule, there's a discussion about the rule would allow dealers to comply with their disclosure requirements by partnering with some of these trading execution platforms. I wonder if you could just discuss for a moment how you would envision that taking place.

MS. CELA: I think we talked a few moments ago about what we would envision to be compliant disclosure in, let's say, a SEF environment, and it seemed to us that there could be a variety of ways. And by this list, nobody should take that it is limiting. It is only some ideas based on technology that you see today when you want to buy an airline ticket and click through terms and conditions and things.

We understand that there is popup capability. We understand that a SEF may have an interest in putting on its own website the documentation or the disclosures that would apply to swaps that are permitted to be traded on that SEF.

The swap dealer might go out by itself and put on its own website disclosures about the transactions that it would do in that environment.

I think you could just imagine a number of ways. Today, for example, if you want to trade a futures contract, the description of the contract that you're trading doesn't come from your FCM. It is posted on the website of the designated contract market.

So there is sort of a business practice that could be elaborated on, that might accomplish the kinds of purposes we're talking about.

And as I say, to the extent that there's any question about whether it would work, I would expect people to come in the way that they do today to get some comfort in the areas that they're unsure of.

COMMISSIONER O'MALIA: Phyllis, can I make a comment?

If we have modeled these rules to be comparable to what airlines disclose, we've completely screwed it up.

MS. CELA: You know what? I'm with it. So let me take that back.

COMMISSIONER O'MALIA: All right. You're going to get a different analogy, right?

MS. CELA: Yeah. So a different analogy, absolutely. I think the better way -- I guess the issue is that the disclosure is particular to the kind of transaction that's being disclosed.

If you're doing what has been described to us as the flow business -- the plain vanilla, this is the business that's going through -- the disclosures, it seems to me, can be in a very standard format, and can be really anywhere where the counterparty will have access and know to go.

The more complex the transaction is, the less available the information is to the counterparty, the more process needs to be put on top of the disclosure process. So you would expect more particularized disclosures, enough time with respect to those, more complex swaps to be able to appreciate the information, the risk and take account of it.

So the problem with this rule is, it's both the good and the bad. It's a principles-based rule that is supposed to take account of the most standardized transactions and the most complex. So depending upon the environment and depending upon the nature of the swap, these kinds of pre-done website references may very well work just fine, particularly if it's the kind of transaction that a particular counterparty is doing day in and day out.

That was all I meant to suggest.

COMMISSIONER WETJEN: No apologies needed. Regulatory harmonization has been an important part of the discussions about Dodd-Frank implementation. It's something that I heard a lot about while I was still working on Capitol Hill, and I've heard about it some more here at the commission.

But I was hoping you could walk me and the rest of the group here through some of the ways that this rule comes into closer harmony with the SEC's proposal.

MS. CELA: Just by way of background, our proposed rules came out last December, about six months ahead of the SEC's proposed rules.

So when we proposed our rules, there was a comment period that followed, and for better or for worse, the SEC had the benefit of the comments that were made to our rules. And so their proposals were different in some respects from ours, in part as a result of the comments that we had received.

So the places where we thought we should move toward the SEC -- because there was really no good government reason to have a different approach -- for example, would be, know your counterparty. We had adopted know your counterparty more from the broker model that existed under the NFA rules, and there were some provisions in the know your counterparty that counterparties were concerned was going to cause them to have to give confidential information to their brokers. The SEC had stripped the rule of those. We went more toward the SEC model.

Another one is suitability. They got at the same thing, but the language wasn't quite the same. We thought it was worth -- since this is an area where they truly are the experts. They have been living under the suitability rule for years. They developed it. It's something understood and observed in the securities markets. And so we moved our suitability rule closer, much closer to have the same kind of outcome there that we had.

The other thing that they had done was when they proposed, not all of the "discretionary rules" applied to MSPs. In the final rules here, we took a closer look at the type of business that we anticipated an MSP to be doing by definition, and we decided that certain of the rules, like scenario analysis, know your counterparty, pay to play would not apply to MSPs because they would not be -- if they were doing the kind of business that those rules presupposed, they would probably be swap dealers.

So those are the kinds of adjustments that we made to our rules that we're really inspired by, with a view toward trying to come together with them.

COMMISSIONER WETJEN: It's more of an observation than a question, but, I think, Phyllis, you touched on it too in some of your earlier remarks, but this part of the statute -- most of it, if not all of it, is self-affecting, I believe.

MS. CELA: Only one provision is, and Terry and I can have a legal debate about whether paragraph four stands on its own, or because there's mandatory rule making -- otherwise in 4(sh), we had to write rules. We wound up writing the rules, but no. It's mandatory rule making. So there's a standard set by Congress, directing the commission to write the rule.

COMMISSIONER WETJEN: Well, not withstanding that point of clarification, I think the other thing I took away from our discussions and my review of the rule is that while there were different pieces of it that were discretionary in nature, I think the sum total effect of the rule is actually one where there's some very, very valuable clarification brought to the statute, rather than unnecessary new, additional burdens. I mean, that was an important takeaway that I had, again, after reviewing the rule and after having our briefing session earlier in the week.

So that's all I had for comments and questions.

CHAIRMAN GENSLER: Thank you, Commissioner Wetjen. Mr. Stawick?

MR. STAWICK: Commissioner Wetjen?

COMMISSIONER WETJEN: Aye.

MR. STAWICK: Commissioner Wetjen, aye. Commissioner O'Malia?

COMMISSIONER O'MALIA: Aye.

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

COMMISSIONER CHILTON: Aye.

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

COMMISSIONER SOMMERS: No.

MR. STAWICK: Commissioner Sommers, no. Mr. Chairman?

CHAIRMAN GENSLER: Aye.

MR. STAWICK: Mr. Chairman, aye. Mr. Chairman, on this question, the yays are four, the nays are one.

CHAIRMAN GENSLER: The ayes have it, and the staff recommendation is accepted. Before you leave the table, if I -- did you have something, Phyllis?

MS. CELA: I just wanted to say that we are going to make an adjustment to one bit of language here that we're going to check throughout, and so I think you do something where you allow --

CHAIRMAN GENSLER: I'm all right. I'm all right.

MS. CELA: I'm sorry.

CHAIRMAN GENSLER: I'm all right. But thank you for that bit of advice.

I just want to compliment the teams for all that you've done here. Not picking anything, but I think that when Mr. Obie suggested when you didn't know it that you'd be the team lead for this, it was an excellent recommendation.

So a shout-out for Phyllis, for Steve Obie, for David Meister for letting the enforcement division so well contribute to this rule making.

So thanks. And with that, I think now we have the team that will be coming up with regard to registration rules. And so I think Gary Barnett's just going to stay at the table, but Barbara Gold and Chris Cummings, Elizabeth Miller, all from the Division of Swap Dealer and Intermediary Oversight present the staff recommendations on the registration of swap dealers and major swap participants.

The team will also present a separate order delegating the performance of registration functions by the National Futures Association, with respect to swap participant.

So we'll get the presentation on both, and then we'll take the votes in term.

CHAIRMAN GENSLER: Phyllis, is that your son who -- another twin and flowers. Congratulations.

From the SEC? It might be. Thank you, for the Securities and Exchange Commission. Thank you very much, fellows.

MS. GOLD: Okay.

CHAIRMAN GENSLER: Handing it over to Barbara Gold, who's been the team lead on this, and Elizabeth, Chris and Gary.

MS. GOLD: Thank you. Preliminary, I'd like to thank the members of my team -- Richard Wagner, Warren Gorlick, Steve Kane, Lee Ann Duffy, Gloria Clement and, specifically from DSIO, my staff, Chris Cummings and Elizabeth Miller.

Chris first developed the concepts of provisional registration and phased implementation, which is a concept we know now that other teams are employing.

As far as Elizabeth, Elizabeth has been involved in every single of this process, and at every single step, her performance has been exemplary. So I'm sure all of us on the team would say that for us, Elizabeth has been the star of this team.

I'd also like to thank Mike Crowley, Associate General Counsel at NFA, for his continuing availability on technical assistance throughout the rule making process.

At the outset, I'd like to clarify that these regulations go solely to the registration process. They don't go to the swap dealer and major swap participant definitions. They don't go to any exceptions from registration because the act prohibits exceptions from registration.

As we've already heard, they don't go to extraterritorial matters because extraterritoriality is going to be considered at a subsequent date, and these regulations don't go to the substance of any of these section 4(s) implementing regulations because those regulations are being separately considered. We just heard one of them -- external business conduct. So again, these registration regulations just go to the process of regulation itself.

The commission proposes registration process in November 2010, and what the commission did at that point in time and what we're recommending it adopt today is amendments to the existing registration scheme for all other registrants. This is identical to what the commission did for retail foreign exchange dealers, or RFEDS, in October 2010.

So what these regulations would do would incorporate swap dealers and major swap participants into part three, which is the commission's registration regulations.

Unlike other registration issues or situations, however, the commission didn't also propose to require the registration of salespeople or associated persons of swap dealers and major swap participants because Dodd-Frank did not give us that authority -- that is, the registration authority over APs of SDs and MSPs.

And as has also been mentioned today, that consistent with prior options the commission proposed to delegate to the National Futures Association, NFA, the authority to register swap dealers and major swap participants.

Based on the comments the commission received, we're recommending that the commission adopt the registration process regulations, essentially in the form as proposed.

So registration of swap dealers and major swap participants would commence with the filing of the requisite forms with NFA that say 7R for the firm and 8R for each principal, and additionally, a fingerprint card for each principal.

Persons must apply on the latest effective date applicable to the SD, MSP or swap product definition. However, they would be able to apply to start the registration process at any time prior to that mandatory date.

When a person applies, they must also submit such documentation as may be required to demonstrate compliance with whatever section 4(s) implementing regulation is applicable to them at that time.

This is this whole concept of provisional registration. So when someone applies -- and until the entire section 4(s) implementing regulation scheme is in place -- an applicant for SD or MSP registration would be issued a provisional registration by NFA. The applicant would be under a continuing obligation to update in its documentation and whatever else would be required as this section 4(s) implementing regulations become applicable to it.

Once all of the section 4(s) implementing regulations are in place and compliance with them has been confirmed by NFA, the SD or MSP applicant would become fully registered, such that at some point in the future, when all of the 4(s) regulations are effective, compliance states have been reached, so on and so forth, and everyone who today is a swap dealer or a major swap participant has been registered, there will be no more provisional registration. This is truly a temporary stopgap measure, intended to permit, intended to not disrupt ongoing business operations. So NFA would confirm initial compliance with section 4(s) implementing regulations.

The proposal would have had a 30-day cure period in the event that NFA advised an applicant that its materials, what it had presented was deficient. However, we're recommending that the commission adopt a 90-day cure period with the provision for an extension in the event an applicant did not -- its compliance with a 4(s) requirement was not confirmed.

As far as associated persons, Dodd-Frank did not make clear whether an associated person of an SD or an MSP had to be a natural person. The Commodity Exchange Act provides that APs of all other registrants are natural persons. We asked for comments. The comments were uniformly in support of the commission having a regulation that clarified that APs of SDs and MSPs were natural persons, and that would appear in the final regulations.

As far as statutorily disqualified associated persons, Dodd-Frank provides that, except as otherwise provided by rule, regulation or order by the commission, no SD or MSP can permit that person to affect swaps if the person is subject to a statutory disqualification and if the swap dealer or major swap participant knows or should know of the statutory disqualification.

The proposal did not have any exception.

The proposal just would have had an outright ban on the association. NFA in its comment letter pointed out that without an exception, this would result in an anomalous situation.

Over the years, the commission has delegated to NFA the authority to register persons, including APs. And in connection with this delegated authority, from time to time, NFA has given a pass to an applicant as an AP or as a principal who has, for example, a statutory disqualification, but it might be any fine for marijuana possession, two ounces, 25 years old. So what NFA said was that if this person had gotten into the system as an AP on the retail side, it would be anomalous not to let it into the system as an AP on the institutional swap side.

So in the regulations you have before you today, we're recommending that the commission does adopt, pursuant to statutory authority, an exception for APs and principals in this situation.

As to the vetting of APs of SDs and

MSPs, we're not recommending that NFA be required to be the third party service provider, but rather that a swap dealer or major swap participant should be allowed to use whatever third party service provider it would like in this regard. For example, Krull is someone who readily comes to mind. Let's see -- consistent -- and this has also been brought up -- consistent with the current registration scheme. And as proposed, we're recommending that the commission would delegate its registration responsibilities under the act to NFA. This would be in the notice in order that you have before you today.

So NFA would process applications for registration as an SD or MSP, and then if they would confirm initial compliance with the section 4(s) implementing regulations. However -- and I believe this also previously had been mentioned, but I believe it bears repeating -- the notice in order specifically states that the commission would retain all authority over SDs and MSPs as its registrants, including the authority to develop regulations for them and to conduct inspections of them. And this is consistent with our current operations, with respect to all other registrants.

Further, with respect to NFA, we're recommending adoption of the proposed requirement that SDs and MSPs become a member of a registered futures association. Currently, NFA is the sole registered futures association, and we are aware that NFA has been taking steps to amend its organizational documents and its rules to include SDs and MSPs within them.

Thank you.

CHAIRMAN GENSLER: Thank you. The chair will entertain a motion to accept the staff recommendation on registration.

COMMISSIONER SOMMERS: So moved.

COMMISSIONER O'MALIA: Second.

CHAIRMAN GENSLER: I might have to ask Dan a question. Can I ask questions about the delegation as well, even though there's not a stint -- I mean -- or do I -- all right. I can ask questions about that. Great. Thanks, Dan.

I think I support both of these -- the rule and the order. But I just have a question on the delegation. We're delegating to NFA the registration function.

MS. GOLD: Yes.

CHAIRMAN GENSLER: And that's a process.

MS. GOLD: Yes.

CHAIRMAN GENSLER: But it ties to the question that Commissioner O'Malia had, I think, earlier with Gary Barnett. Are we formally delegating examination as well, or is it just as a practical effect of this delegation they have the examination? I'm just trying to --

MS. GOLD: We are delegating the authority to confirm initial compliance with the section 4(s) implementing regulations, business conduct, internal, external, designation of chief compliance officer and so on.

We're also requiring that swap dealers and major swap participants become members of NFA. NFA is amending its documents, amending its rules and adopting new rules to provide for the regulation, the oversight of SD and MSPs as their members. These rules are going to be equivalent to or stricter than the rules that we have for SDs and MSPs. This is exactly what goes on today, for example, with FCMs.

NFA conducts oversight activities, has rules for FCMs as its members. We additionally have rules for FCMs. NFA's rules are based off of ours, and we additionally engage in oversight activities. Basically this is a good way, also as I believe mentioned, to leverage off of NFA's existing resources.

CHAIRMAN GENSLER: I think I understood that. I guess -- so we're going to go through. Today, we finalized one of the business conduct rules called the 4(s) rules, and today is a significant day because we're starting this new, critical package of final rules of business conduct.

But I think there's five or six more. There's internal business conduct. There's documentation, segregation for uncleared swaps and so forth -- capital, margin. And so it relates to Commissioner O'Malia's question. I just want to make sure the delegation's all that we need.

The NFA would be conducting ongoing compliance, not just registration compliance but some ongoing examination, ongoing compliance, as I understand our dialogue with the NFA.

MS. GOLD: Yes, with respect to SDs and MSPs as their members.

CHAIRMAN GENSLER: I see. So because it's as a member, we don't have to say anything explicitly in this delegation.

MS. GOLD: That's correct.

CHAIRMAN GENSLER: Okay.

MS. GOLD: Part of NFA or part of the obligations of a registered futures association, to get registered and to stay registered, is to have a regulatory scheme that is comparable, if not more so, than the commission's existing scheme. It's an oversight function.

CHAIRMAN GENSLER: Well, I support this

final rule, as I will also support the delegation. I think that it is just one of the important steps. Critical to this is getting the entity definition rule finalized with the SEC, moving forward, of course, on the product definition rule as well, because there's no registration that is required until both of those occur, and then as we thoughtfully go through this next quarter, next two quarters, maybe three quarters -- but to go through these 4(s) requirements. I think this is an important first step, and I'm glad to see that we're able to take it at this time.

I think critically, as we leverage off of NFA, it's important that we and the public understand that we still have critical responsibilities to oversee this market, and so we may be leveraging off of them, but we also retain oversight of NFA and, ultimately, oversight of the dealers. Is that correct?

MS. GOLD: Yes, and in fact, the very last paragraph of the order says, "Nothing in this order affects the commission's authority to, among other things, adopt and enforce regulations applicable to SDs and MSPs as commission registrants, and to conduct onsite examinations of the operations and activities of SDs and MSPs as commission registrants.

CHAIRMAN GENSLER: Okay. Thank you. Commissioner Sommers?

COMMISSIONER SOMMERS: Thank you, and thank you also to this team for all of your hard work. I just have a couple of questions with regard to compliance.

And so if I understand it correctly, compliance would kick in -- your 7R or 8R would have to be filed 60 days after the effective date of either the latter of entity or product definitions.

So if there are people who are unclear of whether or not either what they trade is a swap or how they're treated as a dealer, they better figure it out in 60 days, right -- or just file an application to be safe. But is that --

MS. GOLD: Correct.

COMMISSIONER SOMMERS: Okay. And then, with regard to demonstrating compliance with the 4(s) requirements and this whole idea of provisional registration, I have a number of different questions, and I'm not sure if you can answer them, or if perhaps Gary can answer them, with regard to what 4(s) requirements we've chosen to pull out and make applicable to our implementation plan, and other 4(s) requirements that have a number of other types of compliance deadlines -- it becomes this very confusing matrix of when you have to be in compliance with what 4(s) requirements, and how it is actually going to work in practice to demonstrate compliance with all of these things separately, and whether or not that's going to be a nightmare.

I mean, you may have a compliance date for some 4(s) requirement kicking in every two weeks for six months, and these people are filing and filing and filing with the NFA, and the NFA's going to have to be continually trying to update and monitor whether or not this actually works.

I'm not exactly sure I get why it's effective or efficient to have provisional registration when there's no way they'll be able to demonstrate compliance with 4(s) requirements that may not have even been finalized.

MS. GOLD: Provisional registration -- and I may ask Chris to jump in and help me because he's the author of the concept -- but provisional registration is intended to bridge the gap, so to speak, between the fact that Dodd-Frank says on a date which we've passed -- but on a date, everyone who comes within the definition must be registered, and the fact that the section 4(s) implementing regulations will not have been issued and their compliance date will not be known by that time.

So provisional registration essentially is a temporary status, intended to permit people to continue in business. There is no requirement, and the regulations do not contemplate, that one must be in compliance, that NFA must have made a finding that an applicant is in compliance on the date that they file. The regulations clarify that subsequent to the filing of the application, the form 7R, 8R prints -- whatever else is necessary at that time -- subsequent to taking that initial action, then NFA will confirm initial compliance with whatever is out there at that time.

COMMISSIONER SOMMERS: I understand all that.

MS. GOLD: Okay.

COMMISSIONER SOMMERS: My actual concerns are with regard to the whole host of different compliance dates. Some things are subject to the implementation plan, which may or may not be finalized. Some things are not. They're all 4(s) requirements.

How is somebody supposed to know -- and I actually think it's an enormous burden for NFA.

GARY BARNETT: They're only supposed to be in compliance with these rules as they become effective. I mean, we're not talking about trying to -- so I'm missing the question, but as they provisionally register, if some rules are not yet effective, they don't have any obligation to be in compliance.

And then as those become effective, they have to show compliance.

COMMISSIONER SOMMERS: Right. My concern is that there is potentially dozens of different dates for compliance. So I guess what I would wonder, if it would be a more efficient way to look at this is to just have one date that all 4(s) requirements become -- the compliance of those requirements become effective on one date.

A dealer that's provisionally registered with the NFA could demonstrate compliance with those 4(s) requirements all at one time.

MR. BARNETT: So you'd have some people in the market who are complying and others are not complying --

COMMISSIONER SOMMERS: That's not what I'm suggesting.

MR. BARNETT: You would just have everything wait until one date.

COMMISSIONER SOMMERS: Exactly.

MR. CUMMINGS: The downside of that is that everything hits NFA all at once.

COMMISSIONER SOMMERS: I understand that. I just --

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

COMMISSIONER CHILTON: I don't have any questions. I think you reached a good middle ground on this, and these are complicated rules because they're complicated markets, and then myriad types of entities. I think you've done a good job of threading the needle.

Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. Before Commissioner O'Malia goes, I just wanted to mention something Commissioner O'Malia and I have both worked with staff on in the General Counsel's office is there's one issue that NFA has raised, which I've asked staff to come back with as soon as thoughtfully and practically, as to a proposal that we could consider to go out to notice and comment on -- if somebody is an associated person of more than one swap dealer -- and I just wanted to, for the record, say that I hope that can occur.

MS. GOLD: It will. Thank you.

CHAIRMAN GENSLER: Thank you. Commissioner O'Malia?

COMMISSIONER O'MALIA: Thank you, Mr. Chairman, for that. That is a -- it's a customer protection issue, and the sooner we can get it done, the better. And I understand we missed it the first time, and due to the rules, we have no choice but to repropose.

I understand Commissioner Sommers's frustration on this thing, because I too have wanted to make sure that we get this right. And we have an early throughput issue, right? We're going to have all these people trying to figure out if they are a dealer.

My concern isn't so much whether Goldman-Sachs or any of the big guys are. It's the little guys that, if we get the dealer rule wrong, whether they are or they aren't, they're going to be hanging on the very last rule. Then they have to develop a compliance regime. These are not big, sophisticated Wall Street firms, more than likely. They're small guys.

And frankly, I suspect, based on what I've seen of the entity definition, I think many of them shouldn't be dealers. But we'll have to kind of work that through.

I just want to make sure that NFA is not under any artificial timeline to make these proposals, and therefore not do an adequate job to make sure that they're in full compliance, and firms have adequate timeframe.

I'm not asking a question, so just relax. We did have -- I did propose an amendment to this proposal that would have put all of the timetable fixes in this so you could see it in this proposal. I understand that is not the will of the commission. They preferred a more piecemeal approach, on a rule by rule basis. I don't like that idea, but I am satisfied that we did have other fixes on the provisional registration that will not force NFA into making bad decisions or untimely decisions so I'm okay with that. Not real satisfied with the piecemeal, but we'll go from there.

So I appreciate --

CHAIRMAN GENSLER: Can I just add something? I think in -- I'll take a rule that I think we won't get to until sometime this spring, and even maybe into the summer -- is a 4(s) requirement on margin.

We're working -- I don't know where Jackie Mesa is, but we're working internationally to try to have a coordinated effort. A lot of people -- Congress would like us to be coordinated internationally, dealers would like us to be, customers would. So that's a 4(s) requirement that, by its nature, could come later, and we might even put a long implementation. I don't know -- whatever the will of this commission and the SEC and other are, whereas others, like external business conduct might -- once people know they're a dealer, might actually go effective, I guess, in the fall of this year.

I think we laid out something which was six months plus two months. I think it was an eight month implementation. So that would probably be going effective -- if we finalize all the other rules in the fall, whereas margin might be later.

So I think that's why I'm more inclined towards this, as you call it, rule by rule -- because I wouldn't want to force a decision on margin earlier because I'm not sure where we'll end up on margin, for instance.

That's why we might have a difference here. Thank you. Commissioner Wetjen?

COMMISSIONER WETJEN: Thanks, Mr. Chairman. Thank you to the team for your work on this rule. Appreciate all your efforts.

I guess, piggybacking on the back and forth to my left here -- I guess what I was wondering is I think I've been hearing different messages from folks. In fact, this comment or question could relate more to Commissioner Sommers's remarks, but it's not clear to me that every market participant wants one single date of compliance just because of the burdens that would pose on their folks internally.

And so I guess the question to the group here, with respect to this rule, is what sorts of things have you folks been hearing along those lines, and why did you settle on the requirement that you did?

MR. BARNETT: I mean, just asking -- market participants have teams in place, allocated and divided responsibilities to put Dodd-Frank into place, and I think they want clarity and they want to know what's required of them as soon as possible.

So I think for them to want to wait for some later date and then be told at once, and then have to make everything move at once -- I don't think that's -- at least that's not what I've heard from people. That's not the message that's been communicated to me, anyway.

MS. GOLD: I can't -- oh, I'm sorry. I can't recall in the comments that anyone specifically said they wanted all of the rules issued at one time, the section 4(s) rules. I think what the comments went more to -- just having adequate notice and adequate time.

COMMISSIONER WETJEN: That's all I got.

COMMISSIONER SOMMERS: Can I clarify something?

CHAIRMAN GENSLER: Sure, Commissioner Sommers.

COMMISSIONER SOMMERS: I wasn't suggesting that we issue all the rules at the same time. There's no doubt, I think, in the schedule that we've talked about putting on the website from today that we're going to be doing these 4(s) rules for the next six months. We've already done some of them.

So there's going to be, I think, a staggered time for us voting on those rules. But if you look far enough ahead in the future to say that there would be one date for compliance, it just seems to make sense to me.

COMMISSIONER WETJEN: Yeah. My question was about compliance, not when the rules were issued, but --

CHAIRMAN GENSLER: I'm just going to add, as I said to Commissioner O'Malia -- and I know that you were out of the room for a second -- I think that it helps lower the cost and lower the burden on the dealer and ultimately the cost of this change that some of these are staggered and phased -- phased implementation.

And I used as an example margin, which, for a lot of reasons, we want to get international input, SEC input, bank -- there's a lot of discussion about what the bank regulators are going to do on margin because we only have the margin on the non-bank dealers.

So that coordination will take awhile to finalize, but also we might decide at that point to give a longer implementation phase because if we finalize it this summer, than, for instance, what we did earlier today on external business conduct.

So I think it helps -- and we might have a difference here, but I think it helps lower some of the uncertainty and cost to allow the dealers to stagger some of these things, and we might legitimately decide margin, for instance, needs a lot more time -- not only because we finalized the rule this summer, but maybe even just to -- if they have to collect margin from people that it takes -- we give them more time.

If there are no more questions on the registration rule, Mr. Stawick.

MR. STAWICK: Commissioner Wetjen?

COMMISSIONER WETJEN: Aye.

MR. STAWICK: Commissioner Wetjen, aye. Commissioner O'Malia?

COMMISSIONER O'MALIA: Aye.

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

COMMISSIONER CHILTON: Aye.

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

COMMISSIONER SOMMERS: Aye.

MR. STAWICK: Commissioner Sommers, aye. Mr. Chairman?

CHAIRMAN GENSLER: Aye.

MR. STAWICK: Mr. Chairman, aye. Mr. Chairman, on this question, the yays are five, the nays are zero.

CHAIRMAN GENSLER: The vote being unanimous, we will send it to the Federal Register, and I thank the team.

But we have to consider a motion on the delegation order.

I'll make a motion because we have to do the delegation as well. That's a separate vote, right?

MR. STAWICK: That's a separate question, correct. So it would be in order at this point to entertain a motion --

CHAIRMAN GENSLER: Yes. So I'm entertaining a motion to accept the staff recommendation to delegate to the NFA this registration function.

COMMISSIONER SOMMERS: So moved.

COMMISSIONER O'MALIA: Second.

CHAIRMAN GENSLER: And are there are any further questions on the delegation? I just want to make sure people had those questions now.

If no further questions, then Mr. Stawick.

MR. STAWICK: Commissioner Wetjen?

COMMISSIONER WETJEN: Aye.

MR. STAWICK: Commissioner Wetjen, aye. Commissioner O'Malia?

COMMISSIONER O'MALIA: Aye.

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

COMMISSIONER CHILTON: Aye.

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

COMMISSIONER SOMMERS: Aye.

MR. STAWICK: Commissioner Sommers, aye. Mr. Chairman?

CHAIRMAN GENSLER: Aye.

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

Chairman, on this question, the yays are five, the nays are zero.

CHAIRMAN GENSLER: The vote being unanimous, not only will we send it to the Federal Register, but we will ask the NFA and Mr. Dan Roth to get ready -- as I know they already have been, and I really thank them for all their collaboration. I thank this team, and I look forward to your recommendations on this associated person matter as soon as you think is thoughtful to bring it to our attention.

Thank you. I think with that, unless -- I'm going to ask my fellow Commissioners. Do you want to just keep going, or do you want a break? All right. So we're going to keep going, and then Dan Berkovitz and Steve Seitz and whomever else -- hey, Paul.

Gary Barnett, you're going to stay with this one? Great.

So we will hear from the staff about proposing under Dodd-Frank section 619 of the

Volcker Rule. And I thank Steve and Gary Barnett and Dan Berkovitz and Paul Schlicting, who is sitting in the audience. I do want to do a little shout-out. Paul is the team lead, and is now over at the Securities and Exchange Commissions because we work so well amongst these two agencies. Sometimes people do move from one to the other, but he can't sit at the table for some reason under the SEC's rules. But we see you here and feel your presence, Paul, and thank you for all you've done.

Is this Steve or Dan? Who's taking the lead here? Steve.

MR. SEITZ: Good afternoon, Mr. Chairman and Commissioners.

Today, staff are recommending that the commission propose rules implementing section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule. Section 619 amends the Bank Holding Act and generally prohibits any banking entities from either engaging in proprietary trading or sponsoring or acquiring an ownership interest in certain covered funds.

Section 619 also contains several exemptions to these general prohibitions, including permitting certain activities, such as underwriting, market-making related activities and risk-mitigating hedging.

Section 619 also provides exemptions for organizing and operating a covered fund, and for making a de minimis investment in these funds.

This proposed rule today would only apply to banking entities, including affiliates and subsidiaries for which the CFTC is the primary financial regulatory agency, as set forth in section two of the Dodd-Frank Act. Most notably, this would include CFTC-registered swap dealers, commodity pool operators and commodity trading advisors.

Before summarizing the proposed rule, I'd like to thank the staff and various divisions here at the commission who have helped draft the proposed rule. And additionally, we'd also like to thank our colleagues at the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, as well as the Treasury Department for all of their help in formulating this proposal.

Section 619 requires the various financial regulators to consult and coordinate with each other to ensure that the Volcker regulations are comparable and consistently applied to the affected banking entities.

This proposed rule is the result of an extensive and coordinated rulemaking process among the various financial regulators.

Accordingly, the CFTC's proposed rule is substantively similar to the joint rule that was previously proposed by the banking regulators and the SEC in October.

Staff is recommending, similar to these other agencies, that the commission propose the entire text of the proposed common rules section from the joint rule. And similar to these other agencies, the CFTC is proposing to modify this commonly shared joint rule with CFTC-specific rule text.

Our proposal also contains several additional questions asking whether certain provisions of the joint rule are applicable and should be applicable to CFTC-regulated banking entities.

As required under section 619 of the Dodd-Frank Act, the proposed rule prohibits banking entities such as registered swap dealers, commodity pool operators and commodity trading advisors from engaging in proprietary trading and having certain interest in, and relationships with, covered funds.

The proposed definition of proprietary trading generally mirrors the statutory definition. And this means engaging as a principal for the trading account of a covered banking entity in any purchase or sale of certain financial instruments. It does not include acting as a custodian, agent or broker for an unaffiliated third party.

The proposed definition of proprietary trading contains two critical terms. The first is trading account, and the second is covered financial position. If a banking entity enters into a transaction or trading strategy that falls outside of these two definitions, then such transaction or trading strategy is not covered by the Volcker Rule prohibitions.

The proposed definition of trading account includes accounts used to acquire financial positions principally for the purpose of short-term gain. Second, positions that are market risk capital rule cover positions. And third, positions held by a swap dealer registered with the commission.

The proposed definition of trading account also includes all positions held by a registered swap dealer. This ensures that the definition of trading account includes all of the dealing book of any banking entity swap dealers, including long data derivatives that are held to term or expiration.

The proposed definition of covered financial position includes positions in securities, derivatives, commodity futures and options on these instruments, but does not include positions in loans, spot foreign exchange or spot commodities.

Although the definition of trading accounts for registered swap dealers is broad, the proposal, like the statute, specifically permits certain activities. The statutory exemptions include underwriting, market making- related activities, risk mitigating hedging, trading in certain government obligations, trading on behalf of customers, trading by insurance company for general accounts and trading solely outside the United States.

This proposal also provides detailed guidance on what banking entities must do to qualify for each of these exemptions, including proposing detailed, quantitative measurements that are indicative of market making-related activities. The quantitative measurements are designed to help differentiate between prohibited proprietary trading and market making-related activities.

In addition, pursuant to the statute, there are limitations on these permitted activities. Banking entities may not use these exemptions if their trading activities would result in a material conflict of interest between the banking entity and its client, customer or counterparty. Second, if it would result in a material exposure to either high-risk trading strategies or high-risk assets, or third, if it would pose a threat to either the safety and soundness of the bank entity or to the financial stability of the United States.

The proposal also requires large banking entities to comply with recordkeeping and recording requirements; specifically, covered banking entities that have, together with their affiliates and subsidiaries, trading assets and trading liabilities equal to or greater than $1 billion will be required to calculate and report these quantitative measurements for their trading units that are engaged in market making-related activities.

Additionally, covered banking entities with more than $5 million in trading assets or liabilities will be required to calculate and report additional quantitative measurements.

These proposed quantitative measurements would cover five categories: Risk management, source of revenue, revenues relative to risk, customer-facing activity and pay-to-receive spread ratio.

The proposal sets forth both a general description and calculation guidance for each of these metrics. The proposed rule also includes questions regarding the applicability of each metric to CFTC-regulated markets and products.

Furthermore, under the proposal, all covered banking entities that engaged in either covered trading activities or covered fund activities under the proposal will be required to develop and administer a program that is reasonably designed to ensure and monitor compliance with the statute and the proposed rule.

This compliance program would include six elements: Written policies and procedures, internal controls, independent testing of the effectiveness of the compliance program, a management framework that delineates responsibility and accountability for compliance, trading for personnel to both implement and enforce the compliance program, and creating and keeping records sufficient to demonstrate compliance with the statute and the proposed rule.

Under the proposal, covered banking entities meeting certain size thresholds for trading would need to establish an enhanced compliance program. The enhanced compliance program would need to meet certain standards outlined in the proposed rule.

The second part of the proposed rule prohibits banking entities from investing in, or engaging in, certain relationships with private equity funds, hedge funds, commodity pools and certain foreign funds. These are referred to in the proposal as covered funds.

In this part of the rule, the proposal defines banking entity broadly to include any affiliate of a bank, such as an affiliate that is a registered commodity pool operator or a commodity trading advisor.

The purpose of the prohibition on investments and covered funds is to prevent a bank from indirectly engaging in proprietary trading through direct investments and covered funds, and also to prevent a bank from possibly bailing out such funds.

The statute contains three provisions governing investments and private funds sponsored by banks. First, the bank and its affiliate advisor can invest no more than three percent of its tier one capital in a private fund and sponsors, which is the aggregate limitation. Second, the bank and its affiliate advisor can own no more than three percent of the private fund. This is the per fund limitation. And third, the bank and its affiliate advisor cannot bail out any fund that it sponsors.

As stated earlier, the proposed rule clarifies the statutory provisional investments and covered funds, and defines terms in a manner that is consistent with the provisions proposed by the federal banking regulators and the SEC in October.

The proposal attempts to not impose unnecessary restrictions on the ability of commodity pool operators and commodity trading advisors to provide advisory services.

CPOs and CTAs can continue to sponsor, advise and invest in commodity pools, provided that they comply with certain requirements, such as setting up a compliance program that independently meets certain conditions.

The proposal also asks questions on how advisors, such as CPOs and CTAs, would be affected by the proposed regulation.

In conclusion, we look forward to receiving comment from market participants and the public on the proposal, and we are happy to answer any questions that you may have.

CHAIRMAN GENSLER: Thank you, Steve. I will now entertain a motion to accept the staff recommendation on this proposal.

COMMISSIONER SOMMERS: So moved.

COMMISSIONER O'MALIA: Second.

CHAIRMAN GENSLER: Now it's time for questions. I'm going to support this proposal, and I'll chat a little bit about why in a minute, but I do have a couple of questions.

Can you just walk through, Steve or Dan, walk through the CFTC's role and how that relates to other -- the bank regulators and the SEC? And the reason -- I mean, we've discussed this in my office a bunch, but I think it's helpful for the public to understand where it fits in. If a banking entity -- these rules only apply to banking.

First question -- this only applies to banking entities, correct?

MR. SEITZ: That's correct. The rule

applies only to certain banking entities, and then within those banking entities, it's the entities that we are the primary financial regulator for, such as swap dealers that are associated or affiliated with those banking entities.

CHAIRMAN GENSLER: So you've answered part of my question. So it only relates to where a primary financial regulator, such as a swap dealer -- or is it also a futures commission merchant that's part of a larger banking entity?

MR. SEITZ: That's correct. There's a series of entities for which we're the primary regulator under section two. It includes swap dealers, futures commission merchants, CPOs, CTAs.

CHAIRMAN GENSLER: So if you can answer a question I asked yesterday -- but if there's a swap dealer that's part of a bank, does any rule that we finalize eventually one day finalize apply to the rest of the bank, or what portion of the bank does it apply to -- our rule versus the Federal Reserve's rules and everybody else's rules?

MR. BERKOVITZ: Our rule would apply to those activities with respect to which we are the primary regulator.

CHAIRMAN GENSLER: So in essence, it's the swap dealer activities.

MR. BERKOVITZ: Correct. The activities that make somebody a swap dealer, that's who it would apply to.

CHAIRMAN GENSLER: And another example, just for the public -- if it was a joint futures commission merchant/broker-dealer, would it apply to the broker-dealer activities of the joint FCM broker-dealer or would the SEC's rules?

MR. BERKOVITZ: The CFTC's rules would apply to the FCM activities and the SEC's rules would apply to the broker- dealer activities.

CHAIRMAN GENSLER: So it's just targeted, in essence, to those -- because Commissioner O'Malia and I have had a lot of discussions about this and with you, Dan -- can you walk us through? We have rule writing authority. What is our examination or enforcement authorities with regard to this rule, or is it the banking regulators that have some of that?

MR. BERKOVITZ: Section 619, which amended the Bank Holding Company Act and gives the CFTC several authorities with respect to the Volcker Rule. One is rule writing authority, rule making authority -- and that is the authority we're using to promulgate this rule.

As part of that rule, we are given authority to require records be kept and information to be reported, and along with that authority, that recordkeeping and reporting, is authority for us to look at those records and require periodic reporting to us as we determine appropriate -- or allow us to examine the books and records that they have and we require them to keep.

So that is the basic -- we, I think, could refer to it as examination authority, to look over those books and records.

The statute also provides authority when there is a violation of the prohibitions on proprietary trading. After notice and opportunity for the potential violator to be heard, we can order that the offending activity be terminated or undone. So we do have that very specific enforcement authority -- when there's been a violation, to terminate the activity in order that the investment be divested, basically.

CHAIRMAN GENSLER: But in fact -- am I correct that under the Bank Holding Company Act, it's the banking regulators that have the broader enforcement authority for any violations of rules promulgated onto the Bank Holding Company Act?

MR. BERKOVITZ: That's correct. The banking regulators have broad authority under the Bank Holding Company Act to take enforcement action for any violation of that act, and that would include our rules that we have promulgated pursuant to that act.

CHAIRMAN GENSLER: Right. So they would have that enforcement authority.

MR. BERKOVITZ: Correct.

CHAIRMAN GENSLER: The reason I ask it

is -- I do support the proposed implementing rule. I think it's important to put it out to public comment. The banking regulators and the SEC put out to public comment in September -- no, I guess it was October. In October, this is virtually -- I mean, it's a mirror of that. I mean, we changed all references to the SEC to references to us and things like that, but this is basically a mirror.

I'm glad we added a handful of additional questions, and the spirit of those questions were, do we really need this in our rule? Is this necessary for swap dealers and futures commission merchants? But it's a mirror of what they have done.

To answer a question that's come up from Congress and the press and sometimes from fellow Commissioners -- why didn't we do it in October? From my perspective as Chairman, it was pure capacity, pure just what we had on our agendas in October. The document came to us that last week of September. First week of October, we distributed it to Commissioners' offices, and I as

Chair decided not to press forward, partly because Commissioner Dunn was also about at the end of his long, distinguished term here, and Commissioner Wetjen was coming on board.

So that's a large part of why I -- but I also didn't hear back from Commissioners that they wanted changes in the documents, and so that's the document we're doing right now. And Commissioner Sommers is right. Now the public is able to weigh in on ours and the banking rules together. As I understand it, they've extended their timeline. So I think that they and we will hear -- we're going to put this out for 60 days. So our comment period might go a little longer than theirs, but I would envision if we adopt the proposal today, that we'll be considering comments that will be consistent with the comments they're getting.

From my perspective, what's most important to hear from the public is how to get this -- if there's ways to make it less of a compliance burden, to make it less of a compliance burden. I think it's a very challenging thing that Congress has given the regulators to do here, and ultimately the dealers and the banks to do, is how to legitimately make markets, how to underwrite securities, how to keep liquid markets going but at the same time not proprietary trade. I mean, that's what we'll be sorting through in these comments.

Truly, I look forward to the comments and to your question. I mean, if for some reason the other regulators decide that something's not a logical outgrowth and has to be reproposed, I would assume that we'd be right in there with them doing similar things, to your question, Commissioner Sommers -- because I think our role here is -- it's important, it's significant, but it's actually just a supporting member, where the bank regulators have the lead role. I don't know if, Dan or Gary, you agree with that, but I think they have the lead role, from what I understand, in this. Is that right?

MR. BARNETT: Yes.

CHAIRMAN GENSLER: So I'm going to --

Commissioner Sommers.

COMMISSIONER SOMMERS: I just have a couple of questions, and one of them is a followup to, Dan, your answer that you just gave about what our enforcement authority is. So if there is a violation of a prohibited trade, we can ask them to get out of that trade.

What if they refuse? Do we have the ability to then rip their registration, to do other -- what's the hammer to tell them, you need to get out of this trade -- but if we can't do anything about it if they don't --

MR. BERKOVITZ: Well, I think that we -- along with the statutory provision, we have the authority to require the divestment, which would be judicially enforceable, that -- an order issued under that authority of the Bank Holding Company Act that we would have would be something that's judicially enforceable in and of itself.

COMMISSIONER SOMMERS: So we could take them to court to say get out of the trade, but we couldn't fine them or --

MR. BERKOVITZ: The enforcement authority for that type of civil penalty authority, the statute, section 13, the Bank Holding Company Act, does not give us that authority.

COMMISSIONER SOMMERS: Okay. My other question is with regard to a change that was made this morning, and I'm just trying to make sure that I understand this additional text on page 57, which has to do with the interplay between market making in the Volcker Rule and what we end up doing in the entity definition rule making.

So if we define market making in the entity definition rule, whether or not it's considered -- in a way, to determine whether or not it's considered bona fide market making -- and that is in conflict with what's in the Volcker Rule, what happens then?

MR. BERKOVITZ: The purpose of the additional language that was circulated was that when this was proposed, when this language was proposed last -- it was basically proposed last

October, and it was proposed at that time by the four financial regulatory agencies.

And now we're in -- as Steve has explained -- in this proposal here, we're basically just taking what the proposal was in order to be consistent and take the consistent approach, recognizing at the same time in our entities definitions rule making, we're addressing the issue of what is market making -- because that is one of the components of this swap dealer definition. We have to determine what is -- actually referencing a couple of the components of the definition -- somebody's who making a market, somebody who's known as a market maker.

So the question arises, should we have the same considerations for market making in both rules, or are there considerations that would lend that there be one different than the other, or should it be the same?

So the purpose of the additional language was basically to put the public on notice that we're coming out with this entities definition rule making. We've gotten a lot of comments on what market making is in the context of that rule making, and therefore is it appropriate in this rule making to be consistent with what we come out with market making and the entities definitions rule making, rather than just go with what was proposed.

MR. SEITZ: They don't need to be the same, and one shouldn't drive the meaning of the other. So you could look at too much market making as a definition cuts into Volcker, but too much prop trading can cut into swap dealing for purposes of our swap dealer definition.

You look at definitions in the context in which they're adopted. By analogy, you could look at U.S. person -- definition of U.S. person -- and used in one context, you might exclude foreign vehicles that are invested in by U.S. People. In another context, you might define it in a different way, where you want to look through to U.S. people. So there's no need to look at it that way, but we will be considering it.

COMMISSIONER SOMMERS: Okay.

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

COMMISSIONER CHILTON: Thanks, Mr. Chairman. Like I said, I support the proposals. I did want to clarify something -- because for the longest time, I just assumed that we didn't even need to do a proposal on this, that this was pretty much in the banking world and that what they did sort of superseded what we did.

So in following on the Chairman's questions about what this proposal would do and who it would impact, and essentially just our registrants -- Mr. Berkovitz, if the banking regulators obligated the rule as proposed, would we even need to follow all the rules?

I mean, doesn't their ability with regard to overseeing and enforcing this sort of supersede anything we would do? Not anything, but couldn't it be done without us, I guess is my question.

MR. BERKOVITZ: They would have the

ability to finalize their rule with respect to the entities for which they are the primary financial regulator, but with respect to the entities for which we are the primary financial regulator, we would have to finalize a rule to make it effective for those activities for which we are the primary financial regulator.

COMMISSIONER CHILTON: So if they use some language, Dan, that said something like any bank or entity thereof may not be involved in proprietary trading, that wouldn't take care of an FCM? Any bank or entity thereof -- that wouldn't just automatically say that the FCM can't be involved in prop trading?

MR. BERKOVITZ: Yeah, we would have to issue the rule with respect to the FCMs for which we are the primary financial regulator. It specifically gives us the authority in those areas. So that's why the rule is joint between all the various agencies -- because each agency has to do it within the scope of its own authority.

COMMISSIONER CHILTON: So the reach does not include FCMs from the banking regulators. If they say bank or entity thereof -- or whatever the appropriate word -- there's no way that they would be able to cover what's going on in our space?

MR. BERKOVITZ: That's correct. And I just want to be clear -- in our space. As the Chairman's question initially indicated, an FCM may be an FCM broker-dealer so they may have several -- an entity may have several different spaces, and the rule could be effective for things that are not in our space, but things that are specifically in our space such as the FCM registered activities -- futures commission merchants basically activities for their customers, swap dealers for their swap dealing activities. We have to issue the rule to have the proprietary trading prohibitions and fund investment prohibitions going --

COMMISSIONER CHILTON: Okay. Just one more -- keep it out, just one more little bit here.

So you said earlier in answer to a question, Dan -- you said that the banking regulators would have enforcement authority, if they saw that the banks were involved in proprietary trading even in our space. So they'd have some enforcement authority, but not overseeing authority in our area?

MR. BERKOVITZ: They would have enforcement authority because this would be a rule promulgated under the -- it will have been a rule that will have been promulgated under the Banking Holding Company Act. So once it's promulgated and the entity is within their jurisdiction and the entity is subject to the Bank Holding Company Act and the requirements thereunder, which would include our regulations at that time -- then there would be that type of enforcement authority that they would have.

And it's my understanding that in the near future, the agencies, the various regulatory agencies who are involved in this will be getting together and working together, and starting to figure out how to allocate these enforcement authorities and how to work cooperatively together so they'll be done in a coordinated way.

But essentially, the answer is yes, that once we promulgate our rules, we will have certain authorities that we can do -- inspection authorities -- examination authorities, I should say. We will have the authority to terminate the investments, and then they will have certain authorities too over the books and records because ultimately these are banking entities that they have a broader jurisdiction over under the Bank Holding Company Act.

COMMISSIONER CHILTON: Okay, thank you. I have nothing further. Thank you.

CHAIRMEN GENSLER: Thank you, Commissioner Chilton. I'm going to turn to Commissioner O'Malia, unless you thought you had anything you had to add. No? Okay, Commissioner O'Malia.

COMMISSIONER O'MALIA: Thank you, Mr. Chairman. This is a difficult situation.

Obviously we have to comply with the statute, and do so in a responsible way. And my questions and concerns with this fatally flawed rule do not imply that I don't agree that we don't have a job to execute the statute, but this rule is not it.

The rule suffers from massive conflicts, and the regulatory sphere has been highlighted and certainly confirmed by Mr. Barnett's statement about swap dealer definitions. The statute dictates a trade by trade oversight, yet the rule attempts to develop a broader entity compliance approach, which frankly is the only way they can be accomplished.

But it's unclear how any sort of regulatory consistency across entities, assets and markets -- this can be achieved.

The commission is voting on a document that's nearly 300 pages in length, establishing CFTC rules and regulation under the Volcker Rule. However, the rule fails to provide the CFTC with any specific enforcement authority as highlighted by Commissioner Sommers's questions, and leaves us with an ineffective capacity to simply audit firms with the strongest possible remedy of liquidating the position.

Do you believe that's a very effective deterrent?

MR. BARNETT: No. I actually wasn't tracking your whole question to the end.

COMMISSIONER O'MALIA: Do you believe liquidation is a fair, effective deterrent for a violation?

MR. BARNETT: No.

COMMISSIONER O'MALIA: The rule imposes a massive oversight responsibility to verify the complex metrics required by this rule. And it's a tiered regulatory approach. I think maybe that's a good idea. I don't know if -- $1 billion or $5 billion -- I don't know where they got those numbers. Do you have any sense?

MR. BARNETT: No, but I think what they -- I mean, to the extent you're asking me, I think they were trying to excise prop trading as concisely as they can. I mean, it's a colloquial term. To define it colloquially would have left permitted activities at risk.

So you see a lot of stuff going on where they're trying very hard to define prop trading, and at the same time, they're building in all kinds of safeguards against permitted activities, and by the time you're done, you've got this very, very large rule that everybody said go back and think about it again.

COMMISSIONER O'MALIA: All right. Do you have any sense of how many entities this commission will be regulating under this rule?

MR. BARNETT: I do not at this point. I could run it down for you, but I haven't it.

COMMISSIONER O'MALIA: Okay. And I'm curious as to how we're going to perform this oversight rule. Clearly, we require firms to set up a compliance program. We have either 17 or seven metrics, depending on how big you are in your tiered approach. That reporting has to come in on roughly a monthly basis on very subjective things.

How are we going to surveil that? It seems difficult to me. I don't think this is a technology solution.

MR. BARNETT: I agree with you. I mean, I think we're looking at this as dealing with 619. That requires comparable and consistently applied statutes, and we know that we want to get on the same page with our coregulators and go back through these questions. So I don't know that we're looking at how to comply with what is here, but we need to get into the discussion here, and then --

CHAIRMEN GENSLER: If I could try just -- I think that -- though I have not yet taken any part of this, I know from the staff that the banking regulators are looking to work with the SEC, and also on some understands, whether those are documented in literally a written document or whatever, to answer some of your very question -- that if a banking entity is under the Federal Reserve and they have supervisors usually there anyway -- I mean, they have more staff than us --

that we might actually -- in this arrangements with the banking regulators -- answer your questions, but I think it's still to be worked out, rather than us having to go in there.

COMMISSIONER O'MALIA: That still doesn't solve the conflict here. Realize we've got 300 pages of regulation that are specific to this body, and we have kind of an obligation now. We've created this obligation that we have some oversight and responsibility, yet no way to enforce it, no way to make it happen. Frankly, no way to understand how the metrics are being used.

I mean, MF Global highlighted the fact that on 30 days after -- we have the seg reporting requirement. 30 days after, they have to report how their seg funds are doing. In a matter of days, that all changed, and now we've got brand new metrics that are, frankly, wide, vast, and vague, and require us to pinpoint at an exact time whether these firms are in compliance or not -- after the fact, on an ad hoc basis.

It's an impossible job for us to do, and yet, even if we did do it, utilizing the resources we don't have, we have no authority to enforce it.

I'm going to keep going. On page 67, 68, the document discusses seven criteria a bank must rely on for a hedging exemption. In the third criteria, there's a discussion about "dynamic hedging." At the top of page 68, it says:

The CFTC recognizes such dynamic hedging, material changes and risk may require a corresponding modification to the banking entities' current hedge position. That makes complete sense to me. I get it. Especially in a principal to principal OTC market, things are changing, markets change. There's credit risk, et cetera.

We go on to the next criteria, the fourth criteria. The proposal lays out several factors that would impact the "reasonableness of correlation, depending on the facts and circumstances."

And these are the factors: Initial

position, risk created, liquidity of the instrument and legitimacy of the hedge. Again, all of those make sense to me, but it doesn't make our job very easy, of course, because these are somewhat subjective, based on kind of a point in time.

But then the fourth paragraph closes with this last sentence: Regardless of the precise degree of correlation, if the predicted performance of a hedge position, during the period that the hedge position and the related position are held, would result in a banking entity earning appreciable more profit on the hedge than it stood to lose, the hedge position would appear likely to be prop trading designed to result from profit rather than the exempt hedge position.

So we've gone through all these criteria, saying it's very subjective, facts and circumstances, blah, blah, blah. And then we go at the end of the day and say, oh by the way, you made too much money. It's kind of an ad hoc ex-post determination.

How is anybody supposed to have any confidence that they can put on a position and have this type of standard being the controlling regulation? What do people do with that?

It's more rhetorical.

MR. BARNETT: I understand.

COMMISSIONER O'MALIA: Well, maybe -- I mean, we did go through a number of these questions about these criteria, and I am really struck by how many questions we asked, whether this is even the right criteria for something that we seem -- we're prepared to vote on today and approve. We asked so many questions about is this the right criteria.

Let me ask you one question. This is not going to be rhetorical. I actually want the answer on this one. Hedging a customer trade -- this is something we dealt with in position limits -- trying to figure out if a dealer is supporting a customer that's a legitimate hedging entity, they're entitled to go lay off that hedge, but they can only do it once.

So what happens when they lay that off in the market? The dealer takes that legitimate hedging trade and goes to meet somebody else in the market. How do they find liquidity if every other dealer is banned from that proprietary -- from meeting them in that proprietary trade, unless they have some serendipitous position at the exact same time that they're looking -- they're too qualified looking to hedge. How does this happen? In what world does this happen?

Let me ask -- I was actually going to ask, looking for an answer. Anyone want to take that? I mean --

MR. BERKOVITZ: Can I -- let me just make a couple points, and maybe this is not directly responding, but the philosophy under this is it's basically a facts and circumstances test for whether this is proprietary trading or bona fide hedging or market making or whatever. There's a number of factors and metrics that are going to be looked at.

The firms are supposed to have

compliance programs. They look at the metrics. They're going to see whether their hedges are correlated or not correlated with the positions they took, and if you have consistently uncorrelated positions, well, maybe that's an indication that your trader is not really hedging, that they are taking proprietary positions. And your compliance program is designed to detect that, and then the regulatory agencies are going to oversee the compliance program and how it's working. It's going to be on some audited basis, I presume.

So each element in this is really going to go to that and not if you have one trade that doesn't correlate, that means that your entire hedging program is out. It's going to go into these facts and circumstances tests, and so you have to look at the big picture.

So I think you need to look at more than --

COMMISSIONER O'MALIA: But --

MR. BERKOVITZ: -- one element to

determine what the effectiveness will be.

COMMISSIONER O'MALIA: And I'm -- well, this unfortunately does look at it from a trade by trade standpoint, but the compliance has to be kind of portfolios larger -- I get that, but that's why I read what's on page 67 and 68. It certainly goes back and says, well, on that per trade basis, that's not a legitimate hedge. That's an individual trade. That is not the book kind of approach that I was hoping that we might try to enforce.

I get how difficult this is, and I understand the conflicting objectives of market making and then banning prop trading, and that's not a bright line. I do understand that, but this rule doesn't get that.

Corporate debt issuance -- I understand dealers will help underwrite corporate debt issuances and say, listen, we'll make you a firm commitment. We'll take the rest of it -- anything you don't sell. Is that prop trading, taking the remainder?

Paul, you want smoke signals from the back?

MR. BARNETT: It's a colloquial term. I mean, prop trading -- I don't know how you want to define it for purpose of the statute. I think -- I don't know if you're -- the way I'm looking at this is we have to adopt rules, and do we want to start off on our own, or do we want to get back -- do we want to be in the game with the group that's going to reexamine this rule and how do we do that?

But I understand the criticisms that have been made of the rule that was proposed by the other regulators, and we can restate those criticisms of this one, but then what is it that we want to do?

COMMISSIONER O'MALIA: We received -- Volcker Rule provides for an exemption from prop trading ban for U.S. Treasuries or U.S. obligations, but does not provide a similar exemption for Canadian or Mexican debt, and whether or not this -- I'm interested to know whether this -- A, we know it ticks them off, but whether this violates any NAFTA agreement. And did FSOC consider any ramifications of this policy decision by declaring all foreign debt obligations to be prop trading?

MR. BARNETT: I don't know.

MR. BERKOVITZ: The list of specific government obligations that are not considered prop trading, specifically statutory -- in the statutes so the proposed rule just follows the statute in that respect.

COMMISSIONER O'MALIA: Yep, I did notice Canadian debt on there. And obviously we -- the point being, we have a letter from the Canadians and others saying, this is problematic if you ban investment in our -- anyway -- Dan, we were working on some language.

This is to Commissioner Sommers's point about trying to figure out the definition -- reconcile our definition and the Volcker definition with regard to swap dealer, and we were -- it appeared as though the document, the Volker document, contains the SEC version of dealer definition -- dealer/trader distinction. And we don't do that in our entity definition.

And then two minutes, three minutes before this markup began, we received an email from you saying that we're changing that. And we ask a question -- which wasn't the way I would've drafted it certainly, although I think we were asking for a question on this. And it says -- the question is, to what extent should the CFTC incorporate concepts regarding market making from the entities definition for the proposed section 13 of the Bank Holding Company Act? Couldn't we fuzz that up to say either the CFTC definition or any other entity?

Maybe we can get comment on the full panoply of different definitions out here, since we're asking questions. I mean, we've asked thousands of -- over a thousand questions. Why do we have to draft this so narrowly?

MR. BERKOVITZ: This question was specifically -- I was mentioning in response to the question from Commissioner Sommers that the proposal had a very specific definition of specific treatment of market making, and we wanted to indicate that we're going to be addressing market making in the context of the entities definition.

So as we address it in that context is how we're addressing it in entities definition. We wanted people to comment on whether that would be an alternative way, whether or not it's appropriate, as Gary was mentioning, to address it in the Volcker Rule, and get comments on that.

And I believe the comments that are already in the document -- the questions in the document seeking comments, asking whether the treatment of market making -- and I don't have question 88 right in front of me, but I believe that should enable folks to comment on this incorporation, even without question 88.1, which was the one I was just referring to -- was the concept of market making that is in this document useful?

Generally, these questions say, what other concept would be useful? I think there's already implicit in here an invitation to suggest other market making concepts. If people don't believe that either of these is right, they're free to suggest. Certainly don't see any problem with proposing other concepts in here.

COMMISSIONER O'MALIA: All right. Definition of high-risk asset and high-risk trading strategy -- this is a beauty. It says -- basically defines high-risk asset as an asset or group of assets that would, if held by a banking entity, significantly increase the likelihood that a banking entity would incur substantial loss or would fail.

Is this under the 30 day reporting requirement? And how do we -- it's a pretty broad definition, I think. What would we do if we found somebody with -- just liquidate the position?

MR. BERKOVITZ: If the permitted activity exceeds that level, then they would have to bring it down.

COMMISSIONER O'MALIA: So we would leave it up to the entity to define what high-risk asset and high-risk trading strategy is, and if they went over that -- if they crossed their own line, then we would have to go get them.

MR. BERKOVITZ: That's right.

COMMISSIONER O'MALIA: So it's like trusting MF Global to say what the seg rules are.

MR. BERKOVITZ: Well, they have a compliance program. They have metrics. They have a compliance program. They have considerable discretion the way this is to determine how it's employed, and we will have the oversight program, and this is what we will be working with the fellow regulators to ensure that indeed their compliance program, that their use of their metrics are appropriate.

But in the first instance, it is going to be their compliance program, and we will be responsible for ensuring that it's appropriate.

COMMISSIONER O'MALIA: I've got plenty more questions, but I don't want to take it out on you guys. I'm done.

CHAIRMAN GENSLER: Commissioner O'Malia, I want to thank you. It's a good primer for me for next week's Congressional hearing.

Commissioner Wetjen.

COMMISSIONER WETJEN: I did have a question related to the applicability of these quantitative measurements to CFTC regulated entities, but Commissioner O'Malia touched on that a little bit in his questions.

So I guess my only remaining question would be, would you be disappointed if I had no others?

MR. BARNETT: Absolutely not.

COMMISSIONER WETJEN: I didn't think so. Okay, fair enough. That's all I have.

CHAIRMAN GENSLER: Fair enough. Commissioner Sommers?

COMMISSIONER SOMMERS: I have one other question on the effective date of this rule. And so if, hypothetically, the other agencies decided they were going to repropose and we join in that reproposal and it's not finalized by July, does the statutory language go into effect no matter what?

MR. BERKOVITZ: The statutory effective date, I believe, it's a hardwired effective date, which would be two years after enactment. There is authority in there to extend the compliance period. So the compliance period could be extended.

COMMISSIONER O'MALIA: Since -- who gets to extend the compliance period? Could we do that unilaterally, since we're going to define dealers unilaterally?

CHAIRMAN GENSLER: I think it's the Federal Reserve, Commissioner O'Malia.

MR. BERKOVITZ: That's the Board. It's the Federal Reserve -- has the authority under the statute.

CHAIRMAN GENSLER: I'm going to call a vote in a second, but at the core -- I mean, it's lots of pages and lots of questions, and we're going to -- this is just a proposal, and we're trying to, as, I think, Gary Barnett said so well, get into the slipstream. I mean, in October, everybody was saying why isn't the CFTC doing this? And it was capacity, and now we're doing it, and we have letters from the Canadians and others.

But at the core, as I understand this -- and maybe this is a question, but that this rule making requires that the banking entity have any of their trading -- and it's got to be over these $5 billion and $1 billion numbers, but any of their trading must be in compliance with rule 619.

But it's a policies and procedures approach, is it not? Isn't it that they have to have policies and procedures and compliance programs to ensure that they're in compliance with 619? Is that right?

MR. BERKOVITZ: That's basically correct -- that the activities are prohibited, and they're only permitted unless they are conducted pursuant to the compliance program and policies and procedures.

CHAIRMAN GENSLER: Again, I'm going to say -- I mean, I support getting this proposal out there, being consistent with the other regulators, letting the public have the opportunity to comment with us for 60 days, and I know the bank regulators have extended their comment period. And then seeing what the public says, to get this right and balanced and so forth, and I appreciate because you're helping me for next week.

Anytime, Mr. Stawick.

MR. STAWICK: Commissioner Wetjen?

COMMISSIONER WETJEN: Aye.

MR. STAWICK: Commissioner Wetjen, aye. Commissioner O'Malia?

COMMISSIONER O'MALIA: No.

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

COMMISSIONER CHILTON: Aye.

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

COMMISSIONER SOMMERS: No.

MR. STAWICK: Commissioner Sommers, no.

Mr. Chairman?

CHAIRMAN GENSLER: Aye.

MR. STAWICK: Mr. Chairman, aye. Mr. Chairman, on this question, the yays are three, the nays are two.

CHAIRMAN GENSLER: The ayes have it. The staff recommendation is accepted.

I also at this point ask unanimous consent to allow the staff to make technical corrections to the documents voted on prior to sending them to the Federal Register.

Without objection, so ordered. Our next scheduled public meeting is Wednesday, January 25. Subjects of the rule making will be published a week in advance, seven days in advance.

As many people have heard, one of the things in our docket -- and very critically -- is this entity definition rule, but there's some others in the dockets, and we'll just see how Commissioners feedback. And I appreciate all that we've done here as well.

But I think with that, if there's no

more, then I'll entertain a motion to adjourn the meeting.

COMMISSIONER SOMMERS: So moved.

COMMISSIONER O'MALIA: Second.

CHAIRMAN GENSLER: All in favor, aye. Thank you. Thank you. Thank you. Paul, good to see you again and good luck at the SEC.

(Whereupon, at 1:36 p.m., the PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

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

(Signature and Seal on File)

Notary Public in and for the District of Columbia

My Commission Expires: April 30, 2016