

UNITED STATES OF AMERICA  
COMMODITY FUTURES TRADING COMMISSION

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

Washington, D.C.

Thursday, January 13, 2011

1 PARTICIPANTS:

2 Commission Members:

3 GARY GENSLER, Chairman

4 BART CHILTON, Commissioner

5 MICHAEL V. DUNN, Commissioner

6 JILL SOMMERS, Commissioner

7 SCOTT D. O'MALIA, Commissioner

8 Presenters:

9 STEVE SHERROD  
Division of Market Oversight

10 RICK SHILTS  
Division of Market Oversight

11 SARAH JOSEPHSON  
12 Division of Clearing and Intermediary  
Oversight

13 ANANDA RADHAKRISHNAN  
14 Division of Clearing and Intermediary  
Oversight

15 Also Present:

16 DAN BERKOVITZ  
17 General Counsel

18 DAVID STAWICK  
19 CFTC

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

(9:38 a.m.)

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2  
3 CHAIRMAN GENSLER: This meeting will  
4 come to order. This is a public meeting of the  
5 Commodity Futures Trading Commission to consider  
6 issuance of proposed rulemakings under Dodd-Frank  
7 Wall Street Reform and Consumer Protection Act.  
8 It will be regarding position limits for physical  
9 commodities which is the pending business before  
10 the Commission and swap trading relationship  
11 documentation requirements for swap dealers and  
12 major swap participants.

13 Before we hear from staff I'd like to  
14 take this opportunity to congratulate Commissioner  
15 Mike Dunn on his 25 years of service to the  
16 federal government. Mike is a trusted colleague  
17 who works incredibly hard in service to the  
18 American public here at the CFTC, but he also  
19 served at the Farm Credit Administration, the  
20 Department of Agriculture, the Senate Agriculture  
21 Committee under Senator Patrick Leahy's  
22 chairmanship and probably a few other places.

1 He's been nominated by presidents of both parties  
2 and confirmed by the U.S. Senate I think it's six  
3 times. Having done that myself a few times, six  
4 is something to be honored. I am honored to work  
5 with Mike and call him my friend and colleague. I  
6 want to present him with a plaque if that's all  
7 right. This is his 25 years of service plaque.

8 COMMISSIONER DUNN: Thank you, Mr.  
9 Chairman.

10 (Applause)

11 COMMISSIONER DUNN: Thank you very much,  
12 Mr. Chairman. This is an unexpected pleasure, and  
13 I must say the 25 years of service in the federal  
14 government, and that even goes back to some time  
15 starting with Lyndon Johnson to today, so that  
16 I've earned every gray hair that I have. The most  
17 amazing thing that I have found in my tenure  
18 working with the federal government was the  
19 dedication to the men and women who are known as  
20 the Civil Service Corps. It is too often in the  
21 press today that folks have said the government is  
22 the enemy or is the problem, and then it's shifted

1 not from the government but for the men and women  
2 who work day to day in government as a problem and  
3 that's just simply not true. I think all of us  
4 and the 25 years that I have in I've never been a  
5 career civil servant. It's always been in an  
6 appointed position and that's pretty amazing.  
7 Some people may say I've managed to fool a lot of  
8 folks, but the reality is that working with career  
9 civil servants has been an honor for me in the 25  
10 years that I have in, the successes I've had are a  
11 result of the great support we've had with those  
12 staffs. Failures, I have to put those on my  
13 shoulders, but thank you all and thank you, Mr.  
14 Chairman, with presenting me with this plaque.  
15 I'm honored.

16 CHAIRMAN GENSLER: No plaques, but I do  
17 want to thank Commissioner Jill Sommers and  
18 Commissioner Bart Chilton who is joining us by  
19 phone I hope, Bart, you're on, and Commissioner  
20 O'Malia for all their thoughtful work on  
21 implementing Dodd-Frank. I'd also like to make  
22 this as a personal moment to honor somebody's

1 birthday who have been today and that's my wife.  
2 We lost Francesca about 5 years ago but our three  
3 daughters and I miss her dearly. She was a  
4 beautiful woman and I can't help but thinking  
5 about her today because it was her birthday.

6 I will return now to the business of  
7 today's meeting, welcoming members of the public,  
8 the market participants, members of the media to  
9 today's meeting as well as those listening by  
10 phone and watching on webcasts. This is our ninth  
11 public meeting to consider rules with regard to  
12 Dodd-Frank rulemaking. Our next meeting will be  
13 January 20. We will also schedule some additional  
14 meetings in February. I think we'll take up the  
15 dates of those meetings at our January 20 meeting.

16 As we have been doing, we'll announce  
17 the actual rulemakings that we'll consider one  
18 week before the meetings. Staff has worked very  
19 hard on the rulemakings that the Commission is  
20 considering today. They will present their  
21 recommendations. Of course, position limits is  
22 the one that's in front of us so I think we'll be

1 probably taking some questions for staff on that.  
2 And we of course continue to look forward to  
3 receiving public comments on all the rules that we  
4 put out and there will be questions on answers on  
5 these rules posted on our website. Before I turn  
6 it over, I turn it over to my fellow Commissioners  
7 for their opening statements. Commissioner Dunn?

8 COMMISSIONER DUNN: Thank you, Mr.  
9 Chairman. Thank you all for joining us today in  
10 this important meeting regarding the  
11 implementation of the Dodd-Frank Act. Today's  
12 meeting will address proposed rules regarding  
13 position limits for physical commodity derivatives  
14 and documentation requirements for swap dealers  
15 and major swap participants. The Commission is  
16 required pursuant to the Dodd-Frank Act to set  
17 position limits as appropriate to diminish,  
18 eliminate and prevent excessive speculation.

19 There has been the suggestion by some  
20 that once we set position limits on physical  
21 commodity derivatives the price we pay for gas,  
22 bread, milk and other things will inevitably drop,

1 and that volatility in the commodities markets  
2 will simply cease to exist. I believe this is a  
3 fallacy. Price volatility exists in markets that  
4 have position limits and in markets that do not  
5 have position limits. Price volatility exists in  
6 markets that have substantial participation from  
7 index funds and markets that do not have index  
8 fund participant whatsoever. As Nobel Prize  
9 winning economist Paul Krugman pointed out in a  
10 recent editorial, price volatility exists in a  
11 market because we live in a finite world where  
12 there is not at any given moment in time an  
13 inexhaustible supply of oil, wheat, milk or other  
14 physical commodities to meet the global demand for  
15 such products. Simply put, sometimes prices are  
16 higher because the demand for products around the  
17 globe is greater than the supply. Since these are  
18 global commodities, the demand driving higher  
19 prices might not even be from U.S. consumers but  
20 from a growing middle class in countries with  
21 emerging economies. Mr. Krugman does point out  
22 that this doesn't necessarily mean that



1 speculation plays no role.

2 With the passage of the Dodd-Frank Act  
3 now clearly as a mandate to set position limits on  
4 commodity markets and the over-the-counter markets  
5 as appropriate to diminish, eliminate or prevent  
6 excessive speculation, to date CFTC staff has been  
7 unable to find any reliable economic analysis to  
8 support either the contention that excessive  
9 speculation is affecting the market we regulate or  
10 that position limits will prevent excessive  
11 speculation. The task then is for CFTC staff to  
12 determine whether position limits are appropriate.  
13 With such a lack of concrete economic evidence, my  
14 fear is at best position limits are a cure for a  
15 disease that does not exist, or at worst it's a  
16 placebo for one that does.

17 I am voting for the proposed rules on  
18 position limits in order to gather more  
19 information. If there is more than anecdotal  
20 evidence that there is excessive speculation  
21 distorting prices in our markets, we need to see  
22 it. If there is statistical or economic analysis

1       that shows that excessive speculation exists and  
2       that position limits will diminish, eliminate or  
3       prevent it we need to see it.  If there is  
4       evidence that position limits will lower the price  
5       we pay for gas, milk and steak while  
6       simultaneously ensuring the integrity of our  
7       markets in the price discovery process, we need to  
8       see it.  Only after these questions have been  
9       answered will I be able to determine whether or  
10      not position limits are appropriate.  If we  
11      determine that position limits are appropriate to  
12      diminish, eliminate and prevent excessive  
13      speculation, I think we must then work with our  
14      sister regulators around the globe to ensure that  
15      limits set here in United States markets are not  
16      simply evaded by trading in other venues around  
17      the world.

18                 Lastly, I would like to speak briefly  
19      about the budget crises facing the CFTC.  The CFTC  
20      is currently operating on a continuing resolution  
21      with funds insufficient to implement and enforce  
22      the Dodd-Frank Act.  My fear at the beginning of

1       this process was that due to lack of funds, the  
2       CFTC would be forced to move from a  
3       principle-based regulatory regime to a more  
4       prescriptive regime. Now if our budget woes  
5       continue, my fear is that the CFTC may simply  
6       become a restrictive regulator. In essence, we  
7       will need to say no a lot more. No to new  
8       products. No to new applications. No to anything  
9       that we do not believe in good faith we have the  
10      resources to manage. Such a restrictive regime  
11      may be detrimental to innovation and competition,  
12      but it would allow us to fulfill our duties under  
13      the law with the resources that we have available.  
14      Again I would like to thank staff of the CFTC for  
15      all the hard work in regard to these very  
16      important proposed rules.

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

19                   COMMISSIONER SOMMERS: Thank you, Mr.  
20      Chairman. Good morning. I'd like to start again  
21      today by thanking both of the teams that we have  
22      before us today for all of their hard work on the

1 proposals we're considering. I know that Sarah  
2 Josephson who is the team lead for Internal  
3 Business Conduct Standards has been before us on a  
4 number of different occasions and this is the last  
5 proposal for her team. I want to thank all of  
6 them for all their hard work on the proposals that  
7 we've already put out and the one today and also  
8 to the Position Limit team who has been before us  
9 on a number of different occasions. I want to  
10 thank all of them for their perseverance on these  
11 very difficult issues surrounding position limits.

12 I will be supporting the swap trading  
13 relationship documentation proposal today because  
14 I believe this documentation is a critical  
15 component to well- functioning swaps markets. The  
16 documentation increases transparency to the  
17 regulators and increases certainty among  
18 counterparties both of which are vital.

19 Regarding the position limits proposal,  
20 let me say at the outset that while I opposed the  
21 Commission's 2009 proposal and I oppose this  
22 proposal today, I do not have a per se

1 philosophical opposition to position limits. I  
2 understand that Congress has directed the  
3 Commission to implement position limits as  
4 appropriate. If we had a reasonable and  
5 enforceable position limit proposal before us  
6 today based on analysis of complete market  
7 information, I would support it. We have not in  
8 the past nor do we now have such a proposal before  
9 us.

10 I opposed our 2009 position limit  
11 proposal because I thought it was a bad idea to  
12 impose position limits on exchange-traded  
13 contracts when we had no authority to consider  
14 limits on the vastly larger over-the-counter  
15 markets. I believe that had we imposed limits  
16 solely on exchange-traded contracts, we risked  
17 driving market participants out of our regulatory  
18 purview and into the opaque over-the-counter  
19 markets or overseas. This would not have been a  
20 positive regulatory outcome.

21 I oppose the proposal before us today  
22 because I believe it is flawed in a number of

1 respects. First, I believe we should conduct a  
2 complete analysis of the swap market data before  
3 we determine the appropriate formula to propose.  
4 We have not done that. Second, without data on  
5 swap market positions, the spot month limits we  
6 are proposing are not enforceable. I think it's a  
7 bad policy to propose regulations that the agency  
8 does not have the capacity to enforce.

9 Third, in Section (a)(1) Congress  
10 specifically authorized the Commission to consider  
11 different limits on different groups or classes of  
12 traders. This language was added in Section 737  
13 of Dodd-Frank. The proposal before us today does  
14 not analyze or in any way consider whether  
15 different limits are appropriate for different  
16 groups or classes of traders.

17 Finally, Section 737 of Dodd-Frank  
18 states that the Commission shall strive to ensure  
19 that position limits will not cause price  
20 discovery in the commodity to shift to trading on  
21 foreign boards of trade. This proposal does not  
22 contain any analysis of how the proposal attempts

1 to accomplish this goal. In fact, the proposal  
2 does not even mention this goal. Driving business  
3 overseas is a longstanding concern of mine and  
4 that concern remains unaddressed. Position limits  
5 has presented and still presents a number of  
6 different challenges for this Commission that I  
7 believe strongly the proposal before us today  
8 still misses the mark. Again, thanks to the two  
9 teams before us today and our enormous efforts in  
10 helping us get these proposals out. Thank you.

11 CHAIRMAN GENSLER: Thank you,  
12 Commissioner Sommers. Commissioner Chilton I  
13 believe is online.

14 COMMISSIONER CHILTON: Yes, I'm here,  
15 Mr. Chairman. Thank you and thanks to the staff.  
16 I support both of these rules. I do have a  
17 statement that I'd like to have included in the  
18 record which is short and without objection, Mr.  
19 Chairman.

20 As regulators, I think we have one key  
21 mission. It is embodied in the Commodity Exchange  
22 Act. We have a singularity of purpose to ensure

1 efficient and effective markets and to prevent and  
2 deter fraud, abuse and manipulation. Quite  
3 frankly, I think we can do better. We can because  
4 the new Wall Street Reform and Consumer Protection  
5 Act requires that we develop what many of us  
6 consider to be some fairly precious parameters.

7 Today, I am hopeful we will move forward  
8 to propose a position limits rule, a most precious  
9 parameter that we should have proposed much  
10 earlier in a way that would have implemented the  
11 provision as Congress intended. That's not  
12 happening.

13 Yesterday, eight U.S. senators told us  
14 to move forward on limits. That follows two other  
15 senatorial letters from last month.

16 This is a commission of five  
17 individuals, a group of people who make these  
18 decisions. That pretty much ensures no individual  
19 will get their way all the time. I'm certainly  
20 not getting my way on position limits, nor are the  
21 senators who wrote to us.

22 I am thankful that we will have position



1 points in place as a kind of glide path to  
2 position limits. As I've said repeatedly, points  
3 are not limits. However, they will help us learn  
4 more and do better as we go forward in further  
5 developing important -- and precious --  
6 parameters.

7 I would also like to congratulate  
8 Commissioner Dunn on his long service. I've had  
9 the pleasure of working with Mike and following  
10 Mike at different places in the Senate and at the  
11 Farm Credit Administration, but also working with  
12 him at USDA and I'm pleased that most of the time  
13 we've been on the same side of issues and that  
14 really makes me comforted and I've known that I'm  
15 doing the right thing a lot of times. We don't  
16 always agree and we both I think are supporting  
17 the position limit rules but for different  
18 reasons.

19 The only comment I'd make about that is  
20 that the as appropriate language in there I don't  
21 think Congress ever intended that that was to be  
22 interpreted with such elasticity that it meant

1       that we could say nothing is appropriate. I think  
2       it means we have to do something, it's just  
3       figuring out the right level. Maybe my colleagues  
4       don't disagree with that, but either way we'll see  
5       how things go forward and I support both the rules  
6       and I thank everybody for their work on this and  
7       congratulate Commissioner Dunn.

8                   COMMISSIONER DUNN: I thank Commissioner  
9       Chilton for following behind and cleaning my  
10      messes.

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

13                  COMMISSIONER O'MALIA: Thank you. I'd  
14      like to also extend my congratulations to  
15      Commissioner Dunn for 25 years of excellent and  
16      outstanding service. He's done a great job and  
17      I've enjoyed working with him in the short time  
18      I've been with him and I enjoy being such close  
19      suite mates upstairs and I can always rely on his  
20      counsel and I appreciate that and his advice is  
21      always well appreciated. Thank you and  
22      congratulations.

1           I believe that releasing the proposed  
2 rule for position limits for physical commodity  
3 derivatives for comment in its present form while  
4 simultaneously implementing a separate position  
5 points directive is an attempt to set position  
6 limits that is inconsistent with the language and  
7 the purpose of the Dodd-Frank Act. I believe that  
8 the proposed rule and the supplemental directive  
9 will create uncertainty regarding the regulatory  
10 standards for the Commission action and  
11 enforcement in a way that does not comply with the  
12 Administrative Procedures Act.

13           The uncertainty that will result from  
14 the publication of both the Commission's proposed  
15 rule and a possible attempt to enforce position  
16 points proposal will stymie the ability of market  
17 participants and specifically large commercial  
18 interests to manage their hedging and investment  
19 strategies. Semantics and affirmations of intent  
20 will not lessen the real impact of what  
21 essentially amounts to an attempt to affect legal  
22 rights and obligations. The new position points

1       proposal operates as a Trojan Horse by attempting  
2       to articulate a requirement of general  
3       applicability without providing the opportunity  
4       for public notice and comment as required under  
5       the Administrative Procedures Act. If setting  
6       federal accountability levels is the preferred  
7       course of action then it should be embodied in the  
8       proposed rule subject to notice and comment under  
9       the APA. That has never been a option put before  
10      me and is not the in the rule today.

11                With regard to the proposed rule for  
12      position limits, I appreciate the fact that  
13      comprehensive changes to this rule have been made  
14      including two important reforms. The first change  
15      has been the removal of the onerous crowding-out  
16      position and instead looking through the dealer  
17      and applying position limits to the actual  
18      customer. Any customer conducting bona fide  
19      hedging would not be limited by this position  
20      limit proposal. Second, the rule provides that no  
21      position limit will be set until the Commission  
22      has the data to monitor and enforce such limits

1 and only those can be effectuated through a future  
2 Commission order.

3           This begs the question how can the  
4 Commission decide to impose position limits on  
5 swaps positions without having the facts or  
6 understanding the impact on the market? Without  
7 the actual data we have no idea as to the impact  
8 on liquidity or excessive speculation as a result  
9 of these limits. I hope that through a public  
10 comment period we will develop a better  
11 understanding of whether or not these proposed  
12 limits are appropriate or if they should be  
13 changed. Further, if the Commission is going to  
14 proceed with implementing limits, I hope that the  
15 supporters of position limits will provide  
16 relevant data and evidence to demonstrate that  
17 position limits will stifle the upward pressure on  
18 prices in the markets as they have stated in their  
19 previous comments. I'd like to thank the staff  
20 for their efforts. They've been through this  
21 wringer a couple of times and they've done a great  
22 job to respond to the Commission's concerns.

1           Mr. Chairman, you and I have spoken this  
2 morning about position limits. I don't object to  
3 staff collecting data. That's their job. They do  
4 it every day and they do it very well. I do  
5 expect that they will also inform the Commission  
6 as to the applicable hedge limits in their  
7 investigation of the positions at your direction.  
8 I do object to taking any action to enact these  
9 position limits proposals outside the appropriate  
10 rulemaking process however. I will ask a number  
11 of questions to the staff regarding the  
12 implementation of the position points proposal and  
13 will make my decision based on that. Thank you.

14           CHAIRMAN GENSLER: Thank you so much,  
15 Commissioner O'Malia and all the Commissioners. I  
16 think consistent with our other public meetings,  
17 the staff is here to present proposals and of  
18 course with regard to this group it's the pending  
19 action. I think that taking up where we left off  
20 on December 16 there is currently a motion pending  
21 on the floor to accept the staff recommendations  
22 while the proposal remains the same. Staff has

1 taken the last month to make some technical  
2 changes to the proposal so that I first ask for  
3 unanimous consent to adopt the substitute proposal  
4 that contains those technical changes. Without  
5 objection so ordered.

6 In terms of voting on this, I suspect  
7 there are going to be some additional questions so  
8 that I open it up first to Commissioner Dunn if  
9 there are additional questions.

10 COMMISSIONER DUNN: This is in essence  
11 the same motion we had before us at the last  
12 meeting?

13 MR. SHERROD: Yes, that's correct.

14 COMMISSIONER DUNN: Thank you. With  
15 that, Mr. Chairman, I'd like to ask you a few  
16 questions if we could. Mr. Chairman, I'd like to  
17 further understand the direction you gave staff  
18 about surveillance at our last meeting. Is your  
19 direction to staff consistent with what staff  
20 currently does?

21 CHAIRMAN GENSLER: Yes, it is  
22 consistent. For decades the Commission's

1 surveillance staff has briefed the Commission  
2 weekly on the positions of traders in futures  
3 markets that are of regulatory interest.  
4 Sometimes this regards large traders, price  
5 volatility, supply-and-demand imbalances, issues  
6 around delivery in the spot month or even around  
7 convergence matters. In that regard, staff  
8 currently monitors large traders in these markets.  
9 Specifically what I've asked staff to report  
10 monthly to the Commission is regarding staff  
11 surveillance activities related to traders with  
12 positions at or above the 10 and 2-1/2 level of  
13 futures open in the market on these 28  
14 agricultural, metal and energy markets for which  
15 we're proposing position limits.

16 COMMISSIONER DUNN: Mr. Chairman, what  
17 are some of the typical activities that they  
18 engage in and what do they do if they have  
19 concerns?

20 CHAIRMAN GENSLER: Staff currently  
21 receives information including Forms 40 from large  
22 traders and when traders' positions get large,



1 staff familiarizes themselves with the business  
2 purposes of the traders' use of derivative in the  
3 markets. This may involve reviewing public data,  
4 confidential market data or contacting traders  
5 directly. When staff has potential concerns, they  
6 may also issue special cause to obtain additional  
7 information about traders' cash and swap activity.  
8 Ultimately, if staff continue to have concerns,  
9 they can recommend appropriate action to the  
10 Commission for its consideration.

11 COMMISSIONER DUNN: Mr. Chairman, does  
12 this direction given to staff in any implement  
13 position limits for the 28 markets covered by this  
14 proposed rule on position limits?

15 CHAIRMAN GENSLER: No. Implementation  
16 of these position limits can only be done in a  
17 final rule.

18 COMMISSIONER DUNN: Thank you, Mr.  
19 Chairman. I'd like to ask General Counsel  
20 Berkovitz a question. Is there anything in what  
21 I've done in directing staff to keep us informed  
22 in this monthly way, this information I've asked

1 for for all of us that is inconsistent with the  
2 Administrative Procedures Act or any other laws  
3 that you know of for the Commission?

4 MR. BERKOVITZ: No, Mr. Chairman. As  
5 you have described the surveillance to be  
6 undertaken by staff and as staff as Rick described  
7 the surveillance that will be undertaken, the  
8 surveillance is consistent with current practice  
9 so that this surveillance is fully consistent with  
10 the Commodity Exchange Act and the Administrative  
11 Procedures Act.

12 CHAIRMAN GENSLER: Thanks. Commissioner  
13 Sommers?

14 COMMISSIONER SOMMERS: I don't have any  
15 questions with regard to this proposal.

16 CHAIRMAN GENSLER: Thanks. Commissioner  
17 Chilton?

18 COMMISSIONER CHILTON: I don't have any  
19 questions. Thank you. I thought the colloquy was  
20 helpful.

21 CHAIRMAN GENSLER: Commissioner O'Malia?

22 COMMISSIONER O'MALIA: Thank you. I

1 have a couple questions for General Counsel  
2 Berkovitz. The colloquy was helpful and did  
3 clarify many concerns I had. Let me ask does the  
4 directive from the Chairman to staff amount to a  
5 Commission policy or guidance and does the staff  
6 directive have any binding legal affect on  
7 registrants or market participants?

8 MR. BERKOVITZ: Commissioner O'Malia,  
9 the directive is a directive to staff so that this  
10 does not establish Commission policy toward  
11 registrants or the exchanges. This is a manner in  
12 which Commission surveillane will be conducted  
13 internally.

14 COMMISSIONER O'MALIA: Thank you. When  
15 might the Commission's statutory emergency  
16 authority give it authority to require a trader to  
17 hold or reduce its position below the proposed  
18 position points limit? Will the crossing of a  
19 position point in and of itself amount to an  
20 emergency?

21 MR. BERKOVITZ: In order to invoke the  
22 emergency authority under Section 8(a)(9) of the

1 Commodity Exchange Act, the Commission must find  
2 reason to believe that an emergency exists and  
3 that when it finds reason to believe that an  
4 emergency exists the Commission may take such  
5 action as in the Commission's judgment as  
6 necessary to maintain or restore orderly trading  
7 and/or liquidation of a futures contract so that  
8 there are particular statutory criteria that must  
9 be met in order to invoke the emergency authority.  
10 Simply crossing a predetermined threshold or  
11 numerical level in and of itself, there would have  
12 to be additional findings. In and of itself it  
13 wouldn't be sufficient.

14 COMMISSIONER O'MALIA: Thank you. With  
15 regard to privacy concerns, market surveillance  
16 generally deals with confidential data. With the  
17 position point system the public is put on notice  
18 that at least once a month a list of names and  
19 positions will be presented to the Commission and  
20 Commissioners will likely engage in some  
21 discussion regarding whether or not any action is  
22 necessary. What protections will be in place to

1 ensure that Section 8 is complied with?

2 MR. BERKOVITZ: The Commission's normal  
3 practice in its surveillance is obviously fully  
4 consistent with Section 8 and the Commission does  
5 not release any matters that are discussed in the  
6 surveillance meetings. These meets are closed to  
7 the public and the information is protected to  
8 that the protections that have been effective in  
9 our surveillance meetings will be continued to be  
10 applied and the information discussed in those  
11 meetings would be protected from public  
12 disclosure.

13 COMMISSIONER O'MALIA: Can you remind me  
14 of what the penalties are for violating Section  
15 8(r)?

16 MR. BERKOVITZ: I would have to look up  
17 exactly the penalties so I can get that to you.

18 COMMISSIONER O'MALIA: Fair enough.  
19 From a resource standpoint, is the Commission  
20 currently in the position to collect and analyze  
21 the visibility position and related reporting  
22 requirements? Maybe I'll ask that to Rick,

1 please.

2 MR. SHILTS: Yes, because as the  
3 Chairman said in the colloquy, we do currently  
4 gather information about reportable traders who  
5 would file a Form 40. We're in regular contact  
6 with them to have a better understanding of their  
7 activity in the markets and as their positions get  
8 large we would have further discussion and  
9 dialogue with them. And our ISS, our surveillance  
10 systems, do get information on traders' reportable  
11 positions so that we do have that information on a  
12 regular basis so it's just a matter of assembling  
13 it in a way that's presentable to the Commission  
14 to provide that information to them about those  
15 traders who have positions above these specific  
16 levels.

17 COMMISSIONER O'MALIA: When you refer to  
18 ISS technology, you're only referring to the data  
19 on either the futures market data or related SPDC  
20 data?

21 MR. SHILTS: Yes, futures and options  
22 and then the SPDC and then foreign boards of trade

1 that have linked contracts.

2 COMMISSIONER O'MALIA: But by and large  
3 the swap data is not included in that?

4 MR. SHILTS: It's not included.

5 COMMISSIONER O'MALIA: And we would only  
6 be working off of the futures- and options-related  
7 data?

8 MR. SHILTS: That's correct.

9 COMMISSIONER O'MALIA: In understanding,  
10 would legitimate hedge exemptions apply? Is that  
11 incorporated in the ISS and TSS database? Is that  
12 electronic or is that a manual effort that we're  
13 going to have to bring hedge exemptions and  
14 positions together manually or is that automated?

15 MR. SHERROD: As you know, there are  
16 only nine commodities subject to federal limits  
17 currently and our process for exemptions involves  
18 three types of activities. One is the filing of a  
19 form, it's the 04 Series form that provides us  
20 with the bona fides of commercial traders. Two  
21 other types of exemptions are granted by  
22 Commission staff. And all of those exemptions and

1 those two other types are of course for  
2 anticipatory hedges and for the risk- management  
3 exemptions under Regulation 1.47 that are  
4 considered bona fide under the existing  
5 regulations. All of those are automated and  
6 they're in our Integrated Surveillance System, the  
7 ISS system, so as we receive daily reports from  
8 the FCMs on large trader positions, our systems  
9 pick up that data and we can compare it on a  
10 regular basis so that automated system of  
11 exemptions.

12 COMMISSIONER O'MALIA: Thank you. If we  
13 only have nine contracts with applicable position  
14 limits and therefore hedge exemptions, what  
15 standard for bona fide hedging will we apply to  
16 the other contracts that we'll be looking at in  
17 this new surveillance?

18 MR. SHERROD: We would continue our  
19 current surveillance practice of monitoring  
20 traders that are very large in the markets and it  
21 wouldn't change our current practice. Because the  
22 traders aren't subject to federal limits and in



1 many cases there are not applicable exchange  
2 limits, there would be no hedge exemption  
3 provision. They would simply continue to trade as  
4 they currently trade.

5 COMMISSIONER O'MALIA: How will you  
6 inform the Commission in your monthly surveillance  
7 of the relationship with commercial hedging and  
8 these position points?

9 MR. SHILTS: As we had said before, we  
10 do gather information from these traders on a  
11 regular basis to have an understanding of the  
12 nature of their positions but we wouldn't  
13 necessarily be conducting an analysis looking  
14 behind each position as to whether it would  
15 qualify as a hedge exemption under the proposed  
16 rules. We would have some idea of the commercial  
17 nature of the position or whether it's  
18 speculative, but not necessarily making a  
19 determination about whether they get a hedge  
20 exemption although having an understanding of the  
21 nature of the trading activity might suggest that  
22 they would qualify for one if limits were in

1 place.

2 COMMISSIONER O'MALIA: Thank you. It  
3 does occur to me that obviously if we're going to  
4 be looking at applying a 10/2-1/2 standard in this  
5 proposed rule then we ought to be cognizant of the  
6 relationship to their hedging positions.

7 CHAIRMAN GENSLER: I would say I think  
8 we're going to benefit over the course of these  
9 months as a rule is outstanding because we'll be  
10 informed and we'll be able to see. Some contracts  
11 as you know have federal limits and some don't,  
12 but for the ones that don't, currently we'll be  
13 better informed as we hopefully address ourselves  
14 to a final rule. Later all five of us will be so  
15 much better informed by this monthly briefing of  
16 the staff.

17 COMMISSIONER O'MALIA: I hope we are  
18 better informed. I certainly hope the market is  
19 better informed about our intentions and we need  
20 to be honest and clear about how we're going to be  
21 reacting and treating those market participants  
22 going forward and understanding in the interim

1 period whether we have position limits or not how  
2 this will affect them. I guess I'm satisfied that  
3 based on General Counsel Berkovitz' responses that  
4 the position points proposal is not enforceable  
5 and certainly the colloquy with Commissioner Dunn  
6 is satisfying as well and I appreciate you going  
7 through that.

8 I'm willing to put out the position  
9 limits proposal for comment as I did in previous  
10 rulemaking meetings but I'm very concerned about  
11 how we treat this going forward and will watch  
12 this very closely. I would like to say that I  
13 have concerns about understanding whether these  
14 are the right limits and how they're going to  
15 affect it because we absolutely do not have the  
16 data on the swaps market and understanding how  
17 that integrates and as we are now picking a limit  
18 and asking the market to comment on it, we don't  
19 have the data to understand how that relates to  
20 excessive speculation or position limits and  
21 liquidity. So I'm willing to put it out to get  
22 the comment but I'm very skeptical of it.

1                   CHAIRMAN GENSLER: I appreciate that,  
2                   Commissioner O'Malia and I think that's part of  
3                   why like all proposals, it's a proposal with a  
4                   60-day public comment period I believe that will  
5                   add to the many comments that we had in an earlier  
6                   proposal of course, 8,000 I think in that  
7                   circumstance. This will take some time to  
8                   analyze. In fact, as you noted the proposal  
9                   includes that any numbers would only be ultimately  
10                  by Commission order based on data. I know that  
11                  Commissioner Sommers has some further questions.

12                  COMMISSIONER SOMMERS: I wanted to  
13                  clarify something in a question that Commissioner  
14                  O'Malia just asked with regard to what we do in  
15                  the normal course of business in monitoring  
16                  positions. When we're asking for additional  
17                  information with regard to a market participant's  
18                  position, do we usually ask for their OTC  
19                  positions and cash positions?

20                  MR. SHERROD: I don't know that I would  
21                  characterize it as usual. Usually is a hard  
22                  concept because some of these markets are very

1 different, ranging from wheat to corn to crude oil  
2 to gold to silver. What we do is try to make  
3 ourselves aware of the full range of their  
4 business activities so that if they are engaged in  
5 a very large position in futures contracts, we  
6 will want to know whether they are active in the  
7 market for the physical commodity, whether that's  
8 on the purchase side or the forward sell side. We  
9 will want to know what their inventories are and  
10 will want to know what their over-the-counter  
11 derivative positions are. Sometimes the  
12 discussions will be qualitative and not  
13 quantitative. If we have heightened concerns we  
14 may ask for quantitative information verbally, and  
15 if we have particularly heightened concerns and  
16 often times that's focused around the delivery  
17 period in the futures contract, we may actually  
18 issue a special call to get a written response to  
19 our concerns and that additional information helps  
20 us formulate an opinion on the trader's activities  
21 and then apprise you as a Commissioner.

22 COMMISSIONER SOMMERS: Those special

1 calls for that additional data can be done with  
2 staff authority or that has to be done with  
3 Commission authority?

4 MR. SHERROD: They can be done either  
5 way. The Commission has the authority and the  
6 Commission has delegated to staff the authority to  
7 issue special calls.

8 COMMISSIONER SOMMERS: Thank you.

9 CHAIRMAN GENSLER: Thank you. I will  
10 have a statement for the record but I do support  
11 publishing the proposed rule on position limits.  
12 I'm going to summarize one thought as I think some  
13 other Commissioners said. The Commodity Futures  
14 Trading Commission does not set or regulate  
15 prices. Rather, the Commission is directed to  
16 ensure that commodity markets are fair and orderly  
17 to protect the American public. That's the core  
18 and of course there is much that goes into that  
19 including transparency initiatives and  
20 anti-manipulation and antifraud. But one piece of  
21 it since the 1930s has been this authority to set  
22 position limits and in the past the agency has

1 sought to ensure this through a concept that there  
2 is a broad group of market participants or a  
3 diversity of views within the market. That's been  
4 at the core of promoting integrity in the  
5 marketplace and it's at the core of why I'm  
6 supporting proposing this. We in fact in the  
7 1980s and 1990s had position limits on many of  
8 these markets. We still have position limits in  
9 the spot market and I believe on most of these 28  
10 markets, there are one or two maybe that we don't.  
11 I'm not entirely sure why. But with regard to the  
12 all months combined, this is a proposal to in  
13 essence reinstate some position limits in the  
14 energy and the metals markets and I'm looking  
15 forward to the public comments on it, but I'll be  
16 supporting the proposal moving forward and am very  
17 interested in public comments. If there are no  
18 further questions, I think Mr. Stawik you get to  
19 do what we almost did on December 16.

20 MR. STAWIK: Commissioner O'Malia?

21 COMMISSIONER O'MALIA: Aye.

22 MR. STAWIK: Commissioner O'Malia, aye.

1 Commissioner Chilton? Commissioner Chilton?

2 COMMISSIONER CHILTON: Aye.

3 MR. STAWIK: Commissioner Chilton, aye.

4 Commissioner Sommers?

5 COMMISSIONER SOMMERS: No.

6 MR. STAWIK: Commissioner Sommers, no.

7 Commissioner Dunn?

8 COMMISSIONER DUNN: Aye.

9 MR. STAWIK: Commissioner Dunn, aye.

10 Mr. Chairman?

11 CHAIRMAN GENSLER: Aye.

12 MR. STAWIK: Mr. Chairman, on this  
13 question the ayes are four, the nays are one.

14 CHAIRMAN GENSLER: With that I want to  
15 thank the position limit team for their return.  
16 We'll be looking forward to seeing you I know in  
17 the future not only on this rule but also on the  
18 large trader reporting rule that we still have out  
19 for comment and we'll be sending this to the  
20 Federal Register based on that vote.

21 If Ananda and Sarah and the business  
22 conduct team want to come up, that would be great.



1 Today's presenters, it feels like, Sarah, you're  
2 back here every so often, but Sarah Josephson and  
3 Ananda Radhakrishnan both from the Division of  
4 Clearing and Intermediary Oversight. They will  
5 present the staff recommendation on proposed rules  
6 related to documentation requirements for swap  
7 dealers and major swap participants. We usually  
8 call you the business conduct standards, but this  
9 one specifically is documentation, so thank you,  
10 Sarah and Ananda, and why don't I turn it over to  
11 you?

12 MS. JOSEPHSON: Good morning. Today  
13 staff is recommending for the Commission's  
14 consideration a Notice of Proposed Rulemaking with  
15 regard to internal business conduct standards for  
16 swap dealers and major swap participants. The two  
17 proposed rules would be promulgated under new  
18 Section 4(s)(I) of the CEA. This section requires  
19 swap dealers and major swap participants to  
20 conform with standards prescribed by the  
21 Commission that relate to the timely and accurate  
22 confirmation processing, netting, documentation

1 and valuation of all swaps.

2 At the last open meeting on December 16,  
3 the Commission considered proposed rules regarding  
4 confirmation, portfolio reconciliation and  
5 portfolio compression under Section 4(s)(I).  
6 Today staff is recommending two rules pertaining  
7 to swap documentation under the same statutory  
8 provision.

9 Documentation of swaps is a critical  
10 component of the bilaterally traded  
11 over-the-counter derivatives market and has been  
12 the focus of significant domestic and  
13 international attention in recent years. The  
14 proposed regulations would require each swap  
15 dealer and major swap participant to establish  
16 policies and procedures designed to ensure that  
17 prior to or contemporaneously with entering into a  
18 swap, both counterparties agree in writing to all  
19 terms governing their swap trading relationship  
20 including among other things terms addressing  
21 payment obligations, events of default rights and  
22 governing law. The swap trading documentation

1 would also include credit support arrangements  
2 including initial margin and variation margin  
3 requirements and custodial arrangements. The  
4 specific rules on those provisions have been  
5 considered for custodial arrangements already by  
6 the Commission and for margins in future  
7 rulemaking.

8           The documentation would also include an  
9 agreement on the methodology by which  
10 counterparties will value each swap in their  
11 portfolio at any time from execution until  
12 termination of the swap. The agreed-upon  
13 methodology would be required to be complete and  
14 independently verifiable and will include  
15 alternative methods for determining the value of  
16 the swap in the event that one or more inputs to  
17 that methodology are unavailable such as times  
18 during times of market stress is illiquidity. The  
19 regulation would also require swap dealers and  
20 major swap participants to notify the Commission  
21 of any valuation disputes that have not been  
22 resolved within set time periods. This provision

1 corresponds to the portfolio reconciliation rule  
2 that the Commission proposed at its last meeting  
3 and portfolio reconciliation serves to identify  
4 valuation disputes. This would require reporting  
5 to the Commission.

6 For those swaps that are cleared by a  
7 DCO, a swap dealer or major swap participant would  
8 be required to create a record indicating that in  
9 accordance with the rules of the DCO, the original  
10 swap is extinguished and is replaced by equal and  
11 opposite swaps between the clearing members and  
12 the DCO. The regulations would require that all  
13 terms of the cleared swap conform to templates  
14 established under the DCO's rules. This provision  
15 mirrors a similar provision that the Commission  
16 agreed to in the DCO risk-management rules  
17 considered on December 16. Finally, proposed Rule  
18 23504 would require an annual audit for the swap  
19 trading relationship documentation to ensure  
20 compliance with Commission rules and internal swap  
21 dealer, major swap participant policies and  
22 procedures.

1                   Turning to Proposed Rule 23505, this  
2                   provision would require swap dealers and major  
3                   swap participants to obtain documentation from any  
4                   counterparty seeking to exercise its rights under  
5                   the end-user exception from the mandatory clearing  
6                   requirement under Section 2(h)(7) of the CEA. For  
7                   swaps subject to a mandatory clearing requirement,  
8                   the proposed regulation would require that swap  
9                   dealers and major swap participants comply with  
10                  any mandatory clearing requirement by obtaining  
11                  documentation sufficient to provide the dealer or  
12                  the major swap participant with a reasonable basis  
13                  to believe that its counterparty meets the  
14                  statutory conditions required for claiming the  
15                  exception to the mandatory clearing requirement.  
16                  This provision is important because it will fall  
17                  to the swap dealers or the major swap participant  
18                  to report the end-user clearing exception claim to  
19                  a swap data repository, and absent the end-users  
20                  proper invocation of the exception for mandatory  
21                  clearing the swap dealer or major swap participant  
22                  would be required to otherwise comply with any

1 clearing mandate that the Commission were to issue  
2 going forward. I'd welcome any questions at this  
3 point on the two proposed rules.

4 CHAIRMAN GENSLER: Thank you, Sarah.  
5 I'd entertain a motion to accept the staff  
6 recommendation on the documentation rule.

7 COMMISSIONER DUNN: So moved.

8 COMMISSIONER SOMMERS: Second.

9 CHAIRMAN GENSLER: In addition, before  
10 taking questions there is an issue concerning  
11 Title 2 of Dodd- Frank and the Federal Deposit  
12 Insurance Act that the Commission will consider at  
13 a future meeting, and to that end I ask unanimous  
14 consent to revise this proposal consistent with  
15 the Commission's intention to take up these  
16 matters at a separate meeting. Not hearing any  
17 objection, you're advised to make sure it's  
18 consistent with that, Sarah.

19 I have support for this proposed  
20 rulemaking. I think it establishes very important  
21 swap trading relationship documentation  
22 requirements. For many people or the public who

1 have read any of the books, there are so many of  
2 them on the 2008 crisis, you may recall that part  
3 of the crisis became so evident in 2007 and 2008  
4 when these derivatives contracts that a large  
5 insurance company, AIG, entered into, there were  
6 valuation disputes. There were great disputes on  
7 what was the value of these contracts in a rapidly  
8 changing market environment. I think the rule  
9 that we propose today subject to public comment  
10 directly addresses some of these issues. It  
11 mandates that parties like AIG in the future,  
12 hopefully there is never an AIG that brings  
13 taxpayers to the heels as that did, but that they  
14 have to have documentation and have to have ways  
15 to value their contracts and where they have  
16 disputes with others they have to be elevated to  
17 senior management and elevated to the regulators,  
18 but I want you to confirm that that's what this  
19 does.

20 MS. JOSEPHSON: Yes. That is correct.  
21 It requires that the two counterparties agree  
22 ahead of time on, "The methods, procedures, rules

1       and inputs for valuing the swap," so that they  
2       have to agree ahead of time on the valuation  
3       methodology and if there is a failure of an input  
4       to that methodology they have to agree on  
5       alternatives so that they can value the swap going  
6       forward. And then under rules that were  
7       previously proposed, the duties rules for swap  
8       dealers and major swap participants, they would  
9       have to alert their senior management to valuation  
10      disputes, failures to understand, current exposure  
11      and potential future exposure that are usually  
12      based on disputes regarding valuation. So it  
13      works together with that rule and the portfolio  
14      reconciliation rule which is a process by which  
15      counterparties can identify valuation disputes and  
16      then work to resolve them and the burden is on  
17      those counterparties to identify them, resolve  
18      them and report them to the Commission and the  
19      prudential authorities if those swap dealers and  
20      major swap participants are --

21                   CHAIRMAN GENSLER: So Sarah, this is for  
22      those swaps that may stay bilateral. Correct?



1 MS. JOSEPHSON: Yes.

2 CHAIRMAN GENSLER: They don't have the  
3 benefit of central clearing, they're customized  
4 swaps, but if an AIG circumstance happened again,  
5 number one, they have to have an agreement on the  
6 methodology to value the swap. Is that correct?

7 MS. JOSEPHSON: Yes. That is correct.

8 CHAIRMAN GENSLER: And two, if they  
9 can't agree during the 10 years that a swap is  
10 outstanding, then they have to highlight it to  
11 senior management under a separate proposal.  
12 Correct?

13 MS. JOSEPHSON: Correct.

14 CHAIRMAN GENSLER: And they also have to  
15 share it with the regulator.

16 MS. JOSEPHSON: Exactly. And I will  
17 just refresh everyone's recollection on the  
18 portfolio reconciliation rule for swap dealer and  
19 major swap participant trades with each other, the  
20 proposal is and we'll get comment back on this is  
21 to resolve that dispute within one business day  
22 and for disputes that arise between swap dealers,

1 registrants of ours and end users, they're to  
2 resolve those in a timely fashion.

3 CHAIRMAN GENSLER: Sure, but the swap  
4 dealer to swap dealer disputes were at the heart  
5 of the narrative, that from 2007 and 2008 the big  
6 disputes were between these big swap dealers.  
7 They went unresolved and sometimes unreported to  
8 senior management.

9 MS. JOSEPHSON: Exactly. And those  
10 losses can be allowed to accumulate and that could  
11 give rise eventually to systemic risk and so the  
12 failure to value that. And your contrast with  
13 clearinghouses is important because with  
14 clearinghouses you arrive at a settlement price  
15 every day, positions are mark to market and they  
16 collateralize the potential future exposure using  
17 initial margin.

18 CHAIRMAN GENSLER: I thank you. I just  
19 wanted to highlight that to me that's an important  
20 piece and it relates directly to the crisis that  
21 we unfortunately lived through. Commissioner  
22 Dunn?

1                   COMMISSIONER DUNN: Thank you, Mr.  
2 Chairman, and I think you did point out one of the  
3 most salient issues here and I appreciate the hard  
4 work that the staff did with this. This was  
5 difficult because this isn't all within our  
6 bailiwick. It will a great deal of reaching out  
7 to other regulators and other entities. Sarah,  
8 could you describe what you did in that process  
9 and how many people were involved in coming up  
10 with this final proposed rule?

11                   MS. JOSEPHSON: As I've mentioned in  
12 previous presentations to the Commission, we  
13 worked very closely with other U.S. authorities  
14 including the Federal Reserve Bank of New York,  
15 the Board of Governors, the FDIC, the OCC and the  
16 SEC to craft these rules. Indeed, much of the  
17 documentation work and the standardization process  
18 that has been described in the preamble quite  
19 extensively stems from the work that the  
20 supervisors of what's called the Group of Fourteen  
21 Dealers has been working on since 2005 when they  
22 identified the back office concerns including

1       crucially documentation, and this is in the prior  
2       proposal that the Commission considered on  
3       confirmations, the number one trigger was the  
4       failure to confirm individual swap trades. So  
5       when crises arise with Bear Stearns and with  
6       Lehman, they went in and the back office was  
7       perhaps in some degree of disarray and that led to  
8       problems with the winding down or the transfer of  
9       those positions to solvent or potentially solve to  
10      new parties. So we've been working very closely  
11      with U.S. authorities and with market participants  
12      who have been part of that process to address very  
13      real and recognized concerns in the industry.

14                COMMISSIONER DUNN: Sarah, I think that  
15      staff also took a great deal of concern to ensure  
16      that there wasn't an excessive burden on this  
17      reporting and I think the industry appreciates  
18      that. I'm worried about the excessive burden then  
19      our staff will have in bringing us all together  
20      and being responsible for having this overall  
21      view. Are we ready, capable and able to do that?

22                MR. RADHAKRISHNAN: We are ready and we

1 are capable. I can't answer your last question  
2 because as you pointed out, we've been charged  
3 with executing tremendous responsibilities, the  
4 whole agency, and as a taxpayer I'm sorry to be on  
5 this high horse, but I'm just appalled that our  
6 elected representatives would give us this  
7 responsibility and not give us the money. I don't  
8 know how to explain it. So coming down from my  
9 high horse I'll answer your question. I think  
10 what we will do is we will have a discussion with  
11 the National Futures Association because one of  
12 the proposed rules is for all registrants to  
13 register with the National Futures Association and  
14 then make a determination as to who will have  
15 primary responsibility for examining swap dealers  
16 and MSPs.

17 I know that the continuing resolution is  
18 supposed to end sometime in March and it remains  
19 to be seen rather we will be funded at 2010 levels  
20 or whether we'll get more money. If we don't get  
21 extra money, and so far I personally have no  
22 reason to believe we are going to get more money,

1       then I think the National Futures Association will  
2       have to bear the brunt of examination.  It's no  
3       secret to them because I've already alerted them  
4       to the possibility.  Having said that, it would be  
5       unfortunate if Commission staff did not go along  
6       with them purely to understand the operations of  
7       these new categories of registrants that we have.  
8       The worse situation would be if you have 200 to  
9       300 new registrants and Commission staff has no  
10      view and no understanding of the application or  
11      the execution of Commission regulations.  So what  
12      I'm saying is I'm prepared for the worst.  The NFA  
13      has the ability to assess fees which we don't and  
14      they are going to ramp up and we'll probably go to  
15      the largest swap dealers first and examine them.  
16      I want to make sure that staff has an  
17      understanding of what it is we do.  And at the  
18      same time we will be collaborating, the NFA and  
19      CFTC staff, on designing the examination program  
20      because the examination program of necessity has  
21      to be based on the final regulation that the  
22      Commission promulgates.

1                   COMMISSIONER DUNN: Ananda, thank you  
2 for your unabashed and unvarnished answer.

3                   CHAIRMAN GENSLER: Thank you.  
4 Commissioner Chilton. Commissioner Sommers? I'm  
5 sorry. Commissioner Dunn.

6                   COMMISSIONER SOMMERS: Thank you, Mr.  
7 Chairman. I have a couple of different questions  
8 to clarify from the proposal. There is a piece in  
9 the proposal that talks about swaps that will be  
10 cleared and those contractual agreements having to  
11 be conformed to meet the DCO's rules. I was  
12 wondering if you could talk through an example of  
13 that for us to give us an example of what terms of  
14 a documentation would have to be changed or  
15 conformed to meet a DCO's rules.

16                  MS. JOSEPHSON: Yes. This process  
17 actually happens right now and it just clarifies  
18 that the bilateral swap is extinguished so that  
19 this is for swaps that are not executed on a DCM  
20 or futures contracts executed on a DCM. The  
21 original swap is extinguished between the two  
22 bilateral counterparties and the clearinghouse

1 novates the contract so that there are two equal  
2 and opposite swaps with the counterparties and  
3 this is the quintessential clearinghouses become  
4 the seller to every buyer and the buyer to every  
5 seller if I got that right. So they're replaced  
6 by equal and opposite swaps and this creates a  
7 level of standardization. The example when they  
8 moved CDS into clearing, one of the prerequisites,  
9 and this discussed in the preamble, is that they  
10 had to standardize the products, this was the big  
11 bang and the small bang that the industry engaged  
12 in, and that facilities fungibility within the  
13 clearinghouse so that these swaps in the event of  
14 a default can be terminated quickly or transferred  
15 to a liquid or solvent FCM or swap dealer  
16 depending on how that default situation would be  
17 handled by the clearinghouse. It makes very clear  
18 that the clearinghouse documentation is what  
19 prevails over the bilaterally negotiated contracts  
20 between the two counterparties.

21 MR. RADHAKRISHNAN: Also, Commissioner  
22 Sommers, this will ensure that once clearing takes



1 place that the terms of the contract are the same  
2 throughout the chain meaning that the contract  
3 between the clearing member and the clearinghouse  
4 is exactly the same as the contract between the  
5 client and the clearinghouse. Staff believes that  
6 this is essential to make that client clearing  
7 actually has a chance at success because what  
8 would be unfortunate is if in actuality the terms  
9 of the contract between the client and its  
10 intermediary are different from the terms of the  
11 contract between the intermediary and the  
12 clearinghouse. As you know, that does not happen  
13 in the futures space right now.

14 COMMISSIONER SOMMERS: Thank you. My  
15 other question is with regard to standardized  
16 documentation that exists today and whether or not  
17 this proposal would impose substantive changes to  
18 that kind of documentation that exists today and  
19 what we do with existing agreements.

20 MS. JOSEPHSON: We've been very careful  
21 in crafting the proposal and the preamble mentions  
22 all the work that has been done by the industry,

1 particularly with regard to standardizing the  
2 master agreements and the master confirmation  
3 agreements so that the relationship documentation  
4 between two counterparties that allows them to  
5 execute individual transactions and then the  
6 documentation upon which those transactions are  
7 based, to master confirmation agreements, the  
8 protocols that have been put in place for credit  
9 default swaps, they're working on proposals right  
10 now for equity derivatives to standardize terms.  
11 There is a tremendous amount of work being done  
12 and most of that is being done in conjunction with  
13 as I mentioned the OTC Derivatives Supervisors  
14 Group, a group that has been in place since 2005.  
15 We've tried to be consistent with that to the  
16 extent that that documentation meets the  
17 requirements and again we laid out broad  
18 parameters for what our expectation is for those  
19 documents but we didn't prescribe the actual  
20 documentation so that they continue to use those.  
21 There may need to be additional amendments to  
22 reflect the overall reform and certain provisions

1       that we view as this is particularly the case with  
2       the collateralization elements that they have  
3       master agreements, credit support arrangements  
4       with ISDA what's called the Credit Support Annex  
5       and those may have to be modified by amendment,  
6       but for the most part we think that the  
7       documentation will work together so that those two  
8       processes are on parallel tracks with the goal  
9       being as consistent as possible and those would be  
10      applicable on a global basis.

11                COMMISSIONER SOMMERS: To clarify again,  
12      they may need to be modified going forward in the  
13      future or they may need to be modified looking  
14      backwards?

15                MS. JOSEPHSON: There are two things.  
16      An existing master agreement between two  
17      counterparties is usually in place for a number of  
18      years. You execute one of those and they stay in  
19      place for a number of years. Amendments to those  
20      for swaps executed under it going forward would  
21      have to be done for -- and this is where in the  
22      proposal you'll see we ask a question about

1 dormant trading relationships so that if you have  
2 documentation in place but you're not executing  
3 swaps under it, you don't have open positions  
4 under it or they're going to expire in a very  
5 short term, then it wouldn't have to apply to  
6 that. But for the transactions that you execute  
7 going forwards, swaps that are subject to CFTC  
8 jurisdiction, then the provisions we anticipate  
9 would apply but that's where we've solicited  
10 comment from the industry and we are very hopeful  
11 that we will get good comments on the application  
12 of these rules to current practices.

13 COMMISSIONER SOMMERS: Thank you.

14 CHAIRMAN GENSLER: Thank you,  
15 Commissioner Sommers. Now Commissioner Chilton.

16 COMMISSIONER CHILTON: I have no  
17 questions. I thank the staff and I support the  
18 rule. They've done good work. Thank you.

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

21 COMMISSIONER O'MALIA: Thank you. We  
22 had a proposed rule language before us yesterday

1 that was provided by the FDIC to the Commission in  
2 the eleventh hour that was an attempt to give two  
3 regulators, the CFTC and the FDIC, the ability to  
4 take control for 24 hours the uncleared swap  
5 positions of all swap dealers and major swap  
6 participants when there was a defaulting  
7 counterparty. Mr. Chairman, I appreciate your  
8 willingness to remove that language from the  
9 proposal so we could vote this morning on our  
10 documentation rule and give us more time to  
11 understand the ramifications of that proposal. I  
12 appreciate that very much so that that is part of  
13 the reason we have changed this proposal.

14 I have one question. The proposal  
15 discusses providing alternative methods of  
16 valuation. What do you think that might include?

17 MS. JOSEPHSON: Alternative methods  
18 particularly with regard to inputs, you have to  
19 agree, for instance if there's an illiquidity in a  
20 particular asset class or a reference that you  
21 need to use to value a particular type of swap,  
22 that you would agree ahead of time if we're not

1 going to rely on for instance an interest rate  
2 curve that's this one, we'll rely on this interest  
3 rate curve instead. It's to address the issue of  
4 parties saying the mortgage- backed securities  
5 market or municipal bond market, there has been  
6 some sort of illiquidity, we no longer have that  
7 data point so we just can't value the swap on our  
8 books. Instead we're asking them ahead to think  
9 through those possible scenarios especially if  
10 you're doing a structure, very unique, customized  
11 product and agree ahead of time between each other  
12 in a private contractual relationship on how you  
13 will substitute a methodology and input a rule to  
14 arrive at a value again with the fundamental point  
15 of in order to understand what your current  
16 exposure is to your counterparty, this is again  
17 bilateral uncleared or the potential -- if you had  
18 to replace that contract if your counterparty were  
19 to default to you, you need to know that risk and  
20 the fundamental building block in understand the  
21 risk is knowing what the value of that contract is  
22 in a current mark to market way.

1                   COMMISSIONER O'MALIA: What is our  
2 responsibility in overseeing these valuations?

3                   MS. JOSEPHSON: In the provision it says  
4 that, "These rules shall be stated with  
5 specificity necessary to allow the counterparties  
6 themselves, the Commission and any applicable  
7 prudential regulator to determine independently in  
8 a substantially comparable manner." How this  
9 would play out I think is if we see through the  
10 reporting of these valuation disputes, and  
11 generally what happens in a valuation dispute  
12 situation is there is uncollateralized exposure.  
13 That means that the parties have not exchanged  
14 collateral based on potential risk so that we  
15 would be notified of that. We could go to the  
16 industry because there would have to be a  
17 significant amount of accumulated risk in the  
18 system and we could say let's look at your  
19 documentation. How can we solve this? What isn't  
20 working in your dispute resolution processes that  
21 is allowing this uncollateralized exposure to  
22 buildup?

1                   COMMISSIONER O'MALIA: Will we use a  
2 different process in terms of a crisis? Looking  
3 at these things on a bright, sunny day and the  
4 markets are functioning very well is a completely  
5 different matter than when we're in a crisis like  
6 we experienced with AIG and Lehman.

7                   MS. JOSEPHSON: The hope is that these  
8 types of provisions in the first instance  
9 facilitate counterparties resolving this between  
10 themselves before it even comes to the attention  
11 of the regulators so that if they resolve the  
12 disputes under the portfolio reconciliation  
13 proposal in a timely fashion then there is no  
14 uncollateralized exposure. It will allow us ahead  
15 of time hopefully identify exposure in the system  
16 and work with the industry to get that sorted out,  
17 and should it be allowed to continue or for there  
18 to be a failure to recognize that in time to stop  
19 it from becoming a true crisis like we saw in  
20 2008, these processes and the documentation that  
21 will be executed between the counterparties will  
22 allow for an orderly wind-down. That's the hope



1 and that was the provision that you mentioned  
2 under Title 2 in the Federal Deposit Insurance  
3 Act, to allow that sort of concept of an orderly  
4 wind-down transfer of positions to avoid market  
5 disruption so that they work together in that way  
6 hopefully.

7 COMMISSIONER O'MALIA: Assuming Enron  
8 was a dealer, would we have stepped in with this  
9 new authority and resolved it when it went into  
10 bankruptcy?

11 MR. RADHAKRISHNAN: Are you saying the  
12 issue of Enron was they did a lot of swaps and  
13 there were improper valuations?

14 COMMISSIONER O'MALIA: When it failed  
15 there were a number of counterparties that were  
16 impacted by that.

17 MR. RADHAKRISHNAN: I'm not familiar  
18 with the facts of the case. I thought the Enron  
19 problem was because there was massive fraud  
20 outside of the trading engine.

21 COMMISSIONER O'MALIA: When they  
22 ultimately failed, under this new authority would

1 we have stepped in and had the responsibility in  
2 that bilateral space to resolve those  
3 transactions?

4 MR. RADHAKRISHNAN: I would say yes if  
5 this rule is finalized. I don't see how we cannot  
6 step in because its our registrant.

7 CHAIRMAN GENSLER: As I understand the  
8 hypothetical, if it's a swap dealer whether it's  
9 Enron or if it's a swap dealer that we regulate,  
10 would we have the authority? I'm changing the  
11 question a little bit. Would we have the  
12 authority to do things? As I understand it, this  
13 rule is a little narrower than that. This rule  
14 just makes sure that if there are these big  
15 valuation disputes, they have to tell us about it,  
16 but this rule specifically doesn't necessarily  
17 give us the stick. There may be other rules that  
18 do, but this rule doesn't.

19 COMMISSIONER O'MALIA: Going back to  
20 what was originally in this document and what I'm  
21 trying to understand, is that in Title 2?

22 MS. JOSEPHSON: I can try to clarify

1       that. The idea behind that provision which will  
2       be considered in potentially a future discussion  
3       is that there would be in the documentation of the  
4       swap dealer and the major swap participant a  
5       one-day delay in their ability to terminate under  
6       that contract to allow if a U.S. authority under  
7       Title 2 or the FDIA had made the affirmation  
8       decision to enter into that scenario to wind down  
9       the entity in an orderly way. So that it is an  
10      affirmative decision by U.S. Financial regulatory  
11      authorities to step into a situation where there  
12      is a crisis that is clearly of a scope that would  
13      be a systemic shock to the overall markets. And  
14      the participation under that process, this is why  
15      we have a little more time to work through the  
16      provisions under Title 2 which is a new section of  
17      Dodd-Frank obviously and then the similar  
18      provisions under the FDIA.

19                   COMMISSIONER O'MALIA: Let me go to one  
20      last question. In resolving some of these  
21      disputes, do we have the authority to make  
22      decisions about the quality of collateral?

1           MS. JOSEPHSON: Under these rules that's  
2 not something that we are weighing in on. What we  
3 say is the types of assets that may be used as  
4 margin and the asset valuation haircuts so that  
5 the parties have to agree on the types of assets  
6 between each other that can be used to margin the  
7 swaps and then the haircuts imposed which usually  
8 goes to an assessment of the quality of the  
9 collateral but that is in the first instance an  
10 agreement between them on that which will be  
11 guided by rules to be proposed in the future by  
12 this Commission and for those entities that are  
13 banks, by prudential authorities under their  
14 regulations.

15           COMMISSIONER O'MALIA: How are we going  
16 to inform the market of what we view as quality  
17 collateral versus less-quality collateral just so  
18 they have an understanding of what the rules are  
19 going forward?

20           MS. JOSEPHSON: I believe that those  
21 proposals will be considered by the Commission in  
22 a future rulemaking or the staff will be proposing

1       them at a later point.

2                   MR. RADHAKRISHNAN:  This will be part of  
3       the capital margin.

4                   CHAIRMAN GENSLER:  To clarify because I  
5       think these were very helpful questions, most of  
6       the authorities in fact I think all of the  
7       authorities with regard to bank holding companies  
8       or large financial institutions, if anybody is  
9       going to take a wind-down or anything like that,  
10      that's not this agency.  That's the bank  
11      authorities and the FDIC.  Your Enron example was  
12      a nonbank.

13                  COMMISSIONER O'MALIA:  So they don't get  
14      that protection?

15                  CHAIRMAN GENSLER:  What's that?

16                  COMMISSIONER O'MALIA:  They don't get  
17      that -- I don't know if it's a benefit or a curse  
18      to have the feds involved at this point because I  
19      don't know that title very well.

20                  CHAIRMAN GENSLER:  As I understand it,  
21      and maybe Dan wants to explain or somebody else,  
22      Title 2 really goes to bank holding companies and

1       systemically important large financial companies  
2       that are identified by the Financial Stability  
3       Oversight Council. Not to suggest that a swap  
4       dealer we regulate would not be large because it's  
5       possible, but if a swap dealer we regulate because  
6       it's not a bank, it's probably not going to be one  
7       of those entities either. Is that as I understand  
8       it?

9                   MS. JOSEPHSON: Yes. I think generally  
10       speaking that is correct and we'll get some more  
11       information to you on this. But for covered  
12       financial companies which is under Title 2, that  
13       regime if a swap dealer that was not a bank, and  
14       again we'll verify all of this, but my  
15       understanding is if they're making 85 percent of  
16       their profit or more from swap trading then they  
17       could be considered a financial company that under  
18       Title 2 could be a part of this orderly wind-down  
19       process that is contemplated. But again we'll  
20       follow-up with additional information for you on  
21       that topic.

22                   CHAIRMAN GENSLER: Thank you. If there

1 are no further questions, Mr. Stawik?

2 MR. STAWIK: Commissioner O'Malia?

3 COMMISSIONER O'MALIA: Aye.

4 MR. STAWIK: Commissioner O'Malia, aye.

5 Commissioner Chilton?

6 COMMISSIONER CHILTON: Aye.

7 MR. STAWIK: Commissioner Chilton, aye.

8 Commissioner Sommers?

9 COMMISSIONER SOMMERS: Aye.

10 MR. STAWIK: Commissioner Sommers, aye.

11 Commissioner Dunn?

12 COMMISSIONER DUNN: Aye.

13 MR. STAWIK: Commissioner Dunn, aye.

14 Mr. Chairman?

15 CHAIRMAN GENSLER: Aye.

16 MR. STAWIK: Mr. Chairman, aye. Mr.

17 Chairman, on this question the ayes are five, the

18 nays are zero.

19 CHAIRMAN GENSLER: Thank you, and we'll

20 send that to the Federal Register as well. I

21 think I already asked U.C. on this FDIC thing, but

22 in case you have other technical provisions at

1       this point I ask unanimous consent to ask staff to  
2       make technical corrections. And I'm only asking  
3       it for this because the position limit one is  
4       already done. But just a U.C. in case Sarah will  
5       have to make technical corrections. Without  
6       objection and that's so moved.

7               As you know, we've identified 30-some  
8       topics for our rulemaking. Our next meeting is  
9       going to be on January 20, one week from today,  
10       and the subjects of the rulemaking presented at  
11       that meeting will be published on the Commission's  
12       website I guess today sometime. As I said  
13       earlier, I think that we're going to have a couple  
14       of meetings in February but we'll address the  
15       dates of those meetings next week. On January 20  
16       we'll vote on the dates.

17              There being no further business, I'd  
18       entertain a motion to adjourn the meeting.

19              COMMISSIONER DUNN: So moved.

20              COMMISSIONER SOMMERS: Second.

21              CHAIRMAN GENSLER: All in favor. Aye?

22              GROUP: Ayes.



1                   CHAIRMAN GENSLER: The ayes having it,  
2 the meeting is adjourned. Thank you so much.

3                   (Whereupon, at 10:51 a.m., the  
4 PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

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

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

