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UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

PUBLIC ROUNDTABLE TO DISCUSS PROPOSED REGULATIONS  
IMPLEMENTING CORE PRINCIPLE 9 FOR DESIGNATED  
CONTRACT MARKETS

WASHINGTON, D.C.

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

2 MR. SHILTS: All right. I think  
3 we'll get started right on time. Good morning  
4 everyone. My name is Rick Shilts and I'm the  
5 director of the division of market oversight here  
6 the CFTC. I'm pleased to open this public round  
7 table to discussion the implementation of the one  
8 of the key provisions for designated contract  
9 markets or DCM's. This involves the requirements  
10 under DCM core principle 9 which was amended by  
11 the Dodd-Frank Act.

12 The specific purpose of today's  
13 round table is to hear the opinions of persons  
14 with different interests, experience, and points  
15 of view on the commissions proposed regulations  
16 implementing core principle 9 for DCM's. The  
17 round table discussion will focus on the proposed  
18 centralized market trading requirement, certain  
19 aspects of the requirements for exchange of  
20 derivatives for related positions, and the  
21 appropriate reporting time frame for block  
22 transactions in futures contracts.

1                   As you know, one of the key goals of  
2 the Dodd-Frank Act is to bring over-the-counter  
3 derivatives under comprehensive regulation.

4 Certain derivatives are to be traded on  
5 transparent trading platforms and cleared by  
6 regulated counterparties similar to how futures  
7 are now traded and DCM's.

8                   A fundamental goal is to increase  
9 pretrade transparency, which will produce more  
10 price competition and greater liquidity. Open  
11 and transparent markets can benefit the entire  
12 economy, and generate more competitive prices  
13 which lead to more efficient markets, and  
14 ultimately lower costs for companies and their  
15 customers.

16                   With respect to price transparency  
17 on DCM's, the Dodd-Frank Act amended the language  
18 of DCM core principle 9 to provide that Board of  
19 Trade shall provide a competitive, open, and  
20 efficient market and mechanism for executing  
21 transactions that protects the price discovery  
22 process of trading in the centralized market of

1 the Board of Trade.

2 On December 22 of 2010, the  
3 commission proposed rules, guidance, and  
4 acceptable practices to implement the 23 core  
5 principles for designated contract markets,  
6 including core principle 9.

7 Among the rules proposed under core  
8 principle 9 were three areas that are the subject  
9 of today's round table. First, to implement the  
10 core principle's requirement, the DCM's provide a  
11 market and mechanism for executing transactions  
12 that protects the price discovery process of  
13 trading in a centralized market. The notice of  
14 proposed rule making set forth a minimum  
15 centralized market trading requirement.

16 The proposed rule required in part  
17 that 85 percent of the total trading volume of  
18 any one contract listed on a DCM must be on the  
19 centralized market.

20 Second, rules were proposed that  
21 specified requirements related to exchange of  
22 derivatives for related positions or EDRP

1 transactions, which would include exchange for  
2 futures for swaps and exchange of futures for  
3 physicals.

4 Among other requirements, the  
5 proposed rule would require that an EDRP  
6 transaction must be bona fide and is not  
7 contingent upon an offsetting transaction.

8 Finally, with respect to block  
9 trades, the proposed rule would require, among  
10 other things, that each such trade be reported to  
11 the DCM within five minutes after execution.

12 On May 10th of this year the  
13 commission approved the final rule-making on core  
14 principles and other requirements for designated  
15 contract markets. The rules implementing core  
16 principle 9 were not finalized at that time, in  
17 order to provide the commission with additional  
18 time to consider the available alternative  
19 contracts that may not comply with the proposed  
20 centralized market trading requirement, as well  
21 as the related implications of the rules for  
22 blocks and EDRP transactions.

1           It is expected that the commission  
2 will consider the final rules implementing core  
3 principle 9 when it considers the final swap  
4 execution facility or SEF rule making.

5           The commission received many  
6 comments on the proposed core principle 9 rules  
7 and guidance. Staff is continuing to consider  
8 these comments, some of which we look forward to  
9 hearing again today.

10           I'd like to thank the many  
11 distinguished panelists who have taken time out  
12 of their busy schedules and agreed to participate  
13 on today's panels to discuss these subjects.

14           I'd also like to thank the staff of  
15 the CFTC for their work in planning today's round  
16 table. Staff has been analyzing the numerous  
17 comments received in order to develop final rules  
18 that are consistent with the legislation and that  
19 take into account the issues and costs to be  
20 borne by market participants to come into  
21 compliance. The discussion will greatly assist  
22 us in drafting final rules and guidance



1 implementing the core principle 9 requirements.

2 For the record, I'd like to know  
3 that all statements and opinions that may be  
4 expressed and all questions asked by CFTC staff  
5 are those of the staff and do not necessarily  
6 represent the views of any commissioner or the  
7 commission collectively.

8 In order to ensure that we're able  
9 to hear the opinions of all the participants, and  
10 all the panel scheduled for discussion today, I  
11 encourage you to limit your remarks to the issues  
12 at hand.

13 Please note that the meeting is  
14 being reported and a transcript will be made  
15 public. The microphones are in front of you.  
16 Press the button and you'll see the red light.  
17 That means you can talk. Please speak directly  
18 into the mic, when and you finish, please the  
19 button again to turn off the microphone.

20 We also ask that you refrain from  
21 putting any Blackberry or cellphones on the  
22 table, as they can cause interference with our

1 audio system.

2           Before we start, I'd like to go  
3 through today's agenda. As I noted, we have  
4 three panels scheduled. The first is entitled  
5 Proposed Minimum Centralized Market Trading  
6 requirement. It will run for one hour and 15  
7 minutes, after which we will take a five-minute  
8 break.

9           The second panel is entitled  
10 Proposed Requirements for Exchange of Derivatives  
11 for Related Position Transactions. And that will  
12 run for about one hour, after which we'll take  
13 another break. And the final panel is entitled  
14 Proposed Requirements for Reporting Block  
15 Transactions in Futures Contracts which will run  
16 for about 30 minutes.

17           We plan to conclude around 12:30  
18 today. So I'd like to get started with the first  
19 panel, but first I'd like to go around the table  
20 and let everyone introduce themselves.

21           Again, I'm Rick Shilts, director of  
22 the division of market oversight at the CFTC.

1 MS. MARKOWITZ: Nancy Markowitz,  
2 deputy director.

3 MR. BRODSKY: Aaron Brodsky,  
4 division of market oversight.

5 MR. RADHAKRISHNAN: Ananda  
6 Radhakrishnan, director of the division of  
7 clearing and risk, CFTC.

8 MR. VAN WAGNER: David van Wagner,  
9 division of market oversight.

10 MS. ZAKIR: Nadia Zakir, division of  
11 clearing and risk.

12 MR. PENICK: Michael Penick, office  
13 of the chief economist.

14 MR. SHILTS: If the panelists could  
15 introduce themselves. Tom.

16 MR. CALLAHAN: My name is Tom  
17 Callahan. I am the CEO of NYSE Liffe U.S., which  
18 is the U.S. futures exchange of NYSE Urinext.

19 MR. DOWNEY: My name is David  
20 Downey. I am with OneChicago.

21 MR. FARLEY: Tom Farley. I'm senior  
22 vice president of financial markets at ICE.

1 MR. HAMILTON: I'm Pat Hamilton.  
2 I'm the CEO of ICAP Energy.

3 MR. HUMENIK: Stephen Humenik. I'm  
4 the general counsel and chief regulatory officer  
5 of Eris Exchange.

6 MR. LA SALA: I am Tom LaSala. I am  
7 the chief regulatory officer for the CME Group.

8 MS. VED BRAT: Supurna VedBrat. The  
9 co-head electronic trading and market structure  
10 for BlackRock.

11 MR. SHILTS: Thank you all for  
12 participating. Now I'd like to turn it over to  
13 Aaron Brodsky who will lead off with the first  
14 question for the panel today.

15 MR. BRODSKY: Thank you, Rick. Just  
16 a few more quick procedural notes. The first  
17 panel consists of five questions, so the group  
18 will have about 15 minutes to discuss each one.  
19 Please be mindful of this time constraint as you  
20 answer each question, and if you don't have a  
21 response to a particular question, feel free to  
22 pass.

1                   For this panel, for each question  
2 why don't we start on my left and we'll just work  
3 our way down the table for each question.

4                   So let's get started with the first  
5 question. As Rick alluded to in his opening  
6 remarks, the CFTC proposal contemplates that to  
7 comply with core principle 9 there must be some  
8 centralized market trading for price discovery to  
9 occur. How does a contract that does not trade  
10 on the centralized market comply with core  
11 principle 9.

12                   MR. CALLAHAN: Thank you very much,  
13 and thank you to staff for inviting me here today  
14 to speak at this round table. I would start  
15 answering the question with just a perspective  
16 for NYC Liffe U.S. We are a new futures  
17 exchange, probably -- well, I guess after Eris,  
18 the second newest exchange represented.

19                   And our mission is really to provide  
20 competition in the U.S. futures market, largely  
21 based upon innovation, not only in products, but  
22 also in services. We built a new futures

1 clearinghouse called NYC Liffe U.S. -- excuse me,  
2 called New York Portfolio Clearing, which is the  
3 first clearinghouse to offer portfolio margining  
4 between cash bonds at futures.

5 We are also listing many new and  
6 innovative futures contracts, many of which have  
7 never existed before, and our greatest anxiety  
8 around this proposed rule is that it would have a  
9 very chilling effect upon the ability of new  
10 exchanges to compete and upon new contracts to  
11 succeed.

12 There was a statistic that was cited  
13 at the FIA conference in Boca is that 90 percent  
14 of new futures contracts fail. So there is  
15 already a great challenge in this industry to  
16 innovating and launching new products. Our  
17 concern is that the rules as proposed would make  
18 that mountain even higher to climb to launch new  
19 products.

20 So to specifically answer your  
21 question, I would say that, first of all, the  
22 Commodity Exchange Act does provide that a DCM

1 have reasonable discretion in how it adheres to  
2 core principles. And to move away from that  
3 reasonable discretion standard towards a more  
4 prescriptive numerical threshold in terms of  
5 percentages of central order book trading we  
6 think would be counter-productive to the best  
7 interests of the market.

8           Secondly, I would cite that core  
9 principle 9 does say that the Board of Trade  
10 shall provide a competitive and efficient market.  
11 The key word there being "provide," as opposed to  
12 ensure or mandate that any specific percentage of  
13 trades happen through a central order book.

14           And, thirdly, I would say that there  
15 are futures contracts, including those listed on  
16 our exchange, that do not provide the central  
17 price discovery for a given commodity. I would  
18 cite specifically our many gold futures contract.

19           The primary price discovery market  
20 for gold futures is in London, it's the bullion  
21 market. And then secondarily it would be the  
22 COMEX market where large volumes trade. Our --

1     our mini-gold and mini-silver products are really  
2     retail access products not meant to provide the  
3     primary price discovery for that commodity, but  
4     it's meant to provide retail and access to the  
5     market that they would not otherwise have.

6             So I think if you consider that  
7     certain contracts do not meet the standard of  
8     primary price discovery, then to place an  
9     additional burden upon them for percentages of  
10    trades happening at central order book just  
11    wouldn't -- wouldn't be consistent.

12            MR. DOWNEY: Thank you. OneChicago  
13    runs two match engines. We have a central order  
14    book where traditional marketmakers place  
15    two-sided bids and offers, and for firms that  
16    choose to allow their customers to participate,  
17    they're allowed to hit lift electronically, like  
18    every other electronic exchange.

19            There's a feature of the single  
20    stock future which it's imperative that you try  
21    to understand. Not try, actually understand  
22    because it separates us from all other types of



1 futures. We're really not a future, we're a  
2 security.

3 Any swap where two parties swap  
4 collateral for a security, they have a ISDA  
5 agreement that they sign. This is the agreement  
6 is a legally binding document that makes the two  
7 parties conform to the terms of the original  
8 agreement and calls for the return of the capital  
9 and the security at the end of the term.

10 Single stock futures is that  
11 agreement. It is an exchange traded, transparent  
12 centrally cleared, legally binding contract that  
13 is one leg of a swap. Some parties can  
14 participate on it. Other parties cannot. In an  
15 EFP, and exchange of future for physical using  
16 security futures, is an equity financing  
17 transaction akin to a securities lending  
18 transaction or an equity repo. These are  
19 fundamental features of the capital markets.

20 Now, when you call for open and  
21 competitive, I don't understand what you mean,  
22 because many people cannot participate on an EFP

1 because if they do they will generate a tax  
2 event, and they will shy away because if they  
3 sell their stock to buy the future, they will  
4 trigger a taxable event.

5           There are some people who are mark  
6 to mark professional broker-dealers, pension  
7 funds who don't have taxable implications, they  
8 can participate. But if you own IBM stock and  
9 you're long \$80 a share and somebody wants to  
10 borrow it from you, you should be able to use the  
11 EFP but you can't because it would trigger a tax  
12 event.

13           So this doesn't mean that the  
14 product is bad. It doesn't mean that EFP's are  
15 bad. That some people can't participate, even if  
16 they can, but they don't. They won't, because  
17 it's a problem with taxes.

18           Secondly, as I note, November of  
19 2009, the commissions, the SEC and the CFTC, put  
20 out a notice that allowed single stock futures to  
21 be listed, security futures to be listed on  
22 anything that underlies our option. The reason

1 for that is because the CFMA specifically said  
2 that the listing standards of single stock  
3 futures can be no less restrictive than those of  
4 security options. Each time they mention it,  
5 they say to us, and permit the listing and  
6 trading of futures based on any security that is  
7 eligible to underlie an option, may facilitate  
8 price discovery in, and be useful for hedging for  
9 underlying securities. Exactly.

10 It's not price discovery in the  
11 futures market. The commissions have already  
12 understood that this allows for price discovery  
13 in the underlying markets. So when you say, we  
14 have to protect price discovery, allow for the  
15 trading of blocks in EFP's, and we will  
16 facilitate the discovery of prices in the  
17 underlying markets, as you've already stated.

18 MR. FARLEY: I agree with Tom and  
19 David. So I'll keep my answer brief and won't  
20 repeat the same arguments that they mentioned,  
21 but I'll elaborate around the margins. This  
22 issue -- actually, the series of issues that

1 we'll consider today internally at ICE we've  
2 evaluated as thoroughly as any issue that's  
3 arisen as a result of Dodd-Frank.

4           And our thinking has evolved on this  
5 issue to the point where we're concerned that  
6 really any type of 85 percent rule, if you will,  
7 to use a colloquial term, could be disruptive to  
8 the markets; could drive contracts that are  
9 currently cleared, participants that are  
10 currently clearing, particularly end users, into  
11 the bilateral market and generally be  
12 counter-productive as a policy matter.

13           Let me just highlight one additional  
14 point. Core principle 9 that Rick read exists  
15 largely unchanged post Dodd-Frank. And there's  
16 been contracts that are 100 percent traded away  
17 from a centralized marketplace prior to  
18 Dodd-Frank, and there are contracts that are 100  
19 percent traded on centralized marketplace prior  
20 to Dodd-Frank, and I'm not aware of really any  
21 problem with that that's been articulated in any  
22 significant fashion.

1                   The component that's new, if I'm  
2 getting right, and please correct me, Rick, if  
3 I'm wrong, the component that's new is there is  
4 this new phrase or sentence that says core  
5 principle 9 requires the Board of Trade to  
6 protect price transparency. That is distinct  
7 from saying that a board of trade must mandate  
8 that all trading be centralized or on the  
9 centralized market of that board of trade. In  
10 fact, it's an entirely different notion.

11                   So our view is that protecting price  
12 discovery on a board of trade is very different,  
13 in fact, from that mandate and could take many  
14 different forms, such as simply offering an  
15 electronic and efficient central limit order book  
16 without undue burdens in terms of access and how  
17 market participants access that market. Thank  
18 you.

19                   MR. VAN WAGNER: I'm sorry, can ask  
20 just a follow-up, because you're right, it is the  
21 same language as before, except for this phrase  
22 at the end that's been added about the

1 centralized marketplace having some prominence.  
2 And I think this picking up on what Tom said as  
3 well.

4 I don't -- I mean, there's two  
5 phrases there. There's market and mechanism. I  
6 mean, to me, when I read mechanism, I see you've  
7 got to provide a trading system or what have you  
8 that would be compliant. But market is another  
9 word, and obviously they're both there. I mean,  
10 I wonder if there's any meaning that you give the  
11 word "market." Again, sorry to be a lawyer, but  
12 parsing the words of core principle 9, I don't  
13 know if it's simply you get to turn on a switch  
14 which says, you can trade on a trading facility,  
15 an electronic trading facility and that satisfies  
16 it.

17 So, I mean, just to throw that in,  
18 if anybody has any thoughts about what "market"  
19 means in core principle 9 as well, so thanks.

20 MR. HAMILTON: Thank you for letting  
21 ICAP express our views. We -- first of all, the  
22 process of having liquidity off the central limit

1 order book we believe has served the energy  
2 markets well. This has been a process that's  
3 been applied to the energy markets. It seems to  
4 us that the boards of trade have the requirement  
5 to manage the liquidity that happens on their  
6 system or on their central limit order book, but  
7 that they've been given the discretion to take  
8 trades away from the market. That has led to a  
9 high percentage of clearing for those items that  
10 are available to be cleared.

11 The -- pardon me. The core  
12 principle 9 doesn't require that -- we believe  
13 that core principle 9 doesn't require that all  
14 trades take place in a single physical facility.  
15 The variety of execution venues have served the  
16 market well and has led to many of the goals of  
17 the Dodd-Frank legislation. More than 90 percent  
18 of all clearable contracts that we broker are  
19 currently cleared. We don't see any need at this  
20 point to disrupt that flow. That's all.

21 MR. HUMENIK: Good morning.

22 MR. RADHAKRISHNAN: Sorry, let me

1 ask a question. If you're saying that there's an  
2 execution on a venue that exchange A provides,  
3 and then there's an execution on a venue that  
4 somebody else provides, then why isn't that other  
5 venue also a contract market? I think that's the  
6 issue, because it seems to me that, you know,  
7 you've got execution on one venue, I'll pick CME,  
8 for example, right, not to pick on you, but  
9 you're here. So you've got execution on one  
10 venue, but then you're saying that core principle  
11 9 also contemplates execution of that exchange  
12 outside that exchange, which is another venue.

13 So to my simple way of thinking,  
14 isn't that other venue also a contract market or  
15 behaving as a contract market. What you're  
16 saying is that it should be the same. But what  
17 I'm asking is why shouldn't it -- other than you  
18 also be a contract market?

19 MR. HAMILTON: In the case of the  
20 transitory swap, those contracts would be  
21 executed on a SEF and the SEF's going to have the  
22 reporting requirements that it has. There will



1 be the transparency rules that come from the  
2 other rule sets that the designated contract  
3 markets don't manage that, that you're going to  
4 have another whole set -- a whole 'nother set of  
5 requirements that meet your other goals, but that  
6 these executions that take place where there's  
7 different levels of liquidity, other than simply  
8 a screen or a pit or something like that; that  
9 all these markets have been well served by the --  
10 by the variety of execution venues that have been  
11 out there that have been development over time to  
12 push all of those into one place for one size  
13 fits all.

14           And again I can speak in the energy  
15 commodities, that many of these markets have  
16 varying degrees of liquidity. Even the most  
17 liquid product only has liquidity for two or  
18 three months, and there needs to be a variety of  
19 other screens or voice intervention that can take  
20 place to give people the hedges or risk manage  
21 the way they want to.

22           That only one type of execution for

1 a future doesn't seem to further public policy at  
2 this time. I don't know what damage is being  
3 done in that. Yes, it is unusual that they're  
4 being executed in different ways, but at the end  
5 of the day, what problems have arisen from a  
6 variety of execution venues.

7 MR. HUMENIK: Good morning, and  
8 thank you again for the opportunity to  
9 participate in today's panel. As Tom mentioned  
10 before, we're the first execution venue to  
11 receive DCM approval from the commission under  
12 the Dodd-Frank Act.

13 Just a few preliminary remarks just  
14 about Eris and then I'll speak to the question.  
15 Eris was founded to introduce an innovative  
16 product to the marketplace, the Eris Exchange  
17 interest rate swap futures contract. And the  
18 Eris contract attempts to triplicate a  
19 hypothetical collateralized OTC interest rate  
20 swap but process and clear as a future utilizing  
21 existing futures industry infrastructure.

22 We offer the trading of our futures

1 contract both on a central limit order book, and  
2 also under our block trading rules, as well as  
3 part of EF -- exchange for physical -- exchange  
4 of derivatives for related position.

5 As we've expressed in our comment  
6 letters, we strongly oppose the 85 percent rule,  
7 and we take the view of a new exchange in which  
8 we have a new product and in which we're trying  
9 to gain traction in the product, therefore  
10 historically block trading has provided a way for  
11 a new contract to gain traction in the market.

12 Therefore, we believe that the  
13 85 percent rule and a hard percentage would  
14 threaten the ability of new and innovative  
15 products that come to the market.

16 Specific to the question that's  
17 being posed, I think, you know, people on the  
18 panel have mentioned it, and when you look at  
19 core principle 9, it does have a new language  
20 from the amendment with the Dodd-Frank Act, but  
21 it does permit for off-exchange transactions.  
22 And those transactions comply with core principle

1 9 because -- simply because they're permitted  
2 under the act.

3 If an exchange wishes to offer block  
4 trading in a contract, it self-certifies a rule  
5 with the commission, so that rule is subject to  
6 commission oversight as part of the  
7 self-certification process, and then it's a  
8 regulated contract, if it goes through block  
9 trading.

10 The exchange has certain  
11 responsibilities to make sure that the contract  
12 is being regulated subject to oversight.  
13 Therefore, it complies with core principle 9,  
14 again, because it is a regulated contract and  
15 complies with the core principle.

16 You know, I think it's important to  
17 point out as well that there's never been a  
18 specific percentage in the Commodity Exchange Act  
19 of trading that has to occur in the central limit  
20 order book.

21 So to the extent that the commission  
22 finalizes a rule with a percentage, this would be

1 a great departure from where the market has  
2 traditionally been in terms of allowing products  
3 to innovate without meeting some sort of  
4 percentage threshold. And just to go back on my  
5 prior comment, the contracts and the DCM itself  
6 are subject to the core principles. So there's  
7 an overarching regulatory structure that can --  
8 that will serve as a check and balance, if you  
9 will, on the trading of a contract.

10 So to the extent that there's an  
11 issue with the trading of a contract, it can be  
12 by the DCM, and it can also be addressed by the  
13 commission through the regular process.

14 MR. SHILTS: Tom, before you start,  
15 just kind of as a focus, as Steve said, it's  
16 clearly true that the act does provide for  
17 various types of trades to be done away from the  
18 centralized market, whether it be blocks or  
19 EFS's, EFP's and whether or not there's some  
20 specific requirement for a percentage of trading  
21 that would be through the centralized market, but  
22 just as part of the, you know, with your answer

1 and others, can a contract that has no trading on  
2 the centralized market in your view be in  
3 compliance with core principle 9, if there is no  
4 price discovery occurring, no pretrade  
5 transparency at all for a particular contract?

6 MR. LA SALA: Rick, in response to  
7 that question, I think the answer is it can,  
8 because of the fact that the statute in section B  
9 clearly provides for the ability to engage in  
10 transactions outside of a centralized market. I  
11 think the point is that centralized markets, and  
12 we offer lots of centralized markets and  
13 contracts that don't have I think that liquidity  
14 that you're speaking to.

15 Not every market that's offered  
16 provides a price discovery function. I think  
17 that that's an observation that Commissioners  
18 Sommers, O'Malia made, you know, early on when  
19 they dissented to the original rules. We agree  
20 with that. I think that others on the panel have  
21 already spoken to that.

22 DCM's, you know, are afforded under

1 core principle 9, specifically section B, you  
2 know, flexibility insofar as how it in fact, you  
3 know -- mechanisms by which to bring contracts  
4 into -- under the auspices of the Exchange and  
5 into clearing. I think that obviously a matter,  
6 you know, that's very poignant in folks minds is  
7 ClearPort and the effect on ClearPort, and  
8 certainly we'll be talking about this quite a bit  
9 today.

10 The centralized market percentage  
11 standard I think just unduly creates an  
12 obligation that from a practical standpoint  
13 serves no practical benefit. We've got, you  
14 know, a decade of experience now in the manner in  
15 which we've brought these transactions in under  
16 the safety and soundness of futures, of  
17 instruments cleared as futures. And an effort to  
18 artificially install some type of a centralized  
19 standard, you know, to the points echoed by some  
20 of the panel members, inability to innovate, why  
21 would you do it. It almost favors going to a  
22 swap paradigm. Why would we disenfranchise

1 futures in that regard.

2 So I hope that's responsive. Thank  
3 you.

4 MS. MARKOWITZ: Tom, I just have a  
5 quick question. How would you interpret the  
6 requirements of core principle 9 in your view?

7 MR. LA SALA: Nancy, I think that we  
8 have got -- the purpose here is to afford, you  
9 know, abilities for DCM's to offer contracts.  
10 Where there is a centralized market, I mean, I  
11 think we have to keep in balance the notion --  
12 where there is a centralized market that is  
13 serving a price discovery function, I think we  
14 have to keep in balance the use of these other  
15 mechanisms that we don't in fact deteriorate  
16 that.

17 So if we had -- I'll give you an  
18 example. If you had core natural gas or core  
19 crude oil that are liquid central limit order  
20 books, if somehow the off exchange, the B  
21 component were somehow deteriorating that  
22 function, you know, we'd have to examine that.



1       However, where in fact we offer and we do offer,  
2       contracts on -- in a centralized fashion, whether  
3       that be in a pit or on Globex, and in fact the  
4       market for whatever host of reasons has chosen  
5       not to in fact engage that, you know, B certainly  
6       provides, you know, flexibility to allow the DCM  
7       to offer contracts and bring them in as futures.

8                   MR. SHILTS: I'm going to let us  
9       finish here. But then I want to come back to  
10      that, because I'm curious, too, like in your  
11      view, say, as a regulator, what would constitute  
12      a violation in your view of core principle 9 by  
13      an exchange? In other words, what would the CFTC  
14      look for in terms of a violation, and from what  
15      you were saying, it's your view that we would --  
16      the commission would have to conduct like a SBDC  
17      determination for every contract to assess  
18      whether it's serving a price discovery function  
19      before we could apply core principle 9? But  
20      let's finish first. But that's something to  
21      think about.

22                   MR. VED BRAT: You know, my comments

1 are more just from an end user perspective. In  
2 our use of a DCM and the trading protocols that  
3 would go along with it, whether it's off exchange  
4 or in the centralized limit to the book, is going  
5 to be dependent on the liquidity available and  
6 the transparency of price as well as depth of  
7 book. And taking into account, you know, the  
8 ability to allow for new innovation and for  
9 competitive future contracts to come into  
10 existence and functionality that the DCM software  
11 such as, you know, the ability to have an overall  
12 market, anonymous trading and equal and open  
13 access, you know, will be important in that  
14 determination.

15 MR. SHILTS: Any more follow-up on  
16 that or response to my question?

17 MR. DOWNEY: You know, I think it  
18 would be useful to understand, and I take my  
19 product specifically, we created a platform, an  
20 electronic open-access platform for the trading  
21 of blocks, the dissemination of block bids and  
22 offers for the point-and-click participation in

1 those markets.

2 Point and click for EFP's, you can  
3 see them see them on my website, I post them  
4 every day, they update every second. Anybody can  
5 go and see these marketplaces. Again, if you  
6 happen you align yourself with a brokerage firm  
7 that allows you to trade these products, you can  
8 have access to them. They are there. And we do  
9 have individual customers who do participate in  
10 the marketplace. We disseminate every  
11 transaction that we do contemporaneously on our  
12 website.

13 We provide transparency to the  
14 marketplace, A, because we are going after a  
15 particularly dark segment of the securities  
16 business called securities lending, which has  
17 never shown -- never been transparent, and the  
18 forces on that market distort the prices in the  
19 equity options, and they distort the prices in  
20 our stock futures in ways that no academic has  
21 ever been able to explain. You have to simply be  
22 able to have access to it to understand it. We

1 are trying to push this out.

2 So I think that the commission could  
3 in fact try to expand their views of what a  
4 centralized market is and embrace the fact that  
5 even if there is just pricing on -- without any  
6 transactions, that is an information flow that's  
7 extraordinarily valuable to the market, and that  
8 is in fact the transparent competitive  
9 marketplace, even if there's no transaction.  
10 That's an information flow that's valuable.

11 MR. FARLEY: Rick, to answer your  
12 question about what might be a violation of CP9.  
13 If the Board of Trade did not offer a  
14 competitive, efficient, centralized marketplace,  
15 that would be a violation for a given contract.

16 Another example is they didn't give  
17 fair access. Pick an absurd but illustrative  
18 example, you know, they only let companies with  
19 names that began with A through D become members,  
20 well, you get the idea. Those would be  
21 violations in my mind of the post Dodd-Frank  
22 language of CP9.

1 MR. RADHAKRISHNAN: If the  
2 commission were to allow futures contracts listed  
3 on a DCM to be executed completely off exchange,  
4 how would you assure pre-execution transparency?  
5 Because that's one of the hallmarks of an  
6 exchange, right, you get to see the bids and  
7 offers on the exchange. And if we go the extreme  
8 and say, you know, certain contracts you can  
9 trade 100 percent off the exchange, how would  
10 market participants get to see bids and offers?

11 MR. SHILTS: And just to add to  
12 that, just from what you, Tom, you know, your  
13 earlier comment. I think historically the  
14 commission has always viewed off centralized  
15 market trading as an exception. And I guess what  
16 we're trying to get our head around is what  
17 happens when it's the rule, when all of the  
18 trading is off the centralized market? There is  
19 no pretrade transparency on the DCM. Just, I  
20 mean, following up on Ananda.

21 MR. LA SALA: Well, again, I think  
22 that you can have certainly scenarios where the

1 trading can be outside of a centralized market.  
2 And I don't believe, except for language that was  
3 in Dodd-Frank specific to swaps, that there was  
4 any requirement for pretrade price transparency.  
5 You know, you might say it's nice, if in fact you  
6 can get it under the auspices of a DCM, but it's  
7 not required.

8 I think that's, you know, again, in  
9 my opinion, I think that that's -- that's a  
10 cornerstone concept that we -- you know, you're  
11 not necessarily required to. In the market we  
12 allow, you know, market user, where appropriate,  
13 where markets have -- you know, are deep enough  
14 and, you know, parties are able to post bids and  
15 offers, that's a very nice situation where it  
16 avails itself.

17 One or the other speakers mentioned  
18 earlier, markets are different. Some of them,  
19 you know, you could talk about a contract. A  
20 contract has got -- you know, is not only the  
21 front month but it's the back month. We start  
22 talking about, you know, protecting a centralized

1 market and a trading standard, a percentile,  
2 these contracts all start looking different, the  
3 front of the curves look different from the back  
4 of the curves and you get a rather dicey  
5 situation to deal with.

6 MR. DOWNEY: I know, again, in my  
7 marketplace most of the people who are interested  
8 in creating better financing for their equity  
9 positions normally trade in the equity markets.  
10 And they have what's called dark pools.

11 Now, I don't completely buy into  
12 what a dark pool does, but I can tell you that it  
13 works because there are a proliferation of them  
14 and there's a reason for it. It's allows for  
15 transactions to occur without disrupting the  
16 marketplace and there's a valuable rationale  
17 behind that.

18 In these dark pools, there's an  
19 enormous liquidity. People ask, David, there's  
20 no liquidity in single stock futures, and that's  
21 BS, because it's basically arbitrage. If the  
22 futures get out of line in any way, someone's

1 going to come in and sell the overvalued future  
2 and buy the cash and lock in financing till term.  
3 That's very simple.

4 The fact that they don't get out of  
5 line is because the market forces are in fact  
6 keeping those markets in line, even without any  
7 transactions.

8 Now, when you have parties that want  
9 to do large transaction in any market, whether  
10 it's IBM securities or whether it's large  
11 options, on the floors prior to electronic  
12 trading when people came down to an S & P pit,  
13 there was volume going up in that pit all the  
14 that wasn't announced in the crowd or was  
15 announced by whispering in the bottom of the  
16 crowd, right. Or in the options pit, Goldman  
17 Sachs would come down, Eddie Kelly would come in  
18 the options pit, how are you going to get options  
19 in the mid-40s and everyone would freeze. And he  
20 goes, well, I'll buy 200, I'll buy 50, I'll buy  
21 70. Okay, I'll sell, sell, sell. And I'm going  
22 to cross 40,000, is that okay. You see. So is



1 that transparent?

2           You know, so all they did was they  
3 came down and they had to abide by the rules of  
4 the exchange but the fact of the matter is  
5 everybody got out of the way.

6           And I think that if you have the  
7 rules and you have the people that enforce the  
8 rules and you provide transparency to the  
9 marketplace, you are getting to where you want to  
10 go. And I'm all in favor of bringing these  
11 exchanges to markets and that is distorting the  
12 other prices, bring them on, let's post those  
13 prices. Let the market view exactly the forces  
14 that are happening on the order counter all over  
15 the world.

16           MR. CALLAHAN: I would just say from  
17 an NYSE Euronext's perspective, we take a  
18 slightly different view, running both equity  
19 exchanges and fixed income exchanges. You know,  
20 the dark pool phenomenon I think would be a great  
21 tragedy, if that were to ever come to the futures  
22 market, because with, you know, a third of equity

1 volume now happening away from central exchanges  
2 in the equity markets, I think there's no  
3 question that at some point the tail starts  
4 wagging the dog, and the integrity of the central  
5 order book is compromised. And I don't know at  
6 what point that happens, but there would be some  
7 that may argue we're already there in the cash  
8 equity markets.

9           You know, Rick, to specifically  
10 answer your question, there is nothing in our  
11 business plan or anything we're trying to do as  
12 an exchange that would be intended to offer  
13 products that traded 100 percent outside of the  
14 central limit order book.

15           We are a futures exchange. We're  
16 trying to create liquid central order book  
17 products. But the reality is, when you launch  
18 new contracts, sometimes that's very, very  
19 difficult to do, and we're doing it every day.  
20 We have market maker incentive programs. We have  
21 fee incentive programs. We sit around all day  
22 long and try to think of creative ways to drive

1 people into the central order book.

2 But what we have found when we  
3 launch new contracts is that very frequently  
4 customers will choose to establish initial  
5 positions via blocks. And I am concerned that if  
6 there were a sword of Damocles hanging over those  
7 customers head that said, okay, if for some  
8 reason we trade too many blocks and we trigger  
9 some arbitrary threshold, then these contracts  
10 are going to be thrown into sort of an oblivion  
11 of liquidity. Are they a futures contract. Are  
12 they a swap. Who knows. That's really going to  
13 drive people away from new contracts.

14 So what we would argue is that, you  
15 know, there should be a principles based approach  
16 here as you look at any contracts. And if it  
17 gets to a level of liquidity outside of a central  
18 order book, that raises questions. Well, there's  
19 an awful lot of things that could be potentially  
20 causing that. Are the right incentives in place  
21 at the DCM to incentivize that central limit  
22 order book trading. Are there things happening

1 in a related market.

2 A lot of our MSCI equity index  
3 futures, people trade them against ETF's. Well,  
4 is there something happening in the ETF market  
5 that is incentivizing large block trading. What  
6 are the motivations of people that are doing  
7 these block trades. Have they tried the central  
8 order book but they couldn't get liquidity. So  
9 this is sort of plan B. Are they establishing or  
10 are they liquidating positions.

11 You know, there's no simple test.  
12 There's no bright lines. You'd have to take all  
13 of these things into consideration to determine  
14 whether a core principle 9 violation has  
15 occurred, and I think that staff should have that  
16 broad latitude to consider all those factors when  
17 making this determination, as opposed to one  
18 simple numerical test.

19 MR. HUMENIK: If I could just echo  
20 some of those comments as well. I think core  
21 principle 9 does not exist in a vacuum. There's  
22 other core principles that a DCM has to follow.

1 So in terms of determining whether a contract is  
2 complying, you have to look at the whole view.  
3 So core principle 9 is one piece of the puzzle,  
4 so to speak.

5 Echoing on what Tom just said about  
6 core principles for a new exchange and a new  
7 contract, again, you need that time to get  
8 traction in the contract and block trading  
9 provides a mechanism to do that. And I think  
10 it's important, you know, in the theme or in the  
11 essence of principles-based regulation when you  
12 look at the DCM proposed rules that the  
13 commission put out, there's specific guidance as  
14 to how a DCM should look at its block sizes and  
15 what it should do. And it's actually a quite  
16 extensive list. There's nine factors.

17 So I think, you know, in terms of  
18 block sizes, I think if DCM applies those  
19 principles it gets to a good place, a good  
20 starting point that complies with core  
21 principle 9 and complies with the core  
22 principles.

1 MS. VED BRAT: I just want to  
2 respond in answer to your question on pretrade  
3 price transparency. I think it depends on the  
4 stage of evolution of a contract. You know, in  
5 the initial stages when there's something new,  
6 you know, that is -- the price discovery is going  
7 to be based on, you know, the understanding of  
8 the product and between, you know, bilateral  
9 counterparties. You know, then it's going to  
10 move into the stage where, you know, you may  
11 have, you know, broker screens that will provide  
12 some level of pricing.

13 And, you know, if that, you know,  
14 along with end-of-day pricing is available, you  
15 know, it does give, you know, a certain level of  
16 confidence that you were within the ballpark of  
17 where this contract should trade, and that's  
18 going to lead to confidence moving into the  
19 central limit order book where, you know, there  
20 will be liquidity providers as well as clients  
21 willing to act on the prices that they see on the  
22 screens. So It's important to look at the

1 different stages of evolution.

2 And just to comment a little bit on  
3 what Eris and NYPC, what we heard over there.  
4 You know, if we were to see functionality that  
5 would encourage more market participants to  
6 trade, you know, in a central limit book, that  
7 will also help liquidity migrating onto that  
8 platform.

9 Just a simple example, you know, for  
10 something that would help this, you know, if the  
11 DCM, you know, or the clearinghouse were to  
12 offer, consistent average price for futures, you  
13 know, average pricing modules to end clients,  
14 then, you know, which is necessary if you're  
15 trading, you know, in smaller sizes and block,  
16 then that would help price migrate to the  
17 liquidity available on the central limit order  
18 book.

19 MR. FARLEY: I'm largely in  
20 agreement with the comments that have gone before  
21 me, including Supurna's and Tom's and Steven's.  
22 I just want to go back to, Ananda, your question,

1 which I thought was a good question. Interesting  
2 thought exercise. Essentially being, you know if  
3 futures were allowed to trade off a DCM, how do  
4 we know they wouldn't all trade off a DCM.

5 It reminds me of two analogous  
6 situations, not identical. I'll go through just  
7 quickly one, and you know, Ananda, the history of  
8 ICE. But if you go back a decade or so ago, ICE  
9 introduced lots of energy contracts for trading.  
10 And we did so with a flexible execution  
11 architecture, if you will. We had central limit  
12 order book trading, voice trading. You know,  
13 whether it be blocks or what have you.

14 And what you see over time is we  
15 were essentially a board of trade but not in the  
16 regulatory sense, but we were offering an  
17 efficient marketplace much like CP9 asked for,  
18 and over time you've seen the highly liquid  
19 contracts migrate to nearly exclusively  
20 centralized trading, for instance, our Henry Hub  
21 contract which is again essentially all central  
22 limit order book with some de minimis exception.



1 And on the other hand, some off the run Asian  
2 refined product is nearly all negotiated away  
3 from the central marketplace and cleared. And  
4 then in between is everything else.

5 So, for instance, gas, the SoCal gas  
6 basis contract might be 50 percent in the central  
7 limit order book. So I think you can take  
8 comfort that over time the highly liquid  
9 contracts will migrate to the centralized  
10 marketplace, and you can take comfort that were  
11 it not for the innovations of ICE and our  
12 colleagues at CME, all those contracts would  
13 potentially at this point still be bilateral and  
14 so there's been a greater good.

15 And the second example, which I'll  
16 go through even quicker, I promise, is the  
17 example of currency pairs where you have the  
18 transitory EFP's which look and feel a lot like  
19 the contingent EFS's that you have the in  
20 commodity world, if not mechanically certainly  
21 by commercial intent. And what you see in the  
22 listed currencies business is that the euro, that

1 trades in the centralized board of trade. But  
2 the off the run, you know, knocky socky currency  
3 pair is all traded away from the board of trade  
4 and passed in as a transitory EFP.

5 So those are analogous situations I  
6 think will give you an idea of what will  
7 transpire and I think those are also healthy  
8 situations.

9 MR. HAMILTON: I'd just like to add  
10 that -- or two things about the execution away  
11 from centralized board of trade. First of all, a  
12 lot of those would be swaps. You would have a  
13 different set of rule making that would cover  
14 those, depending on blocks and execution methods  
15 that would be prescribed by the commission.

16 And secondly, just because it  
17 happens away, I'd like to emphasize that it's --  
18 there may not be price transparency on the  
19 screen, but to customers there's price  
20 transparency. The competition for some of these  
21 off-the-run markets that he's talking about and  
22 he's talking about customers have three lines

1 open to three different brokers. They have  
2 transparency, they know what's happened.

3 In addition, at least in the energy  
4 space, they're all referenced to the key core  
5 markets that are published continually all the  
6 time. It's not as though there's some dark  
7 corner where these transactions are happening.  
8 Brokers compete all day all the time for these  
9 trades. Customers, we have collectively in the  
10 WNBAA, we have more than 5,000 lines open to  
11 customers all the time. So there is  
12 transparency, at least between the brokers.

13 MR. LA SALA: One point. I think  
14 some of the folks on the staff know that we've  
15 spoken to you in the past about technology called  
16 CME Direct. I just note that whether -- and that  
17 technology might be used, you say, by third-party  
18 lessees, call them brokers, whether those be for  
19 swaps or for futures.

20 So the point, I think, Tom made  
21 earlier, you know, although not necessarily a  
22 central limit order book, whether it be a

1 whiteboard, could at one point be a central limit  
2 order book. You know, customers seeing pricing,  
3 over time you can get to potentially parties  
4 becoming comfortable. That a central limit order  
5 book is appropriate and they've comfortable with  
6 placing that. So I know that we've spoken to  
7 some of the staff on that in the past. That is  
8 obviously something that we're focused on going  
9 forward.

10 MR. BRODSKY: Okay. Well, why don't  
11 we move on to the second question. The  
12 commission proposed that any contract that does  
13 not meet the minimum centralized market trading  
14 requirement must be delisted and transferred to a  
15 SEF or liquidated.

16 What are the implications and  
17 consequences of the commission's proposed  
18 delisting requirements for these contracts and  
19 we're particularly interested in hearing the  
20 consequences for the affected DCM, for SEF's, and  
21 also for traders with positions in those  
22 contracts.

1                   And as a follow-up question, how  
2 long should noncompliant contracts be permitted  
3 to be listed before being required to be  
4 delisted, and what sorts of measures should a DCM  
5 be able to take to increase trading that would  
6 demonstrate trading with core principle 9.

7                   So why don't we start again on my  
8 left and pause afterwards for the new participant  
9 to introduce himself.

10                  MR. CALLAHAN: Thank you. I think  
11 the issue is that both options presented -- being  
12 presented, delisting or being transferred to a  
13 SEF, are going to be enormously unappealing to  
14 market participants, which is going to keep them  
15 away from the contracts.

16                  And I'll just give you a practical  
17 problem that we would face. You know, we're a  
18 small start-up exchange. We have a mission which  
19 is to establish, you know, liquid central order  
20 book futures. We're not in the SEF business, we  
21 don't have plans to become a SEF. We also are  
22 unique in that we're one futures exchange that

1 has two clearinghouse. Our straight products  
2 clear at New York portfolio clearing. Our equity  
3 products and our metals product clear at OCC in  
4 Chicago.

5 So, for example, if one of our MSCI  
6 products were to fail a test that would require  
7 transfer to a SEF, well, I don't have one, so I  
8 don't -- I'd have to find a SEF that would take  
9 it. But even more importantly it's not clear to  
10 me at all that OCC would want to continue to  
11 clear those products. They clear futures  
12 contracts. And if this is no longer a futures  
13 contract with any presumption of liquidity, they  
14 might not clear it anymore.

15 So I look at this, you know, for  
16 just a vertical exchange like some of the others  
17 on the panel and say, easier proposal, you know,  
18 they own the clearinghouse and they're going to  
19 own the SEF, so they move it from, you know, one  
20 division to another. It's not so clear for us  
21 that that's even a possible. So really the only  
22 viable option becomes, delisting.

1                   And we've all seen that when markets  
2 go into liquidation mode fair value and accurate  
3 pricing doesn't matter anymore. Trades to  
4 liquidity, you know, where the buyers and sellers  
5 meet, so things diverge and move away from fair  
6 value and that means that market participants and  
7 the integrity of the market could really be hurt.  
8 So, you know, I think that's the main concern  
9 that market participants would feel when they  
10 looked at these two potential options.

11                   MS. MARKOWITZ: I just have a quick  
12 question, Tom. In the prior panel you said we  
13 should take a principle based approach. If a  
14 contract is trading on the market, liquid, you  
15 know, the parties doing, are they doing incentive  
16 programs. Are they marketing incorrectly.

17                   Is this -- is there any end to that  
18 kind of analysis? I mean, are you saying that a  
19 contract that doesn't trade should just still  
20 maintain being listed? Is there any end that we  
21 should say at some point that this contract is  
22 not -- should be delisted or are you saying that

1 it just -- it's just that analysis should go on?

2 MR. CALLAHAN: I think the reality  
3 is, as much as we -- as exchanges would like to  
4 say that we can control how markets trade, you  
5 know, water finds its own level. You know, one  
6 of our primary missions is trying to move  
7 liquidity from one exchange in certain products  
8 to our exchange and it's very, very difficult.  
9 And you can create all the incentives you want  
10 and sometimes the market still choses to trade in  
11 one venue versus another.

12 So what I would hope the commission  
13 would look at is again all those principles based  
14 factors. And ultimately, if all of the right  
15 incentives were in place, to incentivize central  
16 limit order book trading but if the market were  
17 still choosing to trade in some percentage away  
18 from an order book, there's probably a very good  
19 reason for that. And then I think you'd have to  
20 look back to this issue is price discovery being  
21 harmed. If the answer to that question is no,  
22 then I would say, yeah, there may be a point at



1       which the commission would be satisfied with a  
2       very low percentage of trading happening in a  
3       central order book if that -- if that price  
4       discovery function were not being harmed. And if  
5       it were, then you would at that point choose to  
6       mandate delisting.

7                       MR. COSGROVE: Good morning. I'm  
8       Michael Cosgrove. I've sorry I'm late. It was  
9       Amtrak's fault. They're normally extremely good.  
10      I'm her representing GFI. We're a large global  
11      energy dealer-broker. We arrange transactions in  
12      a broad range of assets classes, and thanks very  
13      much for having me.

14                      I'd like to start by associating  
15      myself with Tom's remarks. I think they're --  
16      they very much speak to the position that we have  
17      on this. I also, though -- and because I'm a  
18      little late, stop me if I cover something that's  
19      already been touched upon. But since we're  
20      talking about the -- about whether -- what  
21      criteria to apply to determine whether a product  
22      trades on a DCM or a SEF, I'm still unclear on

1 what the rules of execution are for a SEF.

2 So it's difficult when asked, what  
3 will the impact be if we move futures contracts  
4 to a SEF, I don't know what rules a SEF is going  
5 to be required to follow in order to satisfy its  
6 requirements for executing those.

7 So depending upon the rules that are  
8 ultimately promulgated, it could be just a  
9 terrible nuisance or it could be, I would say,  
10 market destroying to move instruments from a  
11 futures market to a swap market.

12 If SEF's and DCM's are regulated  
13 essentially to the same standard, then I think it  
14 begs the question of why bother with the  
15 consideration at all, because if you hold a SEF  
16 and a DCM to the same standard, why would anyone  
17 then care if it's a swap or a futures.

18 So I realize that's not this  
19 particular question. This may have already been  
20 touched upon, but again, without knowing  
21 essentially how a SEF is going to be permitted to  
22 operate, it is very difficult, I think, to give a

1 response to this question.

2 I am aware that a number of the  
3 distinguishing factors between swaps and futures  
4 have been resolved in the last couple of years.  
5 I understand that Dodd-Frank section 724 has now  
6 given swaps the same status under bankruptcy law,  
7 which I think was very important.

8 I think that -- let's see, there's  
9 still obviously the difference in tax treatment  
10 between futures and swaps. I don't know the  
11 extent to which that influences traders'  
12 activities on a day-to-day basis. But as near as  
13 I can tell, that seems to be the last remaining  
14 critical distinction between swaps and futures.  
15 And I think -- I wish I was qualified to provide  
16 you with some guidance in regard to how  
17 disruptive that difference would be if a contract  
18 were delisted as a future and turned into a swap.

19 But I would say that some additional  
20 clarity in terms of the permitted range of  
21 execution for a SEF would be extremely helpful in  
22 order for us to formulate a response to the

1 likely disruptive impact that moving a contract  
2 from a DCM to a SEF would likely have.

3 I know that's not a great answer but  
4 it's the best one I have.

5 MR. DOWNEY: I don't have time to go  
6 into how disruptive it would be on my market.

7 I've spelled it out in our comment letters  
8 repeatedly. Respectfully, I don't think you have  
9 the unilateral right to include my listing  
10 standards, and that includes forcing me to  
11 delist. That is something that was put on the  
12 joint commissions of the SEC and the CFTC.

13 Again, the document I referenced earlier put out  
14 by both commissions referenced it as well. It's  
15 a joint authority, not unilateral.

16 If do you ask me to delist my  
17 contract and move it to a SEF, there are no  
18 SEF's, I don't know what they are, but none of  
19 them have the authority to trade security  
20 futures, number one. Even if they did, they  
21 would trigger automatic best execution  
22 requirements that the SEC has already said that

1 they will impose on competing exchanges or  
2 execution arenas, which would cause all of the  
3 market participants to immediately have to  
4 connect to the SEF, which they're not going to  
5 want to do.

6 Furthermore, 75 percent of the  
7 positions are held by FCM's which are not going  
8 to be in a position to go to a SEF. As you move  
9 a product onto a SEF, the security side will  
10 immediate hedge their position by buying or  
11 selling the security and locking themselves in  
12 with no intention of delivering that product at  
13 expiration. The FCM's have no interest in taking  
14 delivery. They would like to roll and now  
15 there's no functional allowing them to roll,  
16 they're stuck.

17 Lastly, if I am forced to delist my  
18 product because of the rules that Congress has  
19 set saying that the delisting standards can be no  
20 less restrictive for futures than they are for  
21 equity options, you would be forced to ask the  
22 equity option exchanges to delist their products

1 as well. Good look when Bill Brodsky comes  
2 visits your door.

3 MR. FARLEY: It's a bit of a mind  
4 bender when you think about the delisting  
5 process. So I want to articulate it and just  
6 make sure that we understand some of the  
7 difficulties that are embedded here.

8 If you think about a given contract  
9 that's being delisted because the contracts that  
10 are being traded are being traded off exchange,  
11 really definitionally what you're saying is that  
12 those contracts are being executed in some other  
13 way that isn't offered by a DCM. Therefore,  
14 despite the fact that a DCM can list swaps for  
15 trading, definitionally the DCM is not going to  
16 just change that futures contract into a swap on  
17 that DCM, because a DCM is not allowed to offer  
18 the additional flexibility of execution that a  
19 SEF is.

20 Now, I want to put a placeholder  
21 there because I want to come back to that. But  
22 we think that that, in and of itself, is an odd

1 and not helpful inconsistency that the same  
2 contract that's fungible at the clearinghouse,  
3 similar compliance standards, position limit  
4 standards has different execution protocols on a  
5 DCM from a SEF. But be that as it may.

6 So the futures contract is delisted.  
7 Now it's going into a new entity, i.e., a SEF.  
8 Compound that to what Tom Callahan mentioned, it  
9 may, too, go to a different clearinghouse at the  
10 same time. And at the same time it is most  
11 likely moving to a different clearing account  
12 class. Each one of those things is difficult to  
13 explain even to a market practitioner. Each one  
14 of these requires contracting, customer hold  
15 handing -- hand holding, pardon me, clearing firm  
16 hand holding.

17 And so I think when you walk through  
18 that process, assuming we understand it  
19 appropriately, the question answers itself with  
20 respect to will that be disruptive.

21 MR. HAMILTON: ICAP Energy opposes  
22 the application of core principle 9 whereby there

1 might be a mass demotion of open interest that's  
2 out there that is currently being traded on the  
3 swap-to-futures market. We believe that our end  
4 users value the EFS process, and we think that  
5 the open interest that's out there would be  
6 particularly disruptive in the electricity,  
7 natural gas, and refined oil contracts. It would  
8 create a great deal of uncertainty at a time when  
9 the market's trying to digest all of the  
10 applications that Dodd-Frank is coming up to it.

11 In addition to that, having some  
12 large transition, as he spoke of, of open  
13 interest in those particular markets, especially  
14 in these less liquid markets where these  
15 contracts have been used for hedging by end users  
16 would create particular difficulties in the  
17 markets.

18 MR. HUMENIK: You know, delisting is  
19 in our view a disruptive regulatory practice. I  
20 think I mentioned before that in terms of a new  
21 product incentivized trading on the central limit  
22 order book you can do so through the block



1 trading levels, and there's appropriate guidance  
2 in the DCM proposals regarding what a DCM should  
3 look to in terms of setting up block sizes.

4 And I think it's important to point  
5 out that if a futures contract is forced to  
6 transform into a swap, it's -- first, it's  
7 contrary to the language of the Dodd-Frank Act  
8 which specifically excludes futures from the  
9 definition of swap. And, in addition, forcing a  
10 futurized swap to delist from a DCM and then  
11 relist on a SEF do only what essentially is a  
12 liquidity requirement relates to disparate  
13 treatment for a DCM and its products.

14 As we pointed out before on the  
15 panel here, principles-based regulation has  
16 worked well and I think there's the ability to do  
17 that in the DCM core principles. And what  
18 happens when you add this uncertainty of is my  
19 product going to be delisted and it's a long  
20 dated futures contract, it just adds a level of  
21 uncertainty to the marketplace that is not  
22 required and is not needed.

1                   And, you know, I've said that the  
2 futures framework is a known regulatory  
3 framework. It's worked well in the past, and it  
4 can work well in the future, if we don't place  
5 prescriptive rules on the core principles and how  
6 they functioned in the past.

7                   And I just point out, to echo Tom  
8 Farley's comments, that delisting is a severe  
9 penalty and an end user won't use a contract, if  
10 they think it's going to be listed. They have no  
11 idea if they actually do compliance with the DCM  
12 core principle 9 and any given percentage. I  
13 don't know if an exchange would have to have like  
14 a meter on its exchange to let people know, are  
15 we getting closer to the 85 percent almost like a  
16 fundraising campaign.

17                   And if a product is forced to  
18 transform from a future to a swap, there's tax  
19 consequences to that as well. It goes from a  
20 60/40 tax treatment to a swap tax treatment. And  
21 as Tom pointed out as well, you'll have an issue  
22 of moving collateral from 4DA to 4DF.

1                   And what if the end user who's using  
2 the futures contract doesn't even have a clearing  
3 firm that supports the clearing of swaps. So now  
4 they have to go out and repaper and get an FCM  
5 that will actually clear swaps for them. So I  
6 think there's so many consequences to having the  
7 penalty of delisting that it's an inappropriate  
8 penalty and there's other ways. Again, as I  
9 mentioned, through block trade management,  
10 incentivized trading in the central order book  
11 that are available to the commission that can be  
12 used that will get to a good policy result.

13                   MR. LA SALA: Let me begin by saying  
14 I think that Steve, Tom, and Mike have stolen a  
15 bit of my thunder on this one. But let me note  
16 to the staff that I can think of right off the  
17 bat about 34 million good reasons why  
18 transforming what's currently futures into what  
19 would be swaps as proposed is just simply the  
20 wrong path to go.

21                   Again, some of the panel has spoken  
22 to them. There are tax implications. It's even

1 beyond 60/40 treatment. I think there is  
2 potentially a taxable event in the context of the  
3 transformation, Unsurety to market users, if in  
4 fact -- again, we talked about liquidation as one  
5 option. The other is, again, the transformation  
6 has got tax implications.

7 Mike talked about, you know --  
8 astutely noted, we don't yet know on the swap  
9 execution front the details because the rules are  
10 not finalized. But at least as proposed, I just  
11 certainly want to raise one point that I struggle  
12 with constantly.

13 That being is, of that approximately  
14 34 million contracts, I seriously question what  
15 regulatory good we've achieved in that  
16 transformation. Meaning that at the very least,  
17 at least as proposed, and again, we don't have  
18 infal rules, some of these contracts are going to  
19 continue to be, I'll simply say, intermediated  
20 and brokered. So they're cleared today, they've  
21 got surety as futures, and they're intermediated  
22 by, you know, by IDB's.

1           Tomorrow they'll be cleared, they'll  
2 be intermediated by IDB's, yet they'll be swaps.  
3 Again, if I take a step back and simply say, you  
4 know, what good to the marketplace did we in fact  
5 achieve by, you know, conducting this -- this  
6 wholesale transfer, I just -- you know, frankly,  
7 and respectfully, I'm struggling with a good  
8 answer to that. So thank you.

9           MR. VED BRAT: You know, what we  
10 would like to see is at a time of listing, you  
11 know, whether it's DCM or a SEF, did  
12 determination of how liquid the contract would be  
13 if made at that time. There is enough  
14 intelligence gathered from the dealer community  
15 or the liquidity providers to make that -- to  
16 make that determination.

17           Also, you know, at the same  
18 evaluation should take place, is it better to  
19 have this type of risk staff in a swap form or a  
20 futures form. And once that's made, the contract  
21 should be allowed to live through maturity.

22           There will be natural -- if the

1 liquidity were to fall, you know, whether it's  
2 because of market events or some other event,  
3 there will be natural market forces that will  
4 allow for the unwinds to take place, you know,  
5 versus a forced liquidity event. And I think  
6 that that's going to be very important for  
7 clients, because it's very hard to price in the  
8 optionality of a termination or a conversion.

9 I think, you know, earlier on it was  
10 mentioned on the conversion between a futures and  
11 a swap, you know, does require redocumentation or  
12 documentation finding a clearing member,  
13 understanding the account classes and everything.

14 You know, we at BlackRock actually  
15 have a very good understanding of all the  
16 different elements, and it is very complex. And  
17 that conversion, you know, also would imply that  
18 the account that you're trading on behalf of has  
19 the ability to trade or, you know, to take in  
20 futures risk as well as swaps, which is not  
21 always the case.

22 So our recommendation would be to,

1 you know, allow contracts, once they're listed,  
2 to live, you know, through maturity and allow  
3 natural market forces, allow the unwind of risk.

4 MR. BRODSKY: Okay. Thank you for  
5 that. Why don't we move on to the next question.

6 If the commission were to move  
7 forward with some sort of centralized market  
8 requirement, should the commission consider a way  
9 to address new products and those with low  
10 liquidity, and one example of that might be an  
11 exemption to delisting for contracts that meet a  
12 specified de minimis level of open interest or  
13 overall trading volume. And if that is something  
14 that you think might be workable, what would the  
15 appropriate measure of liquidity be for purposes  
16 of such an exemption.

17 Why don't we start with you.

18 MR. CALLAHAN: Yeah. I think this  
19 is a critical point, again, with the idea of not,  
20 you know, throttling innovation in our industry  
21 that new contracts, which I think by definition  
22 are going to be more likely to trade in wholesale

1 markets, need to be given a little runway in  
2 order to take off.

3           So I would say if I had to pick a  
4 number in terms of an ADV threshold, something  
5 along the lines of 50,000 contracts, ADV would  
6 make sense. It would be very difficult to argue  
7 below that standard that a contract was  
8 performing a primary price discovery function if  
9 it's trading at small volume, so something around  
10 50,000 to me would make sense.

11           I think it's also important that we  
12 exempt options for the same reason. Options  
13 don't provide a primary price discovery function  
14 for anything. They price volatility of the  
15 underlying. They don't price the underlying.  
16 And options are, by definition, less liquid than  
17 futures in a central order book. So I would say  
18 50,000 ADV for futures with then an exemption for  
19 options.

20           MR. COSGROVE: Is there a definition  
21 for centralized market somewhere that we're using  
22 for this discussion, by any chance? Because



1 I'm -- I don't mean to throw a spanner in the  
2 works, it's just that I can sort of apply my  
3 common sense interpretation of that, but it may  
4 not be the same as everyone else's. I think of a  
5 centralized market as central to limit order  
6 book, an open outcry pit, right.

7 MR. SHILTS: For DCM's, that's  
8 right.

9 MR. COSGROVE: Right. Okay. But I  
10 also think of a centralized market as a trading  
11 pit that can be extended technologically. So I  
12 think of many to many voice market as a  
13 centralized market, too. So with that as a --  
14 you know, sort of my definition of a centralized  
15 market, I think that -- I think that a far  
16 less -- a far higher standard could be applied to  
17 new products, provided that the markets are given  
18 an opportunity to choose the form of centralized  
19 market that best suits that -- that contract and  
20 that market.

21 So, in other words, Tom Farley said  
22 earlier, you know, customers have made the choice

1 over the years about which forms of execution  
2 they've chosen to adopt. And a central limit  
3 order book is immensely effective. It's cost  
4 effective. It's cheap. I mean, it's cheaper to  
5 use, generally. It's the way to go. And the  
6 only reason you wouldn't use that, really, in the  
7 broadest sense, is because it isn't the best way  
8 to get the business done.

9           Perhaps human intermediation is  
10 required. Perhaps some RFQ functionality is more  
11 suited to the market due to an episodic nature or  
12 due to the market participants. And so I would  
13 say that, depending upon whether we define a  
14 centralized market as an electronic central limit  
15 order book, on the one hand, or we apply a  
16 broader definition of, you know, the DCM sort of  
17 definition of an open outcry pit, and my  
18 definition of an open outcry pit extended by, you  
19 know voice technology to create a many to many  
20 voice market.

21           So depending upon which of those two  
22 broad extremes we would take, I would suggest

1 different standards for determining whether or  
2 not a swap is required to be traded on a,  
3 quote-unquote, central limit order book.

4 So I'm very much an advocate for  
5 allowing markets to choose a form of execution  
6 that suits the market within reason, and I think  
7 that provided that centralized market is defined  
8 in a sufficiently broad sense, it becomes less  
9 important as to whether or not the swaps -- the  
10 futures are given some runway, essentially, to  
11 meet certain limitations in order to continue to  
12 be listed.

13 MR. DOWNEY: I think that there  
14 should be some thought given to getting away from  
15 the concept of volume and open interest, and in  
16 certain circumstances activity can be measured by  
17 transaction rates.

18 The average contract per trade in  
19 our central limit order book is five. That's 500  
20 shares of stock. That is something that would be  
21 electronically executed on any electronic stock  
22 exchange, trying to get it out of the way of all

1 the other trading that really makes sense, not to  
2 minimize its strength.

3 But to the extent that you're going  
4 to look at are people interested, are there  
5 incentives? I would say, if you could, please  
6 incent the member firms to connect, and just tell  
7 them, if you don't connect and do enough volume,  
8 you're going to turn into an FCM. And if don't  
9 connect and you're an FCM, if you don't connect  
10 you're going to turn into a broker-dealer.

11 If somebody comes in and wants to do  
12 a contract, but they do it in such a size you're  
13 not going to like it, so you're going to make me  
14 delist the contract. Doesn't make any sense to  
15 put a gun to my head like that.

16 I think you should look at it, is  
17 there actual interest in trading the product at  
18 any level, and I think you can start that with a  
19 transaction rate. And I think that reasonable  
20 transaction rates would be an average daily  
21 transaction rate of 1,000 units per day over the  
22 last six months would be something that says,

1       okay, there's interest in this product, volume  
2       should be migrating to those types of facilities.

3                       Absent that transaction rate, I  
4       think any transaction, any interest in the  
5       product that brings transparency to the  
6       marketplace should be encouraged and not  
7       discouraged.

8                       MR. FARLEY: I suppose, if you  
9       forced ICE to kind of answer this question  
10      directly, yes, we think that a new contract  
11      should not be subject to delisting. But I do  
12      think it's important, I won't reiterate the  
13      arguments from the prior question, but I think  
14      it's important to highlight that that's distinct  
15      from saying that we think that at the end of that  
16      period, two or three years of its low volume, it  
17      should be delisted.

18                      And I just want to highlight an  
19      example or two for you. We would have some  
20      concern -- a lot of the conversation we're having  
21      today I think emanates what our colleagues at CME  
22      have built very effectively, ClearPort and the

1 mechanism there, and it's largely commodities  
2 contracts.

3                   And I would have some concern that  
4 using this methodology of, hey, for new contracts  
5 we'll give them some room to run, but if they  
6 don't have the sufficient percentage of central  
7 limit order book trading, we'll then delist them.  
8 It runs a risk of breaking up or balkanizing  
9 contracts which should otherwise be traded  
10 together, and I'll give you a stark example.

11                   Take a given power contract.  
12 Typically, with power contracts, you have  
13 something called on-peak which refers to the  
14 hours during the day which are the heaviest load  
15 and then you have off-peak, which are the  
16 remaining hours in the day. Those off-peak  
17 contracts, again, definitionally, are more  
18 illiquid. They're traded less. But they are  
19 very much thought of as a piece for the people  
20 trading in that market with the on-peak  
21 contracts.

22                   So could you end up in a situation

1 where, let's say, ICE started trading some  
2 on-peak and off-peak power contracts at a given  
3 location. At the end of three years you look,  
4 and you say, oh, these are 86 percent traded on a  
5 central market and these are two, let's delist  
6 this second contract, and that could foul up the  
7 risk-management approach of the customers who are  
8 using those products to hedge.

9 MR. HAMILTON: I think for us it's  
10 still that we oppose the demotion, so to speak.  
11 So it's very difficult, without knowing more  
12 about what the SEF rules are going to be, other  
13 than with the innovation of clearinghouses and  
14 exchanges and brokers at the table, if there's a  
15 contract that's not going to be successful as a  
16 future, it may become successful as a swap, and  
17 then it will take care of itself. As long as the  
18 market allows that innovation, it may not be  
19 necessary to set a time frame for its demotion.

20 There may be some -- on the other  
21 hand, there may be some other contracts that are  
22 mature and have been around for a very long time

1 and have been used for clearing, and are used by  
2 end users for risk management but don't have a  
3 lot of volume. But having the option of a  
4 central clearinghouse, and it just so happens hat  
5 they might be futures, I don't see any objection  
6 why those need to be demoted today, because end  
7 users have benefited from the central limit order  
8 book or central limit order book counterparty  
9 clearing.

10 MR. HUMENIK: I think the point was  
11 made earlier that I tink 90 percent of contracts  
12 that are listed actually fail and meet their  
13 demise. So I think, you know, at the end of the  
14 day the market will ultimately delist the  
15 contract if it's not serving I'm purpose to, you  
16 know, serve commercial needs or price discovery.

17 You know, again, we're opposed to  
18 delisting as the ultimate outcome. I think  
19 there's other ways to incentivize trading in the  
20 central order limit book for a new product, and  
21 it's critical to give those products the  
22 opportunity to gain traction so they can achieve



1 transparency in the central limit order book.

2 I think I heard at one point there  
3 was discussions about having a study where, you  
4 know, a new contract could be listed and over  
5 time the DCM would have to take a look and decide  
6 why, why is this contract trading, you know,  
7 85 percent block and 15 percent in the central  
8 limit order book. So, again, there's other  
9 methods out there that will allow the commission  
10 and the DCM to achieve the purposes of the core  
11 principles without having delisting as a penalty.

12 MR. LA SALA: I don't have a formula  
13 or some type of an ADV or an open interest  
14 threshold to impart to the staff. What I will  
15 say is that, with regards to CME Group, we're  
16 certainly not adverse to looking at incentives of  
17 putting contracts on, you know, Globex. In  
18 addition to where some of the contracts we offer  
19 are in the pit. Many of them are. Others are  
20 additionally on Globex. We're not adverse to  
21 that.

22 But the point is is that some type

1 of -- again, a centralized standard as a  
2 mandatory item that jettisons something from a  
3 future into, you know, another -- it  
4 recharacterizes it effectively, just doesn't  
5 seem, you know, market serving.

6 I'll further note, as we talk about  
7 it today, we struggle with this question, I think  
8 some of the -- many of the contracts we're  
9 talking about here, these transactions are  
10 happening off the exchange. I think we all know,  
11 we're not targeting aggregates or mom and pop.  
12 These are sophisticated users that, you know,  
13 choose to use multiple venues to execute their  
14 transactions. I think it's an important point  
15 that we don't want to lose in this.

16 And in some regards I say, to the  
17 extent that DCM's or, let's say, boards of trades  
18 fail, are slow to maybe realize that a  
19 centralized market is effective, is ripe for  
20 pretrade price transparency, some of that,  
21 frankly, you know, shame -- shame on us.  
22 Meaning, you know, if there is a board of trade,

1 a DCM, or a would-be SEF that gets there and is  
2 able to find that liquidity base, okay.

3 But, you know, markets tend to do a  
4 very good job of -- or users of markets, of  
5 deciding, you know, what's effective and what's  
6 beneficial and to artificially structure  
7 percentages and requirements that make those  
8 decisions for the market, generally speaking, I  
9 don't think serves the -- serves the market users  
10 well.

11 MS. VED BRAT: The open interest in  
12 volume, I mean, those are quantitative measures.  
13 I think we also have to consider some of the  
14 subjective -- subjective elements that would --  
15 that would support liquidity or trading in  
16 central limit order books. In order for us to be  
17 us to be able to participate in a club or in a  
18 DCM, you know, we need liquidity providers who  
19 provide liquidity. We need clearing members to  
20 provide clearing, you know, for the contracts  
21 that are listed. You know, it's optional on both  
22 ends.

1           So you could have a contract there  
2           that clients, you know, have interests, would  
3           like to be able to participate in, but by the  
4           choices made by, you know, the clearing members  
5           or liquidity providers, you know, choosing not to  
6           provide liquidity, it just makes it an illiquid  
7           product for us.

8           You know, the other thing is, you  
9           know, we can have -- you know, there can be  
10          unintended to consequences to delisting. You  
11          know, you can have a market event, a temporary  
12          market event that may cause, you know, you know,  
13          clients to get out of positions and stop trading  
14          a product, you know, because of the fear of  
15          conversion or termination, which should be  
16          considered as we go through this process.

17          Another point that, you know, I'd  
18          like to make is that, you know, if there is a  
19          concern on the liquidity, low level of liquidity  
20          of a contract on a DCM, then why would we  
21          consider the swap SEF which is also an  
22          electronic, you know, trading medium that is

1 supposed to be standardized to be the right, you  
2 know, area for something to convert into.

3 So, you know, a little bit of  
4 hesitancy over there would be that this may  
5 actually lead to the bilateral world where you,  
6 know, clients would be required to take on  
7 bilateral risk and -- and start to lose some of  
8 the benefits of clearing and counterparty risk  
9 reduction which, you know, we've been very  
10 supportive of on a going-forward basis.

11 MS. ZAKIR: I just wanted to come  
12 back to one of the questions that we posed a  
13 little earlier to give everybody a chance to  
14 comment on.

15 One of the comment letters --  
16 actually, a couple of the comment letters had  
17 suggested that in place -- in lieu of mandatory  
18 delisting of certain contracts that we would  
19 allow DCM's to take specific measures to increase  
20 centralized market trading.

21 Can we just make sure that we go  
22 down the panel one more time just to make sure

1 that we get anyone who has any thoughts on what  
2 those measures can be, specifically any success  
3 stories you have in implementing those measures  
4 in the past, and what time period is sufficient  
5 to allow a DCM's measures to take effect.

6 MR. CALLAHAN: I can comment on some  
7 of the types of incentives that we have in place  
8 right now and that we would consider going  
9 forward to incentivize central limit order  
10 trading activity.

11 Certainly having designated market  
12 maker programs in place, and I would say not just  
13 during U.S. trading hours, but one of the things  
14 we'll been able to do to improve central limit  
15 order book activity is to have those during Asia  
16 or European hours. So you have robust DMM  
17 programs.

18 Certainly adjustments to block trade  
19 thresholds would be another way that you could,  
20 you know, impact central order book trading.

21 Economic incentives, or surcharges  
22 for block trades or discounts for central limit

1 order book trades. You know, some combination of  
2 all of those things I think are important.

3 I think at the same time we also  
4 need to be aware that there are certain trades  
5 that have the potential to be disruptive to a  
6 central limit order book. And we've probably at  
7 various times on our exchange all seen minor  
8 examples of this where sometimes, in a relatively  
9 thin market, you put a really big trade through a  
10 central limit order book, and that can cause  
11 disruptions in and of itself, which could cause  
12 undue volatility.

13 And -- and there are certain trades  
14 that at certain times of the day, when market  
15 conditions are thin, that actually it's less  
16 disruptive to the market to actually have a trade  
17 in a wholesale format. So these are all the  
18 things that need to be balanced, but a  
19 combination of the factors I described are the  
20 things we use to drive activity to a central  
21 limit order book.

22 MR. COSGROVE: Well, I don't have

1 anything to add to that. I'd be interested to  
2 know if anybody else does.

3 MR. FARLEY: Yeah, really, I think  
4 the primary thing you can do is, at the risk of  
5 sounding cavalier, is leave the DCM's alone. And  
6 the reason why I say that is, we are, by nature,  
7 incentivized to have products traded on a central  
8 limit order book.

9 As I was just kind of thinking about  
10 the ICE portfolio, I'd guess, and it's just a  
11 guess, our top 15 products are 90 plus percent  
12 traded in a central limit order book. In other  
13 words, that's where we generate volume. That's  
14 where we make money.

15 Notwithstanding the great success  
16 of ClearPort, when I think of CME, they're big  
17 contracts, they're central limit order book  
18 traded. So there is a natural inclination on  
19 behalf of the DCM's to see those contracts move  
20 in that direction. But it's important to know  
21 note that, you know, you can incent a cat to be a  
22 dog but it will never be a dog.



1           Some contracts will never be central  
2 limit order book trading, and that doesn't make  
3 them a bad thing. And so I'd be careful to say,  
4 hey, given Alberta off-peak power contract, we're  
5 going to go and do a bunch of market making  
6 deals, and we're going to do this, and we're  
7 going to do that, because you could end up  
8 inadvertently querying the market through those  
9 efforts, whereas it serves a perfectly legitimate  
10 purpose, it's just not central order book traded.

11           MS. ZAKIR: And just to follow up on  
12 that, Tom, could you just give us some examples  
13 of what types of programs you've put in place to  
14 increase centralized market trading. I mean, I  
15 understand that maybe products are specific in  
16 some cases, but what are some of those examples?

17           MR. FARLEY: The primary one, in our  
18 case, is good technology, frankly. It's -- it's  
19 having a central limit order book that's very  
20 fast and responsive to customers and has the  
21 order types that customers are looking to add.

22           We've tried many other things, but I

1 can tell you they've all met with varying  
2 success, and the one commonality among our  
3 successful products is that they run on a  
4 technologically sophisticated platform.

5 MR. BRODSKY: Why don't we move on  
6 to the last question for the first panel. And  
7 that is, to what extent do market participants  
8 prefer to clear OTC derivatives through a DCM as  
9 futures contracts as opposed to through a SEF or  
10 a DCM as swaps, and why do markets participants  
11 have these preferences?

12 MR. CALLAHAN: I think my fellow  
13 panelists have covered this pretty well. There's  
14 tax issues, documentation issues, clearing  
15 issues, regulatory uncertainty around SEF rules.  
16 I think all those together probably determine  
17 that preference.

18 MR. DOWNEY: It's our experience  
19 that it comes down to transaction fees. And with  
20 equity swaps, securities lending and equity repo,  
21 they can do that transaction for free without any  
22 regulatory oversight coming down onto exchange

1 that are subject to fees and clearing expenses  
2 that they don't have today.

3 MR. FARLEY: Pardon me. Aaron, was  
4 the question about trading or clearing?

5 MR. BRODSKY: Clearing.

6 MR. FARLEY: Clearing, okay. Yeah,  
7 no. The commission has set up a regime that  
8 greatly favors clearing of futures over swaps.  
9 And without enumerating all the reasons, just to  
10 give you a few that may seem overly technical but  
11 are very important, one is you can use letters of  
12 credit to satisfy margin obligations for futures.

13 While you're unable to do so for  
14 swaps, you can receive 60/40 tax treatment, which  
15 has already been mentioned. It's worth noting  
16 that prior to Dodd-Frank there was some ambiguity  
17 about that. Now there is no such ambiguity.

18 And I think the -- perhaps the  
19 biggest one is the margin requirement which says  
20 that the margin requirements for swaps is kind of  
21 two times plus the margin requirement for  
22 futures. And there are other examples around the

1 margins, but those are -- those are some of the  
2 big ones.

3 MR. HAMILTON: From our customers'  
4 point of view, where they choose which venue --  
5 which venue thing choose to clear, whether it be  
6 the swaps venue and energy advice or the CME  
7 venue for futures, that's not the only terms of  
8 competition. These entities compete on their  
9 price, on the straight-through processing of  
10 technology, what post-trade matching services  
11 they provide. They compete on the quality of the  
12 interday marks. Swaps versus futures is  
13 important. It's not the only thing that they do.

14 In today's environment where there  
15 is some time frame between the -- when customers  
16 are told they're done on the phone or the chat or  
17 however a voice market's done, it may be deemed  
18 that -- understood it was going to clear at one  
19 exchange or the other. If for some reason  
20 someone couldn't clear it at exchange A, the  
21 other counterparty might be okay to switch to B.

22 So it's not an always, everywhere,

1 all the time. It's not -- it's not the only  
2 thing in town. It is -- it is an important  
3 factor, but I think one thing to note is there's  
4 both active markets in both the futures and the  
5 swaps. There's switch markets in between.

6 There's not a normal basis that says  
7 one of those two is more valuable than the other.  
8 It's a day-to-day market -- it's a day-to-day  
9 market. So it's not as if a future is always  
10 more valuable. The price of a similar contract  
11 on a futures exchange isn't different from a  
12 similar contract on the swap exchange.

13 MR. HUMENIK: I think others have  
14 mentioned this, but obviously the regulatory  
15 environment for swaps is still developing so  
16 there's a lot of uncertainty as to what that's  
17 going to look at. Obviously, cost is a  
18 determinative factor.

19 I've pointed out before that, you  
20 know, Eris Exchange believes that the futures  
21 framework provides that, a known regulatory  
22 framework with a lot of advantages. And there

1 are known advantages as well in terms of standard  
2 and straightforward documentation, use of  
3 existing futures post-trade clearing, systems and  
4 infrastructure, the potential to have one day  
5 bar. Real time credit checks on a trading  
6 platform. And also the opportunity to have  
7 traditional bank swaps desk providing liquidity,  
8 as well as additional new liquidity providers.

9 So there's a lot that the futures  
10 market can offer participants, and obviously Eris  
11 Exchange offers those benefits.

12 MR. LA SALA: I think the question's  
13 a bit tough because, as we talk about swaps and  
14 SEF's, some of that just simply doesn't exist  
15 yet. So if I just simply just for a moment  
16 reflect on the future, I think that Tom touched  
17 on a number of the items, including margin and  
18 the like, but I just focus on also margin as it  
19 relates to credits.

20 You know, choices of whether you  
21 want to do -- you know, clear something at a  
22 particular clearinghouse, regardless of whether

1 it's a swap or a future, sometimes becomes a  
2 function of where the mass of someone's book in  
3 fact is. It may be that -- you know, it may be  
4 beneficial to execute a swap to clear it at ICE  
5 versus doing something comparable as a future and  
6 clearing it on NYMEX because the mass of  
7 someone's book is at that other clearing  
8 organization.

9 So I think there are a number of  
10 factors that go into that mix.

11 MS. VED BRAT: You know, BlackRock's  
12 been very supportive of central clearing. The  
13 OTC swap market, it's, you know, it's primarily a  
14 wholesale institutional market.

15 And as we've been going through this  
16 journey on cleared swaps, if you take away, you  
17 know, some of the main characteristics of being  
18 able to customize swaps, being able to transfer  
19 risk immediately as a block to liquidity  
20 providers where they play the role of providing  
21 liquidity to us, and clients are no longer in  
22 control of the market brokerage of day trades and

1 the size of the trades are, you know, reduced,  
2 the swap begins to feel a lot more like a  
3 futures.

4 And, you know, our expectation is  
5 that in the coming months there is going to be an  
6 emergence of many more swap-like contracts or  
7 futures contracts, you know, that will begin to  
8 trade. Especially, you know, if you look at what  
9 would you trade on a SEF club as a swap or, you  
10 know, a DCM futures. They look and feel very  
11 similar.

12 And then, you know, some of the, you  
13 know, characteristics that my fellow panelists  
14 have mentioned, you know, as far as margin  
15 requirements, fee, there is, you know, also a  
16 certain amount of infrastructure and familiarity  
17 already built into the futures framework that I  
18 think will play heavily into a decision of should  
19 we trade futures or should we trade swaps.

20 MR. LA SALA: Can I just add one  
21 last point following what Supurna just mentioned.  
22 Just noting that in those choices that customers



1 have today, I want to be clear that there --  
2 there is a component, I think we might touch on  
3 it in another panel, but there is clearly a  
4 component of an open access or an open  
5 architecture that exists today.

6 I think that some of the -- like,  
7 you know, Mike Cosgrove can speak to the fact,  
8 you know, parties will today go to, you know, is  
9 firm and talk about clearing something, whether  
10 it be NYMEX cleared or ICE cleared, it so happens  
11 that in one instance it's a swap and in one  
12 instance it's a future, but the customers are  
13 making those choices, you know, today.

14 MR. BRODSKY: All right. Well, I  
15 guess that will conclude the first panel so why  
16 don't we take a five-minute break and then we can  
17 resume the second one.

18 MR. SHILTS: Thanks to everyone.

19 (Recess taken.)

20 MR. SHILTS: If everyone wants to  
21 take their seats, we can try to get started with  
22 the second panel.

1                   MR. BRODSKY: Okay. Well, why don't  
2 we get started with the second panel. Why  
3 doesn't everyone just start by introducing  
4 themselves briefly. We have one new panelist but  
5 why don't we start with you and just introduce  
6 yourself.

7                   MR. MACKLE: Scott Mackle with  
8 Constellation Energy and head of power trade.

9                   MR. LA SALA: Again, Tom LaSala, CME  
10 Group.

11                  MR. HAMILTON: Pat Hamilton, CEO of  
12 ICAP Energy.

13                  MR. DOWNEY: David Downey,  
14 OneChicago.

15                  MR. COSGROVE: Michael Cosgrove, GFI  
16 Group.

17                  MR. FARLEY: Apologies. Tom Farley,  
18 ICE.

19                  MR. BRODSKY: Okay. Well, the first  
20 question is a two-part question. How do  
21 companies utilize EDRP's, and what are the  
22 benefits of these transactions. And what are the

1 primary products for which EDRP's are utilized  
2 today.

3 So why don't we start at the end of  
4 the table to my right and we'll just continue the  
5 way we did last panel.

6 MR. MACKLE: Okay. So, I mean,  
7 Constellation is an end-user hedger. We use  
8 EDRP's pretty much in all of the various products  
9 and marks that we trade. You know, across gas,  
10 electricity, you know, oil, you know, coal. You  
11 know, the benefits obviously, you know, the  
12 centralized clearing, you know, centralized  
13 margin, reduced collateral. You know, pretty  
14 much -- I guess that's -- you know, not to go on  
15 too long, but those are the fundamental reasons.

16 Price transparency, liquidity, and  
17 all the reasons that, you know, we've been  
18 talking about here so far today.

19 MR. LA SALA: Thank you. Well, at  
20 CME Group EDRP's are instruments or transaction  
21 types that are used across a host of different  
22 markets. Those would certainly include

1 agricultural markets, equities, treasury markets,  
2 currencies. And, again, their usage, frankly,  
3 varies, depending on, you know, the market.

4 In some cases these are certainly  
5 done in I'll say the traditional EFP, where  
6 you're talking exchange of futures for physicals.  
7 In some cases there's a derivative exposure  
8 that's exchanged.

9 In some of these markets the  
10 transactions are -- I know we'll talk about these  
11 later, some of them, especially the energies, we  
12 do have the transitory or contingent  
13 transactions. In other categories those types of  
14 transactions are expressly prohibited.

15 Again, my other panelists spoke of  
16 some of the reasons why his firm uses them. I'd  
17 agree with all of those. And just further note  
18 that in the end I think this panel is pretty  
19 keenly focused in the energy space.

20 There is, in fact, the mitigation of  
21 counterparty risk through bringing that  
22 transaction in and having a cleared instrument at

1 the end. Thank you.

2 MR. HAMILTON: ICAP's customers use  
3 the EDRP methodologies to access voice markets  
4 where screen liquidity hasn't been available to  
5 them, but because of either no liquidity on  
6 particular contracts or liquidity or the lack of  
7 liquidity in longer dated tenors of more actively  
8 traded contracts.

9 The most -- the primary use for  
10 these products have been in the electricity,  
11 natural gas spaces and refined oil products, with  
12 some further use in agricultural commodities and  
13 coal.

14 This process has benefited these  
15 customers for more than -- for the last 10 years  
16 and ICAP -- ICAP proposes that this venue be  
17 allowed to persist because of the lack of  
18 liquidity in most of the energy markets. We  
19 believe this structure has -- has -- was put in  
20 place primarily for the energy markets.

21 It has -- we don't advocate it being  
22 just generally applied to many -- to all other

1 markets on all other occasions because, number  
2 one, the commission took into -- a deliberative  
3 process to allow this process to take place in  
4 the energy markets because of the particular  
5 liquidity and competition factors in the energy  
6 markets.

7 In order to spread this widely and  
8 beyond the energy markets, we think the  
9 commissions should undertake a similar process  
10 that took into consideration the competitive  
11 factors out of liquidity, various venues.

12 MR. FARLEY: As far as we  
13 understand, EDR -- let me first say, I agree with  
14 what they said and I don't have much to add. I  
15 won't repeat any of the statements of the prior  
16 panelists.

17 Just to add a couple of points.  
18 One, our belief is that our best guess is that  
19 EDRP's have been around for 80 years, if not  
20 longer. In fact, we know they've been around for  
21 80 years, if not longer, and they've -- they've  
22 served -- they've served a good benefit.

1           The second thing I want to add is, I  
2 agree with Pat that they've been particularly  
3 helpful in the commodities world. We at ICE like  
4 to think that we were the prime kind of movers  
5 and innovators in moving energy into a cleared  
6 environment, but -- but we have to acknowledge  
7 that our colleagues at CME, too, were drivers in  
8 moving that business into a cleared world, which  
9 I think we all would agree, coming out of the  
10 Enron bankruptcy and some of the credit crisis  
11 that occurred in that merchant community, wasn't  
12 a very good thing.

13           I also want to highlight that  
14 specifically the short duration or contingent or  
15 transitory EFS that are the norm, specifically at  
16 ClearPort, but elsewhere, serve a very valuable  
17 purpose and the very valuable goal of moving  
18 product into a cleared environment.

19           MR. DOWNEY: Equity participants  
20 have a embedded cost of carry that varies from  
21 the people who trade at Charlie Schwab on a  
22 margin account to a hedge fund that relies on

1 their prime brokers and multiple prime brokers  
2 for financing and leverage.

3 The single stock future pricing  
4 model is simply the stock plus an interest rate  
5 competitively derived that is substantially lower  
6 than even the hedge funds obtain from their prime  
7 brokers.

8 As a preamble to why one would do an  
9 EFP, if they're currently along a stock paying a  
10 relatively high margin rate, they can reduce that  
11 rate by EFP'ing out which is a simultaneous  
12 transaction where they sell their stock and buy  
13 the delta exposure in the future at a  
14 substantially reduced component. It's a  
15 financing game.

16 In a similar way, someone who is  
17 short the stock is subject to varying rebate  
18 rates that vary on a day-to-day basis. They're  
19 also subject to recall where a hedge position  
20 would certainly become unhedged, not because  
21 something that they have done, simply because one  
22 of their brokers have recalled the stock.



1                   This situation could again be  
2                   refinanced by buying stock back in, eliminating  
3                   that short, and simultaneously reestablishing  
4                   that short position with the future, and they  
5                   would be locking in that interest rate and they  
6                   would be locking in that effective loan out till  
7                   time. It's a financing transaction.

8                   In addition, there are many desks,  
9                   they're called delta one desks on the securities  
10                  side. They provide leverage and financing. They  
11                  do not like to take market exposure. They love  
12                  to trade EFP's. They are long stock and they are  
13                  short futures.

14                  They are, in fact, extending money  
15                  on a short-term loan, covered by a legally  
16                  binding agreement which is the single stock  
17                  future. There is no doubt exposure to the  
18                  underlying movements. They can go up and down  
19                  100 points and they don't care because they're  
20                  locked in. But a expiration their future premium  
21                  will decay as profit to them that creates a yield  
22                  for them, so it's all a pure financing

1 transaction. Nothing to do with direction.

2 None of the three that I've just  
3 described have anything to do with taking risk,  
4 has nothing to do with taking a point of view on  
5 the direction of the underlying stock. It has to  
6 do with financing their activity, and that is the  
7 efficiency that I point to in a lot of your  
8 reports is, we should be acting in an efficient  
9 manner. I agree. And that's what the EFP using  
10 security futures does.

11 MR. COSGROVE: In the North American  
12 commodity markets, and energy in particular,  
13 these transactions are used essentially to marry  
14 the best available execution with the best  
15 capital management that is achievable through  
16 clearing.

17 So a customer -- as it has been said  
18 earlier, that the participants in these markets,  
19 at least the market that GFI are involved in, and  
20 I would say that ICAP are involved in, are  
21 professional markets. The users are seeking the  
22 best execution that they can, and they're

1 professionals at achieving this.

2           Once they've got that execution,  
3 then they want the same thing what everybody else  
4 in the room wants. They want to reduce their  
5 exposure to individual credit, individual  
6 counterparties, and they want to achieve -- they  
7 want to maximize their -- the capital that they  
8 have available through margin offsets, and so  
9 they tend to concentrate with a single  
10 clearinghouse where there's portfolio benefits.

11           So I'd say that really this process  
12 allows professional market participants to select  
13 the best execution, and then to -- having  
14 obtained their best execution, to then place  
15 their trade with their preferred clearer to  
16 obtain all of the benefits that Dodd-Frank and  
17 everyone in the room wants the market to attain  
18 in terms of capital efficiency and the reduction  
19 of systemic risk.

20           MS. MARKOWITZ: I have a quick  
21 question for Tom. You had said -- you talked  
22 about contingent or transitory EFS's, and you

1 said they're good because they move a product  
2 into the clearing environment, so they have a  
3 good purpose. Are those necessary post  
4 Dodd-Frank, given the fact there is a clearing  
5 solution on a SEF or just either there is a  
6 clearing solution now for swaps; so is the  
7 contingent EFS's, you know, needed to do this.

8 MR. FARLEY: Yeah. No. That's a  
9 good question, Nancy. Our answer would be yes,  
10 and let me just give you a little bit of context.  
11 Revert back to something I said in the prior  
12 panel. We think there is a need for a set of  
13 final rules and proposed rules that greatly favor  
14 the clearing of futures, and provide greater  
15 certainty to market participants when you clear  
16 as a future.

17 And the contingent or short duration  
18 swaps that are the de facto standard, again in  
19 the ClearPort model and, Tom, I'm talking about  
20 your business, feel free to contradict me if I  
21 get it wrong, they facilitate that. So market  
22 participants are confident entering into that

1 swaps transaction that at the end of the day  
2 they're going to get up with a future which is  
3 something they feel comfortable about, and it has  
4 resulted in this greater good of additional  
5 clearing and in fact clearing as futures.

6 I will highlight, though, Nancy,  
7 because I think it is closely related, that the  
8 act, however, does say that swaps must be  
9 reported to a swaps data repository. Swaps that  
10 are traded count against your swap dealer  
11 designation. And I'm not suggesting that those  
12 would just magically go away with these  
13 contingent EFS.

14 I'm expecting that if somebody  
15 submits a contingent EFS to a DCM, for instance,  
16 to ClearPort, they are in fact saying they have  
17 executed a swap. That's what the S stands for in  
18 EFS. And therefore you should be able to trace  
19 that swap back and see that it was reported to an  
20 SDR, and probably subsequently torn up at the SDR  
21 once the EFS is submitted, and it's going against  
22 the eight billion test for swap dealer

1 designation, et cetera.

2 So a bit of a long answer to your  
3 question. The short answer is yes, we think  
4 they're necessary, but we're not expecting that  
5 it will be completely status quo as it is today.

6 MR. SHILTS: Can I just have a quick  
7 follow-up. And, Tom, you're probably going to  
8 respond too. So you're saying that this EFS  
9 mechanism has benefits and all. But does -- what  
10 is the benefit for having this mechanism with  
11 respect to the DCM as opposed to, say, the DCO?

12 Because I'm trying to understand --  
13 it sounds like the benefit you're saying is  
14 because it brings these products into clearing.  
15 But what -- what advantage is there for going  
16 through the DCM? I mean, particularly for those  
17 where there is no liquidity or there is no  
18 trading?

19 MR. FARLEY: Sure, sure. No, it's  
20 fairly clearcut in my mind. It's that -- it's  
21 what we spoke about in the last panel, without  
22 rehashing it, that you need to nurture new

1 products. Some products will go up to be central  
2 order book, highly liquid futures. Others will  
3 not. But having this mechanism in place allows a  
4 DCM a greater probability, a greater likelihood  
5 of developing, of nurturing, and ultimately  
6 raising, you know, central order book children.  
7 That's a bad metaphor. Carried it too far.

8 MR. LA SALA: I agree with the  
9 points Tom just made, that some of these  
10 instruments can in fact grow in.

11 That stated, I want to speak just a  
12 moment on his commentary about the mechanism and  
13 the usefulness. It's my opinion, our opinion,  
14 when you look at core principle 9, as you're  
15 focused here on questions around contingent EF  
16 EDRP's, I do believe that under B3 there is an  
17 alternative means to in fact potentially bring  
18 the transactions in under the auspices of a DCM  
19 and in fact not use an EDRP, wherein the DCM  
20 clearly seems to have the flexibility to scribe  
21 rules, you know, on its books that would define  
22 the ability and potentially, you know, again

1 limit the type of participants to ECP's as  
2 generally EDRP's are to in fact bring these  
3 positions in as futures from inception. Versus  
4 going --

5 MR. SHILTS: Could I -- I'd just  
6 like to clarify. What position are you talking  
7 about? Because if they're contingent, there's no  
8 position. So what are you -- just so I  
9 understand what you're saying.

10 MR. LA SALA: I'm saying, Rick, as  
11 an alternative to -- to right now you're talking  
12 about the contingent EFRP. You've got a swap and  
13 an offsetting swap that ends up in a future.  
14 There's the contingency that I think you speak  
15 to. But, in fact, the remaining component after  
16 that transaction is in fact a futures transaction  
17 that occurs under the auspices of the DCM.

18 I think the core principle 9 in  
19 section B3 additionally affords another  
20 prospective means to in fact bring the positions  
21 in as futures from inception.

22 MR. VAN WAGNER: Just to ask the



1 overlay, though, which is that -- and this is all  
2 premised that initially there is a swap that is  
3 done. And I understand there's legal uncertainty  
4 now. But, I mean, let's assume two, three years  
5 down the road from now we have a swap that  
6 standardized, subject to clearing, perhaps even  
7 subject to a trade execution mandate.

8 I guess this is both the Toms,  
9 right, are you positing that that swap that will  
10 eventually be the basis of an EFS and result in a  
11 futures contract, are you saying that that swap,  
12 though, is going to be relieved of any kind of  
13 independent trade execution or clearing mandate  
14 because, after all, it eventually, through the  
15 EFS mechanism, it's ending up attributed to a DCM  
16 as a future, attributed to a DCO for clearing  
17 that future?

18 I'm just wondering what -- because,  
19 I mean, obviously, right now there's -- there's  
20 not any kind of requirements around that swap as  
21 a component of ERFs. But looking forward, what  
22 are you envisioning that -- will that swap ever

1 have any independent existence?

2 MR. FARLEY: Yeah. There was a  
3 couple of questions embedded in there. What I  
4 was suggesting and what we are in fact  
5 envisioning is that the swap would not have an  
6 existence -- it would not be cleared, let's put  
7 it that way. And it would either not exist or it  
8 would exist for some infinitesimally small period  
9 of time.

10 However, I'm curious to hear Tom  
11 elaborate. He's gone a slightly different route  
12 saying that what is executed is not executed as a  
13 swap and it therefore independent of SEF rules,  
14 SDR reporting, swap data -- swap data -- getting  
15 caught up in the \$8 billion bucket. I'm not  
16 suggesting that. I'm saying, in fact, because  
17 the market participant is submitting an EFS,  
18 they're saying, look, we executed a swap.

19 The tricky thing here -- it's kind  
20 of mind bending. You say, well, wait. If it  
21 never existed, then what is that thing. The act  
22 contemplates, and historically we've contemplated

1 in the CEA, and CFMA, and Dodd-Frank, a bilateral  
2 swap and a cleared swap. This is a third thing.  
3 It's neither cleared nor bilateral, and it's been  
4 in practice for 10 years, and that's the -- you  
5 know, that's the elephant in the room. And we  
6 see nothing wrong with it but it is a swap, in  
7 point of fact. And therefore we expect it will  
8 be treated as an OTC contract until it is  
9 accepted for clearing as a future.

10 MR. LA SALA: I think that what Tom  
11 first mentioned I would agree with, meaning that  
12 at its inception there's a swap. It will be, as  
13 rules get promulgated, would be subject to  
14 compliance with whatever those finalized rules  
15 were.

16 However, what I proffered, and the  
17 point -- I'm not making this for the first time.  
18 If you folk look back to our comment letter, we  
19 made reference to the use of CP9B3. I'm just  
20 simply positing the notion if, in fact, you know,  
21 contingent EDRP's, you know, were prohibited, I  
22 think there is flexibility still within the

1 statute to allow the DCM to effectuate, you know,  
2 a rule set that would otherwise allow  
3 transactions to be, you know, negotiated, and  
4 this would have to be certainly by registrants,  
5 but they would at inception be futures  
6 transactions that come in through the DCM,  
7 through this rule set.

8 And we haven't -- no one's used  
9 this. You know, I'm not aware of any futures  
10 exchange that's used this. We -- we haven't.  
11 But as we've simply looked at the statute, we see  
12 that flexibility there.

13 MR. SHILTS: And what is the  
14 flexibility for? Because I'm a little -- I don't  
15 remember what B3 says, I'm sorry.

16 MR. LA SALA: What B3 says is a  
17 futures commission merchant acting as a principal  
18 or agent to enter into or confirm the execution  
19 of a contract for the purchase or sale of a  
20 commodity for future delivery, if the contract is  
21 reported, recorded, or cleared in accordance with  
22 the rules of the contract market or derivatives

1 clearing organization.

2           It seems to me, seems to us, that in  
3 the context of this statute, there was some  
4 flexibility there that would allow the DCM to, in  
5 fact, assuming, again, natural progression here,  
6 is that the client certainly has a relationship  
7 with an FCM, to in fact allow a DCM to construct  
8 a rule set that would govern how such  
9 transactions would come in.

10           You'd certainly have, as the statute  
11 says, reporting, recording, so let's call it  
12 prompt or contemporaneous reporting of the price,  
13 which is something you don't get today via the  
14 EDRP. So there -- you know, there's -- I'm  
15 simply noting that as we read the statute, there  
16 is an alternative to the EDRP route that seems to  
17 be available in the -- the statute as it exists  
18 today.

19           MR. SHILTS: So just -- just so I  
20 understand, so you're saying that could develop  
21 another mechanism for bringing whatever  
22 transactions into clearing and not going through,

1 say, an EFS type mechanism? I think as Tom  
2 Farley was saying, if you're using an EFS  
3 mechanism there's a presumption that there's an  
4 S, the bona fide swap. Otherwise it, you  
5 know . . .

6 MR. LA SALA: I'm not disagreeing  
7 with Tom Farley's, you know, point on -- if it  
8 was, you know, an EFS, for example. I'm just  
9 simply positing that there seems to be,  
10 contemplating the statute, the latitude for an  
11 alternative.

12 However, that alternative would have  
13 incumbent upon it additional criteria. That  
14 being -- one of those key criteria being, you  
15 know, I'll say, contemporaneous or a prompt price  
16 report to the marketplace, which is something  
17 that, with regard to EDRP transactions, does not  
18 occur today.

19 MR. FARLEY: And for the importance  
20 of that, I'm not disagree with what Tom's  
21 describe. I'm just simply saying, as Rick  
22 articulated, if you're accepting an EFS, that

1 thing, the swap, should be subject to the swaps  
2 rules. But I'm not agreeing with CME. I would  
3 never do that. You guys are too powerful.

4 MR. LA SALA: And I would agree with  
5 that also.

6 MR. BRODSKY: One of the regulatory  
7 differences between futures and swaps is that a  
8 DCO is required to provide nondiscriminatory open  
9 access for clearing swaps but is not required to  
10 do so for futures.

11 What are the implications of core  
12 principle 9 and the related EFS transaction  
13 issues that we've been discussing on  
14 nondiscriminatory open access.

15 Maybe start with Mr. Mackle.

16 MR. MACKLE: You know, maybe just --  
17 maybe some be better answered by the folks from  
18 the exchanges, I would think. From our  
19 perspective, and again looking into those  
20 differences between, you know, the open access  
21 rules between the swaps and the futures  
22 exchanges, that's not something that, you know,

1 us at Constellation or other end users or market  
2 participants I think, you know, spend a lot of  
3 time thinking about.

4 You know, obviously it's in -- it's  
5 in every respect of exchanges to conduct their,  
6 you know, businesses and practices in such a  
7 manner to, you know, draw business to their  
8 exchange, respective exchanges.

9 So, you know, to the extent that,  
10 you know, the rules aren't technically the same,  
11 you know, I don't know -- you know, again, that's  
12 not something, you know, I guess that's an  
13 embedded risk in the business, you know, as we're  
14 doing it if we're clearing, you know, futures  
15 versus swaps. But that's not -- you know,  
16 practically speaking, I don't -- I can't think of  
17 an example where that's been an issue.

18 Obviously, as a result of core  
19 principle 9, if you've got sort of stranded  
20 futures that you've got to liquidate, you know,  
21 there's -- depending on the rules that are  
22 surrounding that, if it were to come to that,



1 that would be a consideration to -- to take into  
2 mind. But in terms of currently how -- you know,  
3 how we view -- you know, do we direct business or  
4 consider, you know, that difference in stature,  
5 you know, as we're conducting business, you know,  
6 the answer is no.

7           Again, how that would -- how that  
8 would -- the implications for, you know, changing  
9 the rules around, you know, EFS -- clearing EFS's  
10 as futures, you know, obviously, the commission  
11 would have to give serious thought to -- you  
12 know, to what would happen to again the -- the  
13 stranded futures and what would happen to market  
14 liquidity, you know, I think was brought up in  
15 the previous panel.

16           MR. LA SALA: I actually mentioned  
17 in the previous panel, so I'm repeating myself a  
18 bit. I do think that, while I note that the  
19 paradigm you talked about, DCM, core principle 9  
20 versus what's at least proposed for swap  
21 execution facilities, the paradigms are  
22 different.

1           There clearly is a articulated open  
2 access component with regard to the swaps. That  
3 stated, and I go back to what I stated in the  
4 prior panel, I think that open access or open  
5 architecture with regard to customer choice,  
6 frankly, has -- exists today, and has existed for  
7 the last decade, by virtue of the fact that the  
8 principal parties to transactions in this -- in  
9 whatever space we're talking about, I'm making  
10 this very energy centric, because I think that's  
11 where much of the focus is being applied here, I  
12 think that, you know, there are some folks on  
13 this panel that will speak to the fact that, you  
14 know, open access has occurred, because parties  
15 are openly and readily choosing every single day  
16 whether they want the instrument to clear NYMEX  
17 or clear ICE. In one instance it goes in as a  
18 cleared swap. Another instance it goes in as a  
19 clear future.

20           So while I see the difference in --  
21 in the paradigms, I think that you have today,  
22 and you would have, in many regards tomorrow,

1 that open access. I further note that on the DCO  
2 side, if in fact CME Group were offering futures  
3 through its DCM, I'm quite confident that if  
4 there are, you know, similar swap-type  
5 instruments that parties want to clear at CME  
6 Group, we're certainly going to be interested in  
7 clearing those instruments on the DCO.

8 MR. HAMILTON: We believe that the  
9 open -- if a DCM wants to avail itself of a  
10 more -- a broader EF -- broader EFS to futures  
11 model, that they need to comply with the open  
12 access rules as if it was a swap. That the idea  
13 that they could have the ability to, say, close  
14 the window to the swap model doesn't make any  
15 sense.

16 And in the long run it wouldn't make  
17 any sense economically for them either. If they  
18 want this product and they've allowed it in the  
19 past, they're going to continue to allow it. And  
20 just as a mechanism, obviously, in the language  
21 of the day, to speak of the ClearPort model,  
22 those probably wouldn't be something that you

1 would have approved today, but it exists, it's  
2 been in existence for 10 years, it's used quite a  
3 bit. We've -- we have cleared 50,000 trades this  
4 year with 400 different counterparties.

5 The idea that a certain exchange  
6 would want to close that off at some point  
7 doesn't make a lot of sense. I think it should  
8 be memorialized in a way that said, if they want  
9 to avail themselves of that process, then they  
10 should treat that swap to the futures process as  
11 a swap when it comes in because it's a swap to  
12 begin with.

13 MR. FARLEY: I agree with Tom's  
14 comments. Again, I don't have anything further  
15 to add.

16 MR. DOWNEY: Not to wade too deep  
17 into fungibility, but I don't think swaps,  
18 bilateral swaps need to be fungible. I think  
19 that the two parties are either going to want to  
20 carry the position together or exit the positions  
21 together. And I'm not quite sure -- this is my  
22 ignorance, I'm not quite sure how far THE

1 innovation process begins, but if they're trying  
2 to capture some of these bilateral swaps, I don't  
3 think fungibility is necessary.

4 MR. COSGROVE: Well, I think --  
5 well, I think this is kind of a nuclear issue,  
6 actually, because we have -- the two incumbent  
7 clearinghouses in North American energy must be  
8 earning -- I mean, it's all public information,  
9 it's going to eight, \$900 million a year, and  
10 clearly fungibility between clearinghouses would  
11 allow, you know, for some competition to enter  
12 the space.

13 Right now it's kind of siloed. And,  
14 you know, the chairman has used the -- has sort  
15 of referred humorously to fungibility as the F  
16 word in Chicago. And I think that really -- you  
17 know, this is a big issue.

18 Notwithstanding that, I think, you  
19 know, our -- GFI's position is that, you know,  
20 when taken as a package overall, we think the  
21 85/15 rule is -- is not helpful. But on this  
22 particular issue of competition, the requirement

1 for a clearinghouse to provide unaffiliated  
2 execution facilities with impartial access is  
3 something that would introduce a tremendous  
4 amount of competition.

5 It would be -- it would be harmful,  
6 possibly very harmful or possibly just a bit  
7 harmful, to ICE's clearing business and CME's  
8 clearing business, and it would create  
9 competition in the market where I think the  
10 perspective for competition in that regard is --  
11 is weak at the moment. It doesn't mean that it's  
12 the right thing to do or the wrong thing to do,  
13 but I think that's simply a fact.

14 I would echo some of the statements  
15 that Pat made a few minutes ago. But I would  
16 point out that the lack of impartial access does  
17 exist today, and I'll provide one specific  
18 example. And I don't mean to pick on ICE, ICE is  
19 a great business. I've often said it's the best  
20 managed business in the energy space, but ICE  
21 refuses to provide unaffiliated execution  
22 facilities with the same connection to the

1 clearinghouse.

2           So in our case, for example, we're  
3 required to type in manually a transaction that's  
4 going to go to ICE for clearing. Whereas, with  
5 CME, we've had an electronic connection for  
6 post-trade API for years and years.

7           So in the case of -- in the case of  
8 CME, it's very easy for our brokers to broker a  
9 transaction, enter the transaction once into  
10 GFI's trade capture facility, and then have that  
11 transaction populate all of the various databases  
12 and models and so forth both internally at the  
13 clearinghouse and at the customer's location.

14           Whereas with ICE, we literally have  
15 to employ people to sit there and type the  
16 trade into a web interface, and there's no  
17 technological reason why that needs to be done.  
18 That's purely done to make our execution facility  
19 less competitive relative to ICE's affiliated  
20 facility.

21           Now, again, I would do the same  
22 thing, if I were running ICE. And I don't mean

1 to say that these are evil guys doing bad things.  
2 They're smart guys doing smart things, but this  
3 is a fact. And this impartial access issue is  
4 something that, you know, we find troubling.  
5 But, frankly, in the scheme of things, if we had  
6 to opine one or another on the 85/15 rule,  
7 knowing that we were going to be precluded from  
8 having the open access that we'd hoped to obtain  
9 we would forego that in an effort to do away with  
10 this particular issue in favor of the overall  
11 health of the markets that we think this -- this  
12 would create.

13 MR. FARLEY: I just wanted to  
14 respond specifically to the -- to the comments  
15 Mike had about ICE. I don't -- and he referred  
16 to it as this is a fact. I disagree with his  
17 categorization of the facts. I don't think it's  
18 necessarily apropos of this hearing. But just to  
19 be specific, the OTC markets that Mike's  
20 referring to are markets that are eligible to  
21 ECP's, ECE's.

22 These are very -- these are very



1 sophisticated market and they tend to be illiquid  
2 markets, as I think Mike would acknowledge,  
3 particular those that his -- that GFI or even  
4 ICAP for that matter, the markets where their  
5 brokers are entering trades, and they also tend  
6 to be fairly few in number. And, in fact, in  
7 many of those markets ICAP and GFI, they are our  
8 distribution source and, in fact, 100 percent of  
9 the trades can come from -- from these parties  
10 and zero from our own platform.

11 So the idea that we're intentionally  
12 disadvantaging them in those markets where we  
13 have a zero percent market share and potentially  
14 no hope of having central limit order book  
15 trading doesn't pass the sniff test. And further  
16 I just want to point out, as Mike acknowledges,  
17 we provide access to every broker and we do it in  
18 an impartial way. In other words, we don't say,  
19 hey, Pat, you know, you can have a straight  
20 through processing via an API and, Mike, you can  
21 tab it in by hand.

22 MR. COSGROVE: Just one final

1 comment.

2 MR. DOWNEY: I'll back up here.

3 MR. COSGROVE: Sorry. I do have --  
4 I do have a lot of respect for these guys but I  
5 don't understand why there's not an electronic  
6 connection. CME's given it to us for ten years  
7 and ICE hasn't. And this isn't a court of law  
8 where I'm coming to make a case for you guys just  
9 to tell Tom to give us this access. But it is a  
10 fact that we don't have it.

11 And it is, I don't think defensible  
12 that it's technologically impossible to provide  
13 that. It does create an impediment and an  
14 additional cost of business, and an additional  
15 steps where errors can be introduced as a result  
16 of having to key a transaction in twice. And so  
17 I do see no other explanation for this, if it's  
18 not technical, that it can't be provided.

19 Again, I'm not coming to plead for  
20 you to require this to be done, but merely to  
21 point out that it is a commercial issue that we  
22 have -- that does exist.

1 MR. DOWNEY: Not to get in the way  
2 here, but it is a commercial issue. And if he  
3 doesn't want to expend the money or he has other  
4 things that he can build that he thinks is going  
5 to be better for his business, he has that right.

6 MR. COSGROVE: Indeed, he does. But  
7 since we're asked specifically about the question  
8 of, you know, how the impact of impartial access  
9 is for unaffiliated facilities, I felt that  
10 providing a specific example that does have  
11 impact in our world would be beneficial. But,  
12 yes, it is.

13 And again, I -- you know, I don't  
14 mean to throw a lot of mud and then at the end  
15 say, but I love you. I do have a lot of respect  
16 for this organization. They are -- they do a  
17 tremendous job, and if I was in their position,  
18 I'd be doing the same thing. But you've asked  
19 the question and I have answered.

20 MR. RADHAKRISHNAN: So how about  
21 this, the statute says that the rules of a DCO  
22 shall provide for nondiscriminatory clearing of a

1 swap executed bilaterally or on or through the  
2 rules of an unaffiliated DCM or a SEF. You're  
3 neither a DCM or a SEF, but what means whatever  
4 is executed on GFI is executed bilaterally.

5 How about the two of you guys come  
6 and see me, and you can both make your case as to  
7 why you think they are discriminating. Fair  
8 enough? Unless you don't want to.

9 MR. COSGROVE: No. I'd be happy to  
10 do that. I didn't -- you know, I came to respond  
11 to the questions that were asked, not to seek  
12 redress of --

13 MR. RADHAKRISHNAN: I'd like to come  
14 to -- unless you guys can sort it out in the next  
15 five minutes.

16 MR. COSGROVE: Well, no. I think,  
17 as David said, we don't have to sort it out.  
18 They have, in the same way that, you know, none  
19 of the DCO's clearing futures are under any  
20 obligation to provide unaffiliated execution  
21 facilities with impartial access, at the moment  
22 none of the swap clearing facilities are either.

1 If we come and say, give us impartial access,  
2 again, let me reverse the roles. Let me say I'm  
3 sitting here and someone says, give me impartial  
4 access. I would say, on what basis do I have to  
5 give this to you. Well, because the statute says  
6 that you have to give it to SEF's. Are you a  
7 SEF? Well, no because I haven't -- there aren't  
8 any yet.

9 MR. RADHAKRISHNAN: It says,  
10 executed bilaterally or on or through an  
11 unaffiliated DCM or SEF. So there's that  
12 additional language. It says nondiscriminatory  
13 clearing of a swapped execute bilaterally or on  
14 or through the rules of an unaffiliated DCM or  
15 SEF. So the way I see it, you're neither a DCM  
16 or a SEF, so whatever's executed right now on  
17 your platform is a bilateral execution. That's  
18 how I look at it.

19 MR. COSGROVE: True.

20 MR. RADHAKRISHNAN: So the statute  
21 says that the DCO cannot discriminate,  
22 irrespective of the execution.

1 MR. COSGROVE: Okay.

2 MR. RADHAKRISHNAN: I'm trying to  
3 help you out.

4 MR. COSGROVE: I'm happy to come by.

5 MR. RADHAKRISHNAN: Okay.

6 MR. BRODSKY: We talked a bit  
7 briefly earlier in the panel on contingent  
8 transactions. Are there any additional thoughts  
9 of the benefits and costs of a prohibition on  
10 these contingent EDRP transactions?

11 MS. MARKOWITZ: And specifically, I  
12 can't -- I'm trying to wrap my head around this,  
13 and it may be repetitious, but if we are in  
14 agreement that the S has to be legitimate, which  
15 is executed, how likely is it and beneficial that  
16 you're still going to then take an execute swap  
17 and EFS it to become a future and clear it as a  
18 future?

19 MR. FARLEY: We're expecting that's  
20 exactly what's going to happen. In other words,  
21 SEF's will offer contingent swaps for trading,  
22 and market participants will execute contingent

1 swaps on a SEF which will immediately be cleared.

2 And I also want to highlight or I  
3 want to also answer Aaron's question and say, our  
4 expectation is if contingent swaps for some  
5 reason were no longer allowed, that would be very  
6 disruptive. Because the way this market works,  
7 and Pat and Mike can tell you more about it, but  
8 Pat and Mike are out putting together  
9 counterparty.

10 In many cases, those counterparties  
11 may be anonymous to one another. The trade is  
12 put together and the reason why they're  
13 comfortable stepping into that swap trade is  
14 because they are know the contingent nature and  
15 it's going to immediately be cleared as a future.

16 And so to say, hey, these contingent  
17 swaps, which have served a good purpose for ten  
18 years, we're going to decide these are no longer  
19 permitted would be, in our view, disruptive.

20 Again, I just want to reiterate  
21 something I said previously. The expectation  
22 would be the swap is executed and we would argue

1 that, if we can, I know this isn't about the SEF  
2 rules, but if we can preserve the current  
3 execution infrastructure to help out the business  
4 models of the ICAP's and GFI's, that would be a  
5 good thing. In other words, make the execution  
6 very flexible on a SEF. But then there would be  
7 swap data repository reporting. It would count  
8 against the swap dealer. A billion, not to --  
9 not to repeat myself. That's how we see this  
10 fitting together.

11 MS. MARKOWITZ: Well, what's the  
12 contingent, then? So if you don't clear it as a  
13 future, you unwind the swap?

14 MR. FARLEY: That's right. That's  
15 right. Because otherwise if it were rejected for  
16 clearing, you could argue you have an illegal  
17 swap at that point. So, yeah, it's a contingent  
18 swap and if it's not immediately accepted for  
19 clearing as a future, it's torn up.

20 MR. VAN WAGNER: Just to clarify, I  
21 mean, you're speaking about SDR reporting. Are  
22 you also envisioning that this underlying swap is



1 subject to a trade execution mandate? Are you  
2 envisioning that that -- there would be some sort  
3 of pre-execution -- well, that you'd be executing  
4 it actually on the SEF?

5 MR. FARLEY: Well, yes. And I --  
6 and I acknowledge that I've said that. But I'm  
7 being fairly prescriptive. I guess I could ask  
8 the question to you. I mean, what are you  
9 envisioning and how do you -- how do you see it  
10 working?

11 MR. VAN WAGNER: Yeah, I don't know.  
12 Because obviously we're fleshing out what the SEF  
13 rules look like. But as it's been described, as  
14 the elephant in the room, of course, is  
15 ClearPort. And conceded that there's been a  
16 ten-year history of it. But there's an overlay  
17 now which is slightly different, and that is pre  
18 Dodd-Frank, I mean, swaps were not cleared.  
19 Swaps were not traded on a trading venue.

20 Now there's -- you know, Congress  
21 has given us a charge about swaps; that to the  
22 extent standardized and cleared, they should be

1 done on a SEF, on a trade execution facility of  
2 some sort or another, and there's things that  
3 flow from that, realtime reporting. You know,  
4 pretrade transparency, et cetera.

5 And, you know, query -- I'm trying  
6 to envision what you're talking about here. What  
7 the overlay is going forward. Are those  
8 things -- are we going to be able to see those  
9 things on a SEF.

10 MR. FARLEY: Right. And I could  
11 give -- again, I could give a prescriptive answer  
12 or I could just -- I could just tell you, here  
13 are the questions we asked, and we came up with  
14 potential answers.

15 But the questions are, are  
16 contingent swaps going to be allowed. We think  
17 that they should be. Will contingent swaps be  
18 required to be traded on a SEF. Will contingent  
19 swaps be offered by a SEF. Will a contingent  
20 swap that's executed have to be reported to an  
21 SDR. Will contingent EFS be allowed.

22 Once contingent EFS is accepted,

1 will the swap have to be closed at the SDR; in  
2 other words, an offsetting trade submitted. Will  
3 the contingent swap executed on the SEF count  
4 towards the swap dealer definition. Will the  
5 future that ultimately clears be subject to this  
6 swaps part 20 large trader reporting or  
7 presumably futures large trader reporting. And  
8 at long as we get all those answered before we  
9 leave today, we should be set.

10 MR. SHILTS: But those are the  
11 elements of what would -- that we're looking at  
12 that would constitute determination as to whether  
13 the S, the swap, is legitimate and whether it's a  
14 bona fide EFS. So that's all of the things that  
15 we talked about, the real time reporting,  
16 reporting to the SDR, being subject to a trading  
17 mandate, whatever, would go into, presumably, a  
18 determination of whether that is a bona fide swap  
19 and hence a bona fide EFS.

20 MR. FARLEY: And my last comment,  
21 because I'm at risk of monopolizing the time on  
22 the panel, that's why our prescriptive, the

1 scenario we came up involves the executed  
2 contingent, swap on a SEF. Again, hopeful it's  
3 easy to execute. And, you know, voice is a  
4 mechanism to be able to do that. And then you  
5 have to report to an SDR.

6 You -- it does count against swap  
7 dealer, and you're actually reporting twice to  
8 the SDR, once when you open it, once when you  
9 submit the EFS, and ultimately it's cleared as a  
10 future on the DCO.

11 MR. LA SALA: If I could just maybe  
12 another question or note on an item that I'm not  
13 sure. That being, I'm not sure if in fact the  
14 swap that might be, I'll say, offered, if it's a  
15 swap that's mandated for clearing and trading,  
16 I'm not quite sure if in fact it's going to be  
17 appropriate to somehow switch its identity from a  
18 swap to a future.

19 I think those might just simply have  
20 to go in pipeline straight as swaps; whereas, the  
21 contingency may be more applicable to  
22 instrument -- swap instruments that are not

1 clearing and trading mandated. I don't know.  
2 I'm noting it as a -- as a question.

3 MR. VAN WAGNER: I guess I'm -- why  
4 are you troubled? I mean, don't you have that  
5 situation now with ClearPort and EFS's? I mean,  
6 the --

7 MR. LA SALA: I'm not sure if I  
8 understand your question.

9 MR. VAN WAGNER: I thought you were  
10 positing a situation where it's actually somehow  
11 difficult to convert a swap into a future.

12 MR. LA SALA: No. I'm not saying  
13 it's difficult. I think what Tom was stating is,  
14 he was making the case, and I think in a fine  
15 fashion for, you know, contingent, you know,  
16 could be still allowed.

17 And my -- my comment would say,  
18 yeah, with the caveat that I'm not quite sure --  
19 I'm just not quite sure if in fact that -- if the  
20 instrument was at its inception a swap that was a  
21 trading and clearing mandated if in that scenario  
22 it just didn't pipe straight in, if you still had

1 the ability to almost say redirect it. I'm not  
2 sure.

3 MR. SHILTS: Redirect it for  
4 clearing as a future?

5 MR. LA SALA: Correct.

6 MR. RADHAKRISHNAN: Because there's  
7 account implications. The commission determines  
8 that a particular swap, say, an energy swap, has  
9 to be cleared. At the customer level, it has to  
10 be cleared in the cleared swaps account because  
11 it is a swap, not a futures contract.

12 And let's say the next step is it's  
13 made available for trading on the SEF or a DCM.  
14 It is a swap, right. It is not a futures  
15 contract. So if you want to convert it to a  
16 futures contract, the question is, do you have to  
17 get out of the swap and restable a futures  
18 contract or is there some other kind of mechanism  
19 that, you know, could -- that you could exchange  
20 a position in a cleared swap for a position in a  
21 cleared futures contract.

22 MR. SHILTS: And Tom, I'm just --

1                   MR. HAMILTON: I just wanted to  
2 follow up about the contingent -- well, two  
3 things. One, that does it need to continue to  
4 exist. And we would say yes, because there is  
5 most certainly a cost of the change from where  
6 they exist today to where it doesn't exist.

7                   That market participants have found  
8 the ways that are most efficient for them to  
9 execute, be it voice, on a screen, sometimes on a  
10 screen, sometimes on a voice, depending on how  
11 they need to do it. So we think there would be a  
12 very large cost.

13                   The second thing is, I want to talk  
14 about the contingent nature. While it's a  
15 troubling word in this context, how -- it's  
16 contingent, oh, my goodness, how awful is that  
17 going to be. The actual nature of the  
18 contingent -- contingency isn't that great.

19                   Again, we've emphasized that these  
20 are professional market participants. They come  
21 to professional venues where -- where  
22 transactions take effect. The actual amount of

1 trade breaks that happen are very, very low.

2 On a centralized -- you know, in the  
3 pit, trades break. On a block trade sometimes  
4 trades break. And in these venues sometimes  
5 trade break. But the amount -- the number of  
6 trades breaking is very low.

7 The difficulty is going to be in --  
8 even in decreasing that number with respect to  
9 the SEF rules and making sure that pretrade  
10 execution certainty. You know, execution  
11 certainty of 100 percent is much different than  
12 we're well over 99 percent. I would assume  
13 Michael will back this up. There's not a lot of  
14 these trades that break.

15 So I just want to make it clear that  
16 this isn't something all day long trades are  
17 breaking, for ICAP single digits for the whole  
18 year, and we're talking about 100 -- you know,  
19 more than 100,000 clearing events.

20 MR. COSGROVE: Yeah, that's our  
21 experience also.

22 MR. SHILTS: Could I just follow up



1 on a question, Tom, on your comments before. And  
2 I know you said you hadn't -- this was just an  
3 idea you had. But if there was to be a DCM to  
4 generate another provision for bringing trades to  
5 the -- for clearing through the DCM, not through  
6 the EFS mechanism, where that would be done  
7 directly, presumably the trade would then be --  
8 the product would be a future that would be done  
9 off market and then brought on.

10 MR. LA SALA: Correct.

11 MR. SHILTS: But if that product,  
12 say, essentially is identical to, you know, a  
13 swap, which many of them are, maybe previously  
14 they'd been done as an EFS, then doesn't that  
15 create a way just to completely circumvent all of  
16 the pretrade transparency provisions for  
17 Dodd-Frank?

18 I mean, because there wouldn't be --  
19 from what you're saying, there wouldn't be any  
20 obligation for a centralized trading on the DCM  
21 as the future, and then there would be no way to  
22 have a trading mandate on the swap because it

1 would never be a swap? So I'm just -- maybe I'm  
2 missing what you were saying.

3 MR. LA SALA: No, Rick. I think,  
4 like I stated in the earlier panel, I think that  
5 the pretrade -- I see your point. I get it. But  
6 I think that the pretrade provision, you know, as  
7 contemplate in Dodd-Frank, was clearly  
8 articulated or contemplated. Not a requirement  
9 but I think a goal was focused on swaps. That  
10 wasn't, you know, for futures.

11 I'm simply looking at what I read,  
12 and we may have differing opinion on the reading  
13 of the statute. I'm just simply looking at the  
14 statute and saying, it does appear that this  
15 flexibility exists.

16 I completely understand how you  
17 would say, well, I see that there could be a  
18 conflict, you know, between the two. And maybe a  
19 fair observation.

20 MR. SHILTS: Is the implication from  
21 what you're saying is that there's a higher  
22 standard for pretrade transparency on SEF's and

1 swaps than there is for DCM's and futures? Which  
2 seems odd but, I mean . . .

3 MR. LA SALA: In the context of  
4 Dodd-Frank, pretrade price transparency was, you  
5 know, focused on swaps. I didn't see anything  
6 that made a mandate for pretrade price  
7 transparency for futures.

8 MR. SHILTS: Unless it were viewed  
9 as part of the core principle 9 amendment.

10 MR. VAN WAGNER: Well, unless you  
11 also take the position that DCM at bottom is  
12 supposed be a trading facility, which is a fairly  
13 robust definition of many people being able to,  
14 you know, see and trade with many other people.  
15 And perhaps that obviated the need for talking  
16 explicitly about pretrade transparency, but  
17 that's at heart what a DCM is supposed to be.  
18 We're just throwing out possible explanations.

19 MR. LA SALA: Sure, David. But, I  
20 mean, stated again earlier, you've got DCM's that  
21 are offering these arenas. And if the  
22 marketplace doesn't, for whatever reason, choose

1 to use that arena, it does seem that -- again,  
2 the statute certainly seems to provide other  
3 means.

4 MR. FARLEY: Can I just make one  
5 quick comment. You know, I get the sense from  
6 the reaction that the view is, you know, Tom's  
7 making somewhat of a radical comment. I think  
8 his comment was really only radical going back to  
9 the early part of the last century before there  
10 were any form of noncompetitive trades. And then  
11 there were EFP's, and then there were EFS, and  
12 then there were EOO's, and then there were  
13 blocks, and then there were transitory EFP's, and  
14 then there were contingent EFS.

15 And I think what Tom is smartly  
16 suggesting is maybe there's another in that  
17 evolution. And it goes back to what we talked  
18 about in the last panel, just because you allowed  
19 this -- and it actually goes to Mike's expansion  
20 of the trading pit idea to the voice community.  
21 Just because you allowed some futures execution  
22 in the voice and instant messenger ether doesn't

1 mean that all of a sudden a given market would go  
2 wholly in that direction.

3 So I'm reacting on the fly to Tom's  
4 comment, but just pointing to kind of the logical  
5 continuation of existing evolution in the market.

6 MS. MARKOWITZ: I have a quick  
7 question for Tom. Currently in the energy space,  
8 what percentage of the trading is financial to  
9 financial versus end user?

10 MR. LA SALA: I'm sorry, would you  
11 repeat the question, Nancy.

12 MS. MARKOWITZ: In -- for ClearPort  
13 trading, what percentage of the trading is end  
14 user versus financial to financial?

15 MR. LA SALA: I'm not sure. You're  
16 talking about principles to the transactions?

17 MS. MARKOWITZ: I'm sorry?

18 MR. LA SALA: Principals to the  
19 transactions?

20 MS. MARKOWITZ: Yes.

21 MR. LA SALA: We've certainly have  
22 got fair participation by end users and

1 financials. I would be guessing. I don't want  
2 to. I could follow up with you afterwards on  
3 percentages.

4 MS. MARKOWITZ: Okay.

5 MR. BRODSKY: Thanks everyone for  
6 participating in the panel. Why don't we take a  
7 five-minute break again and we'll resume with the  
8 third panel.

9 (Recess taken.)

10 MR. SHILTS: If everyone can take  
11 their seats so we can get started and end this.

12 MR. BRODSKY: Okay. Well, thanks to  
13 everyone for coming back for the third panel.  
14 This one should be a bit shorter than the first  
15 two.

16 What are the challenges of reporting  
17 block trades to a DCM within five minutes of  
18 execution, and what are the benefits of such a  
19 requirement?

20 Start with Mr. Downey.

21 MR. DOWNEY: The -- one, the DCM  
22 could provide cumbersome reporting mechanisms

1 that they have to keypunch in, subject to error  
2 rates that would have to be corrected.

3 Two, some of these trades that are  
4 designed to be reported as block sizes, and I'll  
5 give an example because I'm in discussion with  
6 the commission now on it, as an example, we have  
7 large CTA's who would like to take delta exposure  
8 in futures. Those large positions are -- no one  
9 wants to give them a market on them, so they go  
10 to the delta one trade desk on the securities  
11 side, crossing the divide between the futures and  
12 the securities.

13 The discussions take place as to  
14 what in fact is -- what the basis of the  
15 transaction they would like. They're going to  
16 allow those delta one desks to prehedge and  
17 attach a basis to the view op price of the hedge.

18 And so, as I brought to the  
19 commission's attention, in the middle of this  
20 view op'ing, enough goes on where they say, okay,  
21 now we've done a one-lot single stock future, but  
22 it's not large enough to be reported as a block

1 size transaction, so they're waiting to report  
2 until they get all those executions done. That  
3 accumulates up so it would be a block size.

4 Now, there are times when those  
5 discussions are, I can only do it up to a certain  
6 level. If the marketplace rises above that  
7 level, then the view op stops. And now we're in  
8 this odd limbo where the view op has produced a  
9 certain number of these single stock futures  
10 transactions, unreportable, but they can no  
11 longer do any more view ops because the price  
12 level has risen. So they don't report these  
13 blocks to us, and they should.

14 So we have two rules. One that  
15 says, you must report without delay. And the  
16 other one is, you have to report to only 100 lots  
17 or more. Now, the problem is -- and this limbo  
18 state only occurs when the hedge has produced a  
19 profit, right.

20 So the delta desk have gone in,  
21 they've bought the stock because they're going to  
22 sell the future. Now, they've bought the stock



1 up to a limit, the stock has rallied, they can't  
2 buy any more, but they have a built-in profit on  
3 the stock side, right. Now, they can't report  
4 because my rules say they can't, because it  
5 doesn't meet block trading requirements. But  
6 they have this profit built in.

7           The customer on the futures side  
8 knows he has a profit built in. So now they have  
9 an incentive to say, we can't violate the rules  
10 of OneChicago. So why don't you just sell your  
11 stock and we split the profits. I don't want  
12 that to happen. They agreed that there was going  
13 to be a transaction. So this butts up against  
14 block trading sizes and there are certain -- we  
15 trade 1900 different names. They range from 20  
16 cents to over \$900, all right. So a 100-lot in a  
17 20-cent wide, I think liquidity is pretty good.  
18 But a 100 lot which is 10,000 shares of Apple,  
19 they're not always easy to get off.

20           And so we believe that we have a  
21 very unique product, and I think that it would be  
22 useful to at least examine that one size does not

1 fit all. And we have put forth that but we came  
2 to the decision that block size transactions need  
3 to be reported without delay, and if there is  
4 these problems that force them to hesitate, how  
5 do we address them reasonably.

6 And I think we can address them by  
7 bringing down those block size levels on not an  
8 individual name level, but in bands, maybe three  
9 to five bands, that are reviewable from time to  
10 time that encourages the marketplace to abide by  
11 the rules and report without delay. They can do  
12 that but sometimes our rules get in the way.

13 MR. FARLEY: We -- I'm going to come  
14 at it from a slightly different perspective than  
15 David did, which is really just the logistical  
16 challenges in reporting block trades, which is  
17 the issue or the set of issues that we've had to  
18 deal with.

19 So we, speaking from past experience  
20 at ICE Futures US, we had a block trading  
21 reporting requirement of five minutes. And what  
22 we found was that we were fairly consistently

1 getting late reporting, and then we'd go and we'd  
2 find market participants and, you know, it was  
3 kind of building ill will with those guys because  
4 what they were saying back is, hey, we can't --  
5 we just can't do it in that time period.

6           And when we dug deeper, it was  
7 really with complex trades. So if you're doing  
8 butterfly or you're doing something that has  
9 three legs or four legs and you want to make sure  
10 that you have all the strike prices right and you  
11 don't want to ten-key in a mistake, so we now  
12 have a requirement that's five minutes for all  
13 trades, other than those which are multilegged,  
14 in which case we bump it up to 10 minutes. And  
15 it's actually three legs or more, pardon me,  
16 not -- it's not multilegs, three legs or more, so  
17 in other words, a call spread laid up in the  
18 future, and that's 10 minutes, and that -- that  
19 works quite nicely for us and for the market and,  
20 you know, that's -- that's our view.

21           MR. HUMENIK: I think it was just  
22 mentioned a moment ago by David in terms of ICE

1 fits, all and I think there is another area where  
2 the DCM's self-certify their rules and have an  
3 opportunity to discuss those with the commission.  
4 And, you know, there could be a standard that's  
5 without delay, 15 minutes, five minutes, it  
6 depends on the market.

7 So, again, you know, rather than  
8 laying down a hard and fast five minutes as was  
9 proposed, I think there should be flexibility in  
10 terms of the right time.

11 And as Tom just mentioned in terms  
12 of multileg trades, there are -- there is a  
13 concern about having the time to input that. So  
14 I think that's something that needs to be  
15 acknowledged in the rules as well.

16 And I think, you know, again, just  
17 to point out that, you know, like a DCM will  
18 analyze its block sizes, it's probably going to  
19 look at the time requirement, too, and will do  
20 that on a continuing basis. So again there's  
21 checks and balances within the core principles to  
22 allow that to happen.

1                   And, you know, at the end of the day  
2 the DCM's are a self-regulatory organization so  
3 if they see an issue where the market  
4 participants are reporting too slowly or their  
5 reporting methodology is not working for them,  
6 then it needs to be addressed by the DCM.

7                   MR. LA SALA: I'll be brief because  
8 I think the other panelists have done a good job  
9 with this. I'll just simply make the comment  
10 that markets -- we've heard it earlier today,  
11 markets are all different.

12                   So in some markets the ability to  
13 price report due to liquidity considerations are  
14 different than others. If in fact you've got  
15 complex trades or instruments, you know, where a  
16 DCM chooses to have a block facility, there  
17 should be under -- again, under a concept of core  
18 principles, some level of flexibility and "for  
19 that matter, the DCM should be able to, when  
20 certifying why it chose the timing requirements,  
21 express those to the commission such that you  
22 clearly understand and they're defensible.

1 Thank you.

2 MR. SHILTS: Do you also, just  
3 before we go on, have similar provisions that Tom  
4 was mentioned for multilegged type instruments?  
5 They're longer?

6 MR. LA SALA: We don't articulate it  
7 the same way but, broadly speaking, for options  
8 we allow for longer time period, and implicit in  
9 that is the exact reasoning that Tom put forth.

10 MR. MACKLE: I think a couple of  
11 things I would add. You know, in a couple of  
12 instances where it might be a challenge to get --  
13 have the reporting done within five minutes, if  
14 you're working -- you know, even if it's a  
15 complex trade, this might be two legs and you're  
16 working one spread that's clear and maybe one leg  
17 in another market and you've got -- you know,  
18 you're buying one leg and you agree with the  
19 seller, okay, you know, I'll buy whatever the  
20 contract size is, say 50 megawatts of power.

21 You know, the seller might say,  
22 well, I'd sell 100 there. And you might say,

1 well, I'm working on a leg, you know, let me come  
2 back to you. You run the risk of, you know, the  
3 seller might say, if the market moves, might say,  
4 okay, I'm off, I only sold you 50 or, you know,  
5 you might be able to work the other leg of your  
6 trade and get another -- you know, that leg done,  
7 and that takes you a few minutes or five minutes  
8 or, you know, within a reasonable -- you know,  
9 whatever.

10                   Again, it's hard to say what the  
11 time is, but it could be more than five minutes,  
12 so you've already done a trade, you could add to  
13 it if you get that other leg done. That's not  
14 going to last for half an hour or an hour,  
15 obviously. But, again, to sit there and say five  
16 minutes is the right answer, it's tough to say.

17                   You know, there could be a situation  
18 where, again, you agree to a trade with, you  
19 know, counterparty, we're going to clear. The  
20 counterparty says, oh, I don't know if I want to  
21 do it NYMEX or ICE. Let me check. You know,  
22 they might need a few minutes to, you know, check

1 with their credit departments, you know, if  
2 they're looking to do that to maximize their  
3 margining.

4 So they might come back to you and  
5 say, you know, give me a few minutes. I'll let  
6 you know if it's going to be NYMEX or ICE. Maybe  
7 that takes six minutes or seven minutes or  
8 whatever the answer it. You know, I guess those  
9 are probably a couple of additional examples  
10 where to sit there and say a hard and fast rule  
11 of five minutes you can come up with, in addition  
12 to the, again, the complex trades, you know, sort  
13 of contingent-type trades, again, where it's  
14 credit or whether those are the legs of a  
15 transaction that you're working in the market  
16 through other venues might cause that window to  
17 be exceeded.

18 MR. DOWNEY: Just in addition, our  
19 broke in EFP trading systems allows for the  
20 posting of anonymous bids and offers which can be  
21 hit lifted. Now, when someone does hit lift  
22 that, that is not an instantaneous reporting



1 because I pass that through a series of risk  
2 management devices. These risk management  
3 parameters are set by the firms, and we defend  
4 the firms against fed finger access.

5 From time to time, participants try  
6 to enter block transactions, especially block  
7 rolls which we consider both legs in determining  
8 the risk. Sometimes they do bump up against  
9 their risk limit and we stop the transaction, not  
10 because it's not valid, simply because the firm  
11 has asked us to. And they have to go to their  
12 risk departments to dial in and to reset those  
13 variables which, does from time to time, occur.  
14 They raise those variables up to allow the trade  
15 to go through, and then they come back in and, as  
16 they should, they raise those -- bring those  
17 levels back down so there's no more risk can be  
18 brought on the terms.

19 And in those instances we don't know  
20 whether that is reporting or not. But we think  
21 that reporting is when we tell the tape that a  
22 trade has occurred, and there are times where

1 that trade is stopped from reporting based on our  
2 definition simply because we're doing risk  
3 management reviews, and I think that's  
4 appropriate.

5 MR. BRODSKY: Are there variables,  
6 other than the complexity of a trade, that might  
7 impact the appropriate time for reporting a block  
8 transaction?

9 MR. HUMENIK: I think I've made the  
10 point in the previous panel just about a new  
11 contract. And I think, again, there has to be  
12 flexibility with a new contract because, you  
13 know, typically you won't have as much trading  
14 going in the central limit order book with a new  
15 contract.

16 So the reporting of block trades  
17 obviously impacts what's going on in the central  
18 limit order book, and there also has to be time  
19 for the market participant to hedge their  
20 position and do what needs to be done within that  
21 time. So with a newer market it's just --  
22 there's a complexity there.

1                   So, again, just to point out that  
2                   that exists and, again, it's appropriate for a  
3                   new contract to have flexibility. We have 15  
4                   minutes now for our futures contract and, as I  
5                   said before, part of a DCM's obligation is to,  
6                   you know, surveil their markets and make sure  
7                   that they're complying with the core principles,  
8                   and over time there can be changes that are made  
9                   to the rules.

10                   MR. FARLEY: I agree.

11                   MR. MACKLE: I'd say another  
12                   example, like on the electricity space, for  
13                   example, you know Constellation, if we're  
14                   participating in a load auction and, you know,  
15                   you've got a window, you know, you're notified as  
16                   the winning bidder of a certain load auction,  
17                   typically, as a winner, you're going to be  
18                   notified in advance to give you a window to  
19                   hedge.

20                   Obviously, you build certain hedging  
21                   transactions into your margin, you know, that  
22                   obviously ultimately get passed through to the

1 end user through the load auction process.

2 So, you know, if you've got at  
3 three o'clock or whenever, you know, depending  
4 when the load auction notification is, if -- you  
5 know, you've got to go out and hedge a certain  
6 size, depending on location or the tenor of the  
7 market and, all of a sudden, if the very first  
8 transaction you do, you know, within five minutes  
9 that's got to get reported, you know, the other  
10 participants in this auction process are going to  
11 say, okay, something's just cleared, we didn't  
12 win, and all of a sudden, you know the market's  
13 going to move against you before you get a chance  
14 to sufficiently hedge your exposure, you know, as  
15 the winning bidder in the load auction.

16 So, you know, you've got to  
17 obviously factor that in going forward to your  
18 margin when you're pricing this up, if you don't  
19 have sufficient time to, you know, to hedge the  
20 resulting exposure.

21 So I would say, you know, again,  
22 call its complexity, call it, you know, the

1 nature of the transaction, examples like that, I  
2 would think you'd want a larger window to be able  
3 to, you know, hedge your -- again, you know, the  
4 downstream -- you know, the beneficiary of  
5 successful hedging is going to be obviously the  
6 load that's being served to this load auction so  
7 the ultimate user.

8 MR. DOWNEY: I think that the  
9 exchanges, the DCM's, their goal is to do what's  
10 right. Their rules are written to try to  
11 encourage the people to do what's right, and they  
12 monitor their markets. And if a customer does  
13 something that looks like it's outside of those  
14 prescriptions, I think that I'd speak for myself,  
15 but I know the other exchanges do it as well,  
16 we're all over our customers to make sure they do  
17 it right because the questions from you are going  
18 to come to us, not to them and we're going to  
19 have to respond.

20 So I think there are a very --  
21 varied amounts or varied states that every  
22 exchange is comfortable with, whether it's five

1 minutes, whether it's five minutes or 10 minutes  
2 with contingencies, we chose without delay for a  
3 specific reason.

4           There is a complexity as you jump  
5 from the futures into the securities side and  
6 vice versa in getting these executed, and we  
7 thought that that was prudent on our part just  
8 simply to give the flexibility the customers  
9 needed while holding their feet to the fire at  
10 the same time.

11           MR. BRODSKY: Okay. Well, thank you  
12 all for participating on such short notice, and  
13 we appreciate it. It's been extremely  
14 informative.

15           MR. SHILTS: Thank you everyone.

16           (At which time the meeting concluded  
17 at 12:41 p.m.)  
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C E R T I F I C A T E

I, AMY E. SIKORA, RPR, CRR, CSR-NY, CLR,  
and Notary Public for the District of Columbia ,  
hereby certify that the foregoing transcript is a  
transcription of my stenographic notes of the  
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I further certify that I am not related by  
blood or marriage to any of the parties to these  
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nor am I in the employ of any of the parties to  
these proceedings.

IN WITNESS WHEREOF, I have hereunto set my  
hand this 11th day of June, 2012.

\_\_\_\_\_  
AMY E. SIKORA, RPR, CRR, CSR-NY, CLR  
Notary Public  
for the District of Columbia

My Commission expires: 7/31/14