UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

OPEN MEETING ON THE 24TH SERIES OF PROPOSED RULEMAKINGS UNDER THE DODD-FRANK ACT

Washington, D.C.

Thursday, February 23, 2012

PARTICIPANTS:

Commission Members:

GARY GENSLER, Chairman

BART CHILTON, Commissioner

MICHAEL V. DUNN, Commissioner

JILL SOMMERS, Commissioner

SCOTT D. O'MALIA, Commissioner

MARK WETJEN, Commissioner

Presentation No. 1: Final Rule on Swap Dealer and Major Swap Participant Recordkeeping, Reporting, Duties, and Conflicts of Interest Policies and Procedures; Swap Dealer, Major Swap Participant, and Futures Commission Merchant Chief Compliance Officer

FRANK FISANICH, Office of General Counsel

GARY BARNETT, Division of Market Oversight

WARD P. GRIFFIN, Office of General Counsel

DAN BERKOVITZ, General Counsel

DAVID MEISTER, Director of Enforcement

Presentation No. 2: Proposed Rule on the Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and

Block Trades, and Further Measures to Protect the Identities of Parties to Swap Transactions

CARL KENNEDY, Office of General Counsel

GEORGE PULLEN, Division of Market

PARTICIPANTS (CONT'D):

LYNN RIGGS, Division of Market Oversight

RICK SHILTS, Division of Market Oversight

ESEN ONUR, Office of Chief Economist

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P R O C E E D I N G S

(9:35 a.m.)

CHAIRMAN GENSLER: Good morning. This meeting will come to order. This is a public meeting of the Commodity Futures Trading Commission to Consider Final and Proposed Rules under the Dodd-Frank Act. I'd like to welcome members of the public and market participants, members of the media as well as those listening to the meeting on the phone or watching this webcast. I'd also like to thank Commissioners Sommers, Chilton, O'Malia and Wetjen for their significant contribution to the rule-writing process and thank the CFTC's hard-working and dedicated staff.

In 2008 the swaps market helped concentrate risk in the financial system that then spilled out over the real economy affecting businesses and customers across the country, and as we know, 8 million Americans lost their jobs and thousands of small businesses were lost as a result of the crisis. The derivatives reforms in the Dodd-Frank Act once implemented will lead to

significant benefits for the real economy, that which makes up over 94 percent of private-sector jobs in America. Derivatives reforms also will bring significant benefit to all Americans who depend on pension funds, mutual funds, community banks and insurance companies as that part of the financial system will benefit greatly from the greater transparency and lower risk in the swaps market. They'll benefit from the transparency and lowering risk that also comes from this twenty-fourth meeting of the Dodd-Frank reforms. We will consider rules addressing both lowering risk and promoting transparency. To lower risk we'll consider business conduct standards for swap dealers and major swap participants, what we've come to call internal business conduct rules, and I think Frank and Ward are going to present initially on that. Then to promote greater transparency we'll consider a proposal of the block rule. Last month the CFTC completed some of its first rules or reforms related to dealers. The Commission finished up on a registration rule

where for the first time regulators will be able to monitor swap dealers and major swap participants, and we also finished up on rules establishing robust sales practices in the swaps market. Today's internal business conduct rule, a collection of five proposals from Frank will tell us about a year or two or a year-and-a-half ago builds on this progress. It requires swap dealers and major swap participants to establish risk-management policies to manage the risk of their swaps activities; it requires firewalls to protect against conflicts of interest between trading and research and between trading and clearing units of financial firms. In addition, the rule establishes reporting, recordkeeping and daily trading records critically to ensure that there is an audit trail that details the full trading history. These provisions were congressionally mandated. In addition, swap dealers, major swap participants and futures commission merchants must have a chief compliance officer and a compliance program in place to ensure compliance with the

provisions of the Dodd-Frank Act to protect the public.

In addition, today we're going to be considering a proposal or one might say a re-proposal of the block rule. This proposal benefits from significant comments we received on the real-time public reporting proposal which also included something on blocks. The new methodology in this re-proposal makes a number of significant changes from the earlier proposal. First, it's tailored so that it includes block sizes that vary by asset class. I think for instance there will be 24 separate pieces of the interest rate market. And it will be tailored by underlying reference product or rate. Second, it's been simplified as it will no longer rely on a test which came to be called the social size multiple test for setting minimum block size. Now it's more tailored in more buckets and it's actually far simpler. Third, the proposal moves from being based on transaction counts to being based on net notional amount of swaps within a category. Furthermore,

this new proposal benefits from a review of a significant amount of market data particularly in the interest rate and credit swaps market.

As I've said for quite some time, we're working to complete these rules in a thoughtful, balanced way and not against a clock. We've finalized today 27 rules and if we move forward today it would be 28 rules. We have much to do going forward. Though we've made great progress on the congressionally mandated reforms to bring transparency and competition to these markets and to best protect taxpayers and lower risk and the rest of the economy, it's only going to be with finalizing and I would say also with much needed funding for 2013. Then we're going to be able to actually oversee these markets and how to protect the public. I have great confidence in the Commission and staff that will finish the remaining reforms this year for the benefit of the market.

I also want to take a moment to announced a 2-day roundtable that we're having

here next week that staff is going to be hosting next Wednesday and Thursday which will look at the critical issues surrounding further enhancements to customer protection. Segregation of customer funds is a core foundation of customer protection in both the futures and the swaps markets. We've already taken a number of steps such as enhancing the protections regarding investment of customer funds through amendments to what we call Rule 1.25, and the requirement that future commission merchants and derivatives clearing organizations segregate customer collateral, supporting cleared swaps and ensuring customer money is protected individually all the way down to the clearinghouse, the so-called LSOC for swaps. But there is much more that these panels and the public can weigh in on. Panels will include looking at alternative custodial arrangements for segregated funds, enhanced customer protections and transparency provisions for futures commission merchants, additional protections for collateral possibly in the futures markets, revisions to

bankruptcy rules, so-called Part 190, protection of customer funds trading in foreign futures markets or what we call Part 30 and issues associated with entities duly registered with the CFTC as FCMs and the SEC as broker dealers and we've invited Securities and Exchange Commission staff to partake in any part of these 2 days, and will also be looking at possible enhancements to the self- regulatory structure either here or at the SROs themselves. Before we hear from staff, I'm going to turn it over to fellow Commissioners. Commissioner Sommers?

COMMISSIONER SOMMERS: Good morning. Thank you, Mister Chairman and thanks to staff who have put a tremendous amount of time into formulating the rules that we are voting on today, the final business conduct rules and the proposal for establishing appropriate minimum block sizes for swaps. The challenges we face in implementing the Dodd-Frank Act are ongoing and I cannot emphasize enough how proud I am to be part of an organization that is filled with such dedicated

public servants because it takes a lot of time and effort to get these rules to the place where we're considering them today, and I want to again say how much I appreciate the work of all of the teams.

While I appreciate the hard work that has gone into finalizing the business conduct rules, I unfortunately cannot support the final product. There are too many provisions in the final rules that don't make sense or portend disturbing trends, and I'll point out just a few examples. During the course of the comment period, the Commission received requests to allow substituted compliance for entities to subject comparable regulation by a prudential regulator. This makes perfect sense to me from both a resource and policy perspective. If a registrant is subject to comparable regulation, why do we need to layer on additional regulation? And given our own strained resources and the additional burdens that duplicative regulation places on registrants, shouldn't we be looking for ways to

rely on our fellow regulators whenever we can? Instead, the Commission has "determined that its interests in ensuring that all registrants are subject to consistent regulation outweighs and burden that may be placed on registrants that are subject to regulation by a prudential regulator." This is form over substance, a cookie-cutter approach that we can ill afford at a time when our resources have been stretched as never before. It also does not bode well for how the Commission may be approaching extraterritoriality issues. While we have been hearing for months that staff has been developing guidance on the application of Dodd-Frank to activities outside the U.S., nothing of substance has been shared with my office to date. Given the Commission's unwillingness to rely on comparable regulation by a U.S. prudential regulator, I am left wondering whether we will be abandoning our long-standing policy or recognizing and relying on comparable foreign regulations. I hope the answer to that question is no.

Another provision of the final rules

that baffles me is the requirement that swap dealers and major swap participants diligently investigate the adequacy of the financial resources and risk-management procedures of any central counterparty through which the registrant clears. Given the extensive, detailed regulations the Commission recently finalized for derivative clearing organizations on financial resources and risk-management procedures, any DCO that accepts a swap for clearing presumably will not do so unless it has the proper resources and risk-management procedures in place. The preamble to the rule states, however, that a determination that a DCO is in compliance with the Commission's core principles and regulations is no substitute for the due diligence of registrants who must evaluate the use of a central counterparty in light of their own circumstances. This begs the question what is the registrant supposed to do independently to satisfy itself that a DCO has sufficient resources and procedures to clear a particular swap that it accepts for clearing? Can

a registrant refuse to clear a swap that the Commission has determined must be cleared because the registrant has determined that no DCO that accepts the swap for clearing is truly up to the task given the registrant's particular circumstances? The preamble also states that swap dealers and major swap participants may voluntarily elect to clear swaps that are not required to be cleared through CCPs that are not registered with the Commission, and in those instances some sort of due diligence prior to submitting a swap for clearing would be part of a prudent risk-management program. While this makes slightly more sense, I am again left wondering whether we are signaling something about the extraterritorial application of our rules. Do we contemplate allowing U.S. Swap dealers to voluntarily clear through foreign CCPs? If so, under what circumstances will that be allowed?

I am most disturbed however by the walls we are erecting on the communications between the trading and clearing units of swap dealers and

affiliated FCMs. The only exception we allow is for communications necessary to manage a default. The statute requires swap dealers to establish safeguards to ensure that interactions between trading and clearing personnel do not contravene the provisions of the Act requiring open access to clearing. In typical fashion, our rules go far beyond the intent of the statute and prevent any communication between a swap dealer and an affiliated FCM that would incentivize or encourage the use of an affiliated FCM for clearing. We seem to be worried that a customer's clearing choices will be narrowed if a multiservice financial institution offers options based on bundled or nonbundled services. The end effect of the rules however is to restrict a customer's access to information upon which to make an informed choice. Rather than protecting customers, I fear that the rules will increase their costs and create needless inefficiencies for those looking for full-service options.

With regard to the block trading

proposal, I really appreciate the hard work the team has put into coming up with a practical solution to a very challenging problem. Dodd-Frank mandates that the Commission specify the criteria for determining what constitutes a large notional swap transaction for particular markets and contracts. In determining appropriate block sizes, Congress has directed that we take into account whether public disclosure of transactions will reduce market liquidity. This requires a balancing act. If the block threshold is set too low, there will be reduced transparency in the market. If the block threshold is set too high, there will be reduced liquidity in the market. It is no small task to come up with a solution to this complex problem. I believe it is worth noting that we have been grappling with the concept of appropriate block size and market transparency in the futures markets for years. In July 2004 we proposed guidance on among other things DCM block trading rules. We re-proposed again in 2008 and again in 2010. Setting block

sizes for swaps is not an easy task and absent robust data, comprehensive analysis and the benefit of market experience, we could severely harm liquidity at this critical regulatory juncture where we seek to bring more swaps on to SEFs. Under the current proposal which recommends utilizing a 67-percent notional amount calculation, only the largest 6 percent of all IRS and CDS would be blocks. This proposal ignores Congress's mandate that we take into account the impact of public disclosure on liquidity. We are effectively sacrificing liquidity at the altar of transparency. While I applaud the rule team's efforts to analyze available data in the interest rate and credit asset classes, the team only had access to 3 months' worth of transaction data and that data dates back to the summer of 2010. We are relying on stale data and far too little of it. Absent further transaction data, it is hard to say if the 6-percent relationship would even hold true over a larger transaction dataset. Of greater concern to me is the one-size-fits-all

approach in which we blindly apply the 67- percent formula across asset classes. I do not believe this is prudent given the potential variations in liquidity among the asset classes. The one ray of light that I do see in this proposal is that the team has gone to great lengths to pose numerous questions and to put out myriad alternative approaches. If we're going to get this right in the final rule, we need to be willing to consider all of the comments from the industry. With regard to comments from the industry, I am also concerned that we are working to finalize the rules which will implement Dodd-Frank, I believe it's the most important role I've ever played as a Commissioner at the CFTC and I believe that it is crucial for the marketplace and for market participants that we get these rules right and that we finalize them in a way that is reasonable and that will give these rules the ability to stand the test of time. These rules should not only reflect input from the majority, but from the Commission as a whole and these rules do not do

that. We consistently reject reasoned comments from industry professionals with little justification in our cost-benefit analysis to support those rejections. I have been hopeful for the past year that things would change when we started finalizing these rules and especially the rules that are so integral to the new regulatory framework, but things have not changed. I am longer optimistic. I do not believe that these rules have a chance of withstanding the test of time. But, I believe instead that this Commission will be consumed over the next few years using our valuable resources to rewrite the rules that we knew or should have known would not work because the public commented and told us that. We should have known it when we issued them and we instead are issuing them without taking sufficient comments into consideration. Thank you.

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

COMMISSIONER CHILTON: Thank you. I also thank staff, and I support the rules, both

the proposal and the rule. After Commissioner Sommers speaks I usually take some of the things she said and talk about how insightful they are and helpful they are and I think there are some things in there, Jill, that are really good to learn from. On the block thing, this is a proposal. Just a proposal. We're going to listen to the comments. We messed up on the last proposal and so here we have another one. But I agree with Commissioner Sommers on the balancing part of it. I was reminded recently of a talk I gave a couple-and-a-half years ago called "Sense of Balance." In it I talked about the Flying Wallendas and Karl Wallenda, the trapeze and the high-wire act who used to appear on the "Ed Sullivan Show." For those of you who have no clue what I'm talking about, this is classic entertainment heritage. Go google it. That's what the internet is for. As we do these rules and as Commissioner Sommers was talking about as they get more complex and one is layered upon the other, it gets higher, the safety net needs to be

better and our balance needs to be better and we need to look at these things in concert. The block trading rule is one example where you can't just look at it in isolation so that you need to look at the reporting rule along with the block rule and you need to look at the SEF rule.

Section 733 says as a rule of construction regarding SEFs that there are two things that we need to do in promulgating our rule. One is to promote SEFs, promote trading on SEFs, and the second is to promote pretrade price transparency. So if we set the blocks too low in the block trading rule, we wouldn't be promoting trading on SEFs because the blocks can be traded off of SEFs so we wouldn't be doing that first rule of construction. But with regard to pretrade price transparency, if we set the levels too high, the result is what we'll end up doing is there will be some institutions who won't want to use this risk-management tool at all because if they have to report these very large trades instantaneously, immediately, they won't be able

to lay off their risk and therefore they won't do it, and ultimately that could theoretically impact the prices that customers pay. Dodd-Frank isn't about not having is involving risk management. That's not the goal. We want risk management. We just want the transparency, we want the accountability, so it's all about balance. And I think we also reached a good balance, a good equilibrium on the internal conflicts rules.

You can pick up the paper any day or watch television any day and read about all the problems in the business world. I'm not talking about specifically the industry that we regulate, sort of the conflicts-ridden, insidious nature of business in society today. The American public is sort of fed up with it. So I think the rule on internal conflicts that we've proposed strikes the right balance. It essentially sets up sort of good housekeeping standards for everybody to operate by which allows them continue to do risk management, appropriately addresses conflicts of interest in addition to spelling out the duties

and responsibilities of the people at these firms.

Finally, there's an issue that I've sort of been biting my tongue on lately. It's one that I've talked about a lot and that's position limits. We're not dealing with it today, but I continue to be concerned about it. We passed this final rule on position limits in October and the deal is for those of you who don't know, the clock didn't start ticking on implementation of position limits until we get this joint rulemaking on the definitions rule which includes the definition of nine different products and one of them is swaps. So once we define what a swap is, 14 months after that we can start having position limits on swaps. So it made sense until we had this rule and the Chairman has worked hard on trying to work with our colleagues over at our sister agency the SEC to move forward on these things, but as we know today, on the entities definition rule we got pushed back. Doing a joint rule with two agencies is always a challenge and in this case we thought we were going to get to an agreement in December,

we thought we were going to an agreement in January, here it is February and we're looking at maybe April. If we did it in April there would be 60 days until the regulated exchanges would have the federal limits in the spot and the deferred months. This is a tool that we need now. There is a chart here and I won't mention the company. I know people can't see it, of a meeting we had yesterday and it spelled out where the rules were going to come down and what this company envisioned as when things would be implemented. The last thing here of all of the rules is position limits. It's ironic because Congress told us that position limits was one of the things that we should do, but here it's the last thing to get done on this chart. I hope that's wrong. But to the extent that we can work, Mister Chairman, to try and figure out a way forward that doesn't result in us being sort of hamstrung, whether or not it's going forward with an interim final rule that just went forward maybe using our existing authority on the regulated exchanges limit, again,

limits that exist in the spot month for everything, the 28 designated commodities but exist in the ags and have for decades, or whether or not there's a way that the lawyers can work with the actual swaps definition. Forget about all the other definitions, the other eight definitions, but really just focus in on the swaps definition so we can approve that and then we could have position limits. This is a tool that can help customers. It could help customers now. So I hope like Karl Wallenda we take this good position limits rule that's balanced very fairly but get it to the other end of the wire.

CHAIRMAN GENSLER: Thank you, Commissioner Chilton. If I might just on working with the SEC, it's been a very constructive relationship or partnership these last 2-1/2 to 3 years. But, yes, Congress asked us to work together on a joint rule on further defining swap dealer, securities-based swap dealer, swap and as you said, nine terms. It continues to be that we'll take these rules up when they're ready; the

entity definition rule hopefully very shortly. I think when you were referring to April that that is what we are talking about on the products definition rule. But I too like you have been a supporter, maybe not as vocal, of position limits so that I look forward to working with your staff on any ideas that you have. In the meantime, what we're doing in the Office of the Chief Economist, the Office of Chief Counsel, the Division of Market Oversight, folks have really been engaged with similar folks over at the SEC on both of these rule sets, but of course we're only going to do them when we get them right and when they have input from 10 Commissioners. Commissioner O'Malia?

COMMISSIONER O'MALIA: Thank you. Mister Chairman, I'd like to before I get to my statement comment on the roundtables. I think those are important. We don't have an agenda. You laid it out today, but maybe we can have a little discussion. How much information are you going to give the public to inform this discussion

on the issues? I know we've talked about some of the reforms, but how are they going to know what to comment on?

CHAIRMAN GENSLER: It's been run by the people you know, Bob Wasserman and Laura Estrada, and then over with Gary Barnett, Amanda Olear, Frank and Tom Smith and so forth. I'm sure there are others too. I think that they've been reaching out to your office and everybody's office to get input on the panels and the panelists. I don't normally personally get involved in who's on the panels and so forth. I see Gary Barnett and there is Amanda. Why don't you make sure to inform the Commissioners today on the answer to this question, how the public will know what questions you are seeking input on on these seven panels? I assume that today you'll put up on the website an agenda. So they'll put an agenda up today on the website but then also to Commissioner O'Malia's question, how the public will know what questions you're going to be asking.

COMMISSIONER O'MALIA: That would be

very helpful. Thank you. The latest issue of "The Economist" featured an article entitled "Overregulated America." That features in its archetype for excessive and badly written rules our own Dodd-Frank Act. The problem the article points out is that the rules sound reasonable but impose a huge collective burden due to their complexity. Part of the problem as "The Economist" points out is that we are under the impression that we can anticipate and regulate for every eventuality. Throughout the rulemaking process I have argued that we must ensure that regulations are accessible, consistent, written in plain language and guided by empirical data and that we follow the President's 2011 guidance in his Executive Order 13563 to develop responsible cost-benefit analysis.

I accept wholeheartedly the mission put upon this administration by the President to "root out regulations that conflict, that are not worth the cost or that are just plain dumb." Today in furtherance of his guidance and that mission, I

will not support the final rules governing the internal business conduct standards or the block trading rule.

The Commission has an obligation to make a determination as to whether our rules qualify as a major rule and the OMB's Office of Information and Regulatory Affairs has concurred with our determination that this set of rules qualifies as a "major rule" under the Congressional Review Act with an annual effect on the economy of more than $100 million. However, there isn't a single list of costs associated with the internal rule to make a determination whether that figure is correct or not. Cost-benefit analyses of this rule clearly fail to comply with OMB Circular A-4 which is the how-to manual for government best practices in developing cost-benefit analysis. Our rule fails to discuss anticipated costs. There is no analysis based on reasoned assumptions or an evaluation of the impacts of the rulemaking. We have selected our own baseline to measure costs and have failed to use the prestatutory baseline

in direct violation of the OMB guidance. This rule amounts to regulatory malpractice.

After reviewing the internal business conduct rules, I have reached the tipping point and can no longer tolerate the application of weak standards in analyzing the costs and the benefits of our rulemakings. Our inability to develop quantitative analyses or develop reasonable comparative analyses of legitimate options hurts the credibility of this Commission and undermines the quality of our rules. I believe it is time for professional help and I will be following-up this statement with a letter to the director of OMB seeking review of the internal business conduct rules to determine whether or not the rulemaking complies with the President's executive orders and the OMB guidance found in OMB Circular A- 4. The fact that the Commission has been challenged by weak economic analysis is not new. In fact, the CFTC's IG raised many concerns with our analysis in the June 13, 2011 review. I believe the Commission began to stray from the

President's executive order as a result of staff guidance which was Exhibit 2 in the IG report. The document is intended to guide staff in developing cost-benefit analysis, and unfortunately, it weakens OMB guidance in a number of areas. For example, it directs staff to "incorporate the principles of Executive Order 13563 to the extent that they are consistent with 5A and that it is reasonable feasible to do so." I'm not sure that the President had that in mind when he issued the order. As for the executive order, it appears that we will incorporate the principles only when they neatly align with our own interpretation.

Setting the bar this low is remarkable. Indeed, former CFTC Commissioner and Acting Chairman William Albrecht recently wrote that expecting any detailed cost-benefit analysis of the proposed Dodd-Frank rules is impossible in part because "the CFTC has never had to develop CBA expertise." Additionally, as in today's final rulemaking, the Commission has determined in

contradiction of OMB guidance that it may set the baseline to incorporate the costs of statutorily mandated rulemakings regardless of how the CFTC has interpreted the statutory goals and regardless of the existence of alternative means to comply with such goals. Thereby, the Commission is relying on an arbitrary presumption that "from the rule to the extent that new regulations reflect the statutory requirements of the Dodd-Frank Act, they will not create costs and benefits beyond those resulting from Congress's own statutory mandates in the Dodd-Frank Act." This is unacceptable and that Commission ignores the pre-Dodd- Frank reality and establishes its own economic baseline for its rulemaking is unacceptable. The practice defies not only common sense but rigorous and competent economic analysis as well. OMB Circular A-4 is very specific about cost-benefit best practices. The circular also directs the Commission to consider alternatives available "for the key attributes or provisions of the rule." The circular goes on to recommend "it

is now adequate simply to report a comparison of an agency's preferred option to choose a baseline. Whenever you report the benefits and costs of alternative options, you should present both total and incremental costs and benefits." This is at the most basic level of the analysis where the Commission has failed to provide alternative options for consideration or failed to justify its chose of regulation with specific cost-benefit analysis.

There are multiple examples where concerned raised by commenters were dismissed out of hand without any cost analysis or alternative comparisons provided. However, I'd like to share one example which I found to be the most absurd. It relates to the duplicative requirement to store trade data that is already stored by an SDR. Our rule in the cost- benefit analysis states, "The Commission considered this alternative to its recordkeeping rules but determined that it is premature at this time to permit swap dealers and MSPs to rely solely on SDRs to meet their

recordkeeping obligations under the rules. At present, SDRs are new entities under the Dodd-Frank Act with no track record of operations, and for particular swap asset classes SDRs have yet to be established" which is just astounding since we've already voted on this create the gold standard for data retention in passing various rules regarding swap data repositories and I am stunned at this comment which seems to undermine all of our previous rules on data, swap data core principles and real-time reporting. In addition to finalizing rules governing registration standards, duties and core principles for SDRs, the Commission has already voted on the final rules to establish and compel the reporting of swaps transaction information to SDRs for purposes of real-time reporting and to ensure that the complete data concerning swaps is available to regulators throughout the existence of the swaps and for 15 following termination. It is curious as to how the Commission came to the conclusion that in the internal business conduct rules that

these are cost-effective given that they require firms to keep duplicative and redundant trade records when all trades must be reported to an SDR and including 10 years longer than held by the registrants. I have serious concerns about the Commission's ability to monitor and reconcile two sets of records which is the rational put forth in this rule. Trade repositories are intended to enhance swap market transparency. The Commission should do more to ensure its own transparency with regard to its cost-benefit analysis by disclosing its own assumptions and data to support its conclusions. Again I go back to Circular A-4 which outlines the standards of transparency with the following direction, "A good analysis should be transparent and you results must be reproducible. You should clearly set out the basic assumptions, methods and data underlying the analysis and discuss uncertainties associated with your estimates." It goes on to recommend that "to provide greater access to your analysis, you should generally post it with supporting documents

on the internet so that the public can review the findings" -- that the Commission will comply with either guidance.

I believe that a reasonably feasible standard as articulated in our own staff guidance has cost us to miss the mark for identifying using the best, most innovative and least burdensome tools to meet the regulatory ends laid out in Section 4s of the Commodity Exchange Act. I agree with Chairman Albrecht that the CFTC ought to be able to require -- to undertake a more rigorous cost-benefit analysis. I will be sending a letter to Acting OMB Director Jess Zients requesting his assistance in determining how far off the baseline the Commission has fallen. If OMB Circular A-4 means anything at all, then OMB should take action and hold the Commission to the circular's standards.

With regard to the block rule, I have a complete statement that I would like to have included in the record. To summarize my concern, I am frustrated that this rule proposal changed

significantly last night moving the block size from 50 percent of notional value to 67 percent. Amazingly, this did not affect our cost-benefit analysis. This new proposal looks at lot like our original proposal. Instead of capturing 95 percent of trades, this proposal now will only capture 93 percent albeit with different metrics. I don't agree with the one-size-fits-all approach and I hope we will consider in the rule a more nuanced asset-specific solution based on actual transaction data. I would like to thank the rule teams for their hard work in answering my questions regarding their work and their patience in explaining their complex rules. They have done a remarkable job to respond to the shifting dynamics and these are massive, complex rules and I greatly appreciate the work they've put into them, so thank you very much.

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

COMMISSIONER WETJEN: Thank you, Mister Chairman. I'll be supporting staff's

recommendations on the business conduct rules and the block trade proposal before us today. There are many aspects to the final rule concerning internal business conduct standards for FCMs, introducing brokers, swap dealers and major swap participants which now consist of five prior proposals. For now I'm going to focus on the conflicts- of-interest requirements and qualifications and designation of a chief compliance officer.

Our clearing-related conflicts rules seek to promote customer choice and clearing independence in the swaps markets. Swap users will be best served if they have a range of choices for their clearing needs. Toward this end, the rule requires targeted firewalls to ensure that trading unit personnel do not interfere with or improperly influence clearing-related decisions by affiliates. Importantly, the rule does not prohibit legitimate interaction between business units including coordination in the event of a default. I also

appreciate staff's efforts to modify the rule so that it strikes a better balance in preventing uncompetitive behavior while permitting affiliates to meet customer needs. To be sure, customer protection should not end at clearing. Indeed, recent events in the FCM community suggest that the warnings of a risk or compliance officer may be quickly dampened by others with PNL responsibilities or other incentives to do so and this why I support the requirement that the compliance officer have an independent line directly to the broad of directors. Given the persistent resource constraints on the Commission, it is unlikely that we alone can ensure full compliance with all swaps-related regulations at all times. Empowering and protecting the independence of the compliance are therefore essential components of our compliance regime.

The new large notional block trade proposal builds upon our real-time reporting rules proposed in December 2010. It sets forth possible methodologies for determining block thresholds in

the four major swap categories as well as tenor buckets within these categories. It also requests public comment not only on the appropriateness of the final thresholds, but also on the best method for reaching them. In considering this proposal, the Commission is again faced with the potentially conflicting objectives of promoting transparency and protecting liquidity and a number of my fellow Commissioners mentioned the same issue in their remarks. Congress itself recognized this potential conflict and therefore directed the Commission to protect liquidity through block thresholds for public reporting and execution purposes.

On the one hand, the public benefits from appropriate block trading thresholds because liquidity providers are given a window of time to assume and lay off risks in what can be relatively illiquid markets. If these liquidity providers are not given time to do so, the execution and inventory risks associated with large transactions may result in increased costs for commercial end

users who depend on the markets. On the other hand, if we set block thresholds too low and liquidity providers are able to hide their trading interests for longer than needed to hedge out of their positions, then public pricing in these markets will not reflect economic reality. This would provide unfair execution and informational advantages to large market participants over others. Accordingly, the Commission is attempting to take a measured approach to the block trade issue. Providing for methodologies that are tailored to specific asset classes should result in block thresholds that better balance transparency and liquidity. Yet I recognize this methodology could have flaws. It may result in thresholds that are too high or too low in swap categories or tenor buckets with abnormal transaction distributions. I therefore encourage the public to comment on the potential challenges of our methodologies and suggest alternative approaches as well if better ones exist.

I am also interested in receiving public

feedback concerning block transactions in the other commodity asset class. The Commission proposes certain block thresholds based on those applicable to economically related futures contracts. I am aware of differences in liquidity of these two markets and the concern that the block trade rule could inadvertently create arbitrage opportunities. I worry that the Commission's swap-related determinations could be improperly informed by the liquidity of the futures markets. I look forward to comments concerning this question and whether this approach could unfairly disadvantage certain marketplaces.

I am hopeful that with put input the Commission will able to craft a methodology that uses order data in a way that yields a useful measure of liquidity. If the theoretical justification of block trading turns in part on execution risks, then available liquidity within a reasonable distance of the midmarket price may be a relevant consideration in crafting our final thresholds. As the markets develop, we should

remain open to other ideas and methodologies even as we implement final thresholds. Additionally, the Commission's final block rules must address the interaction of the related SEF reporting and execution method rules. Thank you.

CHAIRMAN GENSLER: Thank you, Commissioner Wetjen. Now Frank and Ward, I hand it over to you.

MR. FISANICH: Thank you, Mister Chairman and Commissioners. I would like to thank the members of the rulemaking team for all of their hard work and dedication in completing this set of final rules. Staff is recommending for the Commission's consideration final rules comprising the first cluster of internal business conduct standards for SDs and MSPs as well as final rules for conflicts of interest, policies and procedures for FCMs and IBs and chief compliance officer requirements for FCMs, SDs and MSPs. The final rules in this cluster for SDs and MSPs cover risk management, monitoring of position limits, diligent supervision, business continuity and

disaster recovery, conflict-of-interest policies and procedures for information firewalls between research and trading and trading and clearing activities, availability of information for disclosure and inspection, recordkeeping and daily trading records and designation of a chief compliance officer and the requirements for an annual compliance report. These final rules implement certain requirements of Sections 4d and 4s of the Commodity Exchange Act as added or amended by Sections 731 and 732 of the Dodd- Frank Act.

Pursuant to Section 4s(j) of the CEA, the risk- management final rule requires swap dealers and major swap participants to establish a risk-management program consisting of written policies and procedures designed to monitor and manage the risks associated with their swaps activities. Under the final rule, the risk-management program must take into account among other things market risk, credit risk, liquidity risk, foreign currency risk, legal risk,

operational risk, settlement risk and the risks related to trading and traders. The rule also requires risk-management issues to be elevated to management through periodic risk exposure reports. The risk-management provisions also require SDs and MSPs to establish business continuity and disaster recovery plans designed to enable them to resume operations by the next business day following an emergency or other disruption. Also pursuant to Section 4s(j) of the CEA, the position limits monitoring rule requires swap dealers and major swap participants to establish procedures to monitor for and prevent violations of applicable position limits established by the Commission, a designated contract market or swap execution facility. A swap dealer or major swap participant is required to provide annual trading for personnel on position limits, diligently monitor and supervise trading, implement an early warning system, test their position limit procedures, document compliance with position limits on a quarterly basis and audit the procedures annually.

Pursuant to Section 4s(h) of the CEA, the diligent supervision final rule requires each swap dealer and major swap participant to establish a system of diligent supervision over all activities performed by its partners, members, officers, employees and agents and requires SDs and MSPs to establish a supervisory system and appoint qualified supervisory personnel. The final rules also implement requirements under Section 4s(j) of the CEA for swap dealers and major swap participants to promptly disclose all information required by the Commission or prudential regulator. To ensure prompt disclosure of all information, swap dealers and major swap participants are required to have adequate internal systems that will permit the Commission to obtain any information required in a timely manner.

The final rules on conflicts of interest for SDs, MSPs, FCMs and IBs as has been mentioned implement requirements under Section 4a(j) and 4d(c) of the CEA. Under these final rules, these

registrants are required to prevent conflicts of interest by establishing appropriate information firewalls between persons researching or analyzing the price or market for any derivative and persons involved in pricing, trading or clearing activities, as well as between persons acting in a role of providing clearing activities or making determinations as to accepting clearing customers and persons involved in pricing or trading activities. The final rules prohibit nonresearch personnel from directing the views expressed in research reports and prohibit the supervision of research analysts by certain trading and clearing personnel including decisions related to research analyst compensation. The final rules also prohibit registrants from offering favorable research or threatening to change research for existing or prospective counterparties in exchange for business or compensation and require disclosure of financial interests of research analysts that may pose a conflict of interest and research reports and public appearances. With

respect to clearing activities, the final rules prohibit swap dealers or major swap participants from interfering with or attempting to influence decisions relating to the provision of clearing or the acceptance of clearing customers of an affiliated FCM. Swap dealers and major swap participants also just maintain appropriate partitions between business trading personnel and clearing personnel of an affiliated clearing member. As required by Sections 4d(d) and 4s(k) of the CEA, the final chief compliance offer rule for SDs, MSPs and FCMs, require these registrants to designate a qualified CCO. The CCO must report directly to the board or to the senior officer of the registrant, administer the registrant's compliance policies reasonably designed to ensure compliance with the CEA and Commission regulations, resolve conflicts of interest in consultation with the board or senior officer and establish procedures for the remediation of noncompliance issues. The final rule also requires that the COO prepare and sign an annual

report that contains a description of the registrant's compliance policies and its compliance with the CEA and Commission regulations including a description of any material noncompliance issues. Either the CCO or the CEO of the registrant must certify the annual report as accurate and complete to the best of his or her knowledge and reasonable belief.

Finally, pursuant to Section 4s(f) of the CEA, the final recordkeeping rule for SDs and MSPs requires these registrants to keep full and complete transaction and position information for their swaps activities including all documents on which trade information is originally recorded. Transaction records would be required to be maintained in a manner that is identifiable and searchable by transaction and by counterparty. The final rules also require that swap dealers and major swap participants keep basic business records including among other things minutes from board meetings, organizational charts, audit documentation and records of marketing materials

and complains. Finally, swap dealers and major swap participants would be required to maintain records of information required to be submitted to a swap data repository or to be reported on a real-time public basis under those rules. The daily trading records rule pursuant to 4(s)(G) of the CEA prescribe daily trading records requirements including records of trade information related to preexecution, execution and postexecution data. Preexecution trade data would include records of all oral and written communications that lead to the execution of a swap. The rules require swap dealers and major swap participants to ensure that they preserve all information necessary to conduct a comprehensive and accurate trade reconstruction for each swap. Under the final rules, records of related cash or forward transactions must be kept when those transactions are used to hedge, mitigate the risk of or offset any swap held by the swap dealer or major swap participant as required under Section 4s(g) of the CEA. Records required to be

maintained under these final rules must be kept in accordance with existing Commission Rule 1.31 with the exception of records of or related to swap transactions which would be retained until the termination, expiration or maturity of the transaction and for 5 years thereafter. A further exception is made for records of oral communications or recordings of oral communications which are required to be kept for a period of 1 year. Rules regarding reports. With respect to reporting, the final reporting rules require swap dealers and major swap participants to report their swaps in accordance with the real-time public reporting rules and swap data rules finalized by the Commission in January of this year. This concludes my prepared remarks and I would be happy to address any questions that the Commission may have.

CHAIRMAN GENSLER: The Chair will now entertain a motion to accept staff's recommendation concerning this final rule.

COMMISSIONER SOMMERS: So moved.

COMMISSIONER CHILTON: Second.

CHAIRMAN GENSLER: Thank you. I support the internal business conduct rule which I think does lower risk that swap dealers may pose to the rest of the economy. These rules I think are a direct result of critical reform in the Dodd-Frank Act and leads to my first question, Frank or Ward. Did Congress direct us to write rules in these various areas, call it (4)(s), f, g, h, j? I can't remember all the letters.

MR. FISANICH: Yes. Each of these rules is pursuant to part of (4)(s) or for the FCMs and IBs, part of 4(d).

CHAIRMAN GENSLER: Does Congress use the word "shall" or "may"?

MR. FISANICH: In each of these areas, each of these were determined to be other than in a couple of instances nondiscretionary.

CHAIRMAN GENSLER: Nondiscretionary, so, "shall." I think that Congress debated quite at length jurisdictional issues about who should do it and they arrived at the Commodity Futures

Trading Commission because this Commission has such a wealth of experience in derivatives though it was in futures rather than swaps, but also debated whether it was important to have robust duties, risk-management, recordkeeping, daily trading records plus an audit trail and firewalls to address conflicts of interest. I think that this collection of what were five proposals greatly benefited from public comment and greatly where we could to make adjustments but also to fulfill the congressional mandate. The final rule establishes a number of duties and I'm going to highlight just one of them that I think is quite critical, that the swap dealers will have risk-management programs with policies and procedures to manage and monitor the risk associated with their activities. This is to ensure that the risk-management programs take into consideration various market, credit, liquidity and other risks. Having spent a little time around this topic from the 1990s, I think one of the core assumptions during that period of time is

somebody is regulating these entities, that Congress didn't need to speak to it. In fact, that was part of the assumption that went into the Commodity Futures Modernization Act which basically said this agency wouldn't have any role in much of this work. I think that that was a false assumption and I will even say I was part of that assumption. That is why I am so happy today to be able to support this rule, that this agency does have a role, Congress asked us to do it, in fact directed us to do it directly to write rules about risk management for swap dealers. Another question I have is how much consultation have you had with the Federal Reserve and the bank regulators on these rules?

MR. FISANICH: Each of those agencies has viewed the proposal, the comment summaries, the first draft of the final rules and the final draft of the final rules.

CHAIRMAN GENSLER: Though you may not have taken every one of their comments, have you done your best to make most of their comments?

MR. FISANICH: We have addressed all of their major concerns.

CHAIRMAN GENSLER: All of their major concerns. So that it's a collaborative approach, but I think Congress sort of decided this one and I think that this is important that we fulfill Congress's mandate. To the question of whether we'll find comparability with foreign regulators, I actually share Commissioner Sommers's view that we've had a long history of addressing ourselves to mutual understanding arrangements and finding comparable regimes where we can. We are as Commissioner Sommers notes a small agency and need to leverage off of those foreign jurisdictions where we can. But I think domestically Congress kind of decided this one and I think Congress was right. I'm going to turn it over to other Commissioners. I have a longer statement for the record.

COMMISSIONER SOMMERS: Thank you. Good morning. I guess following along the same theme, if we would have just stuck with what the statute

said, we actually might be in a good place here. Instead we went above and beyond in most every single area. My first question is regard to the conflicts of interest in the research reports. The way that the statute is written and then the way that the rule is written, there are some conflicts that I'm not sure that I understand. The statutory provision for FCMs and IBs requires firewalls between persons involved in trading or clearing and the activities of persons conducting, this is a quote, "research or analysis of the price or market for any commodity." Then the statutory provision for the swap dealers and MSPs requires firewalls between persons involved in trading or clearing and the activities of persons conducting "research or analysis of the price or market for any commodity or swap." But instead of sticking with that language for the FCMs and IBs, sticking with commodity or sticking with commodity or swap for SDs and MSPs, we've decided to use the word "derivative" and we define derivative. I'm wondering why that was done and why we didn't

stick with what the statute said in those cases.

MR. FISANICH: The definition of derivative is taking from the definition of FCM from the CEA and it defines the scope of an FCM or an IB's business in this area. I think the impetus behind it was to make sure that we were covering all of the possible avenues of conflicts in these areas under these products.

COMMISSIONER SOMMERS: But the word derivative doesn't actually include commodity. Right?

MR. FISANICH: As in a physical commodity? No, it does not. It includes futures products on commodities.

COMMISSIONER SOMMERS: My question would be if the research arm of a swap dealer predicts that the price of the NYMEX WTI contract will reach X number of dollars by a certain date, that would be covered because that's a futures. But would a similar prediction about the price of an underlying commodity in the cash market qualify as a research report?

MR. GRIFFIN: To be clear, certainly our rules don't trump the statutory language so that to the extent there was any concern that research relating to the underlying commodity would not be covered certainly is under Section 4d(c) of the Commodity Exchange Act.

COMMISSIONER SOMMERS: So that commodity is covered because that's what's in the statute even though that's not what the rule says?

MR. GRIFFIN: Correct. It's a statutory requirement.

COMMISSIONER SOMMERS: It's very unclear because it's not included in the definition so that it's very clear as to what that covers.

My next question is with regard to the walls we're erecting on the communications between the trading and clearing units and I'm trying to figure out what we're trying to get at because the way it's written in the rule, it's a little bit different for FCMs and IBs and for SDs and MSPs. We have an exception for communications necessary to manage a default, but the way it's written in

the FCM and IB portion of the rule, we prohibit them conditioning or tying the provision of trading services upon or to the provision of clearing services or for an SD or MSP to otherwise to participate in the provision of clearing services by improperly incentivizing or encouraging the use of an affiliated futures commission merchant. What are we trying to prohibit? What is improperly incentivizing?

MR. FISANICH: The rule is attempting to prohibit -- let's put it this way. The rule is attempting to make sure that the decisions of an affiliated FCM are made on its own.

COMMISSIONER SOMMERS: Is it a violation of the rule -- the tie and bundle, is it a violation of the rule if the pricing of trading or clearing is tied together so that if you say to a customer this is the price if you trade and clear with us and this is the price if you just trade with us?

MR. FISANICH: The rule is directed at the business trading unit of an affiliated swap

dealer or major swap participant so it is only those personnel of the affiliated swap dealer that are prohibited from engaging in this activity. It is a very narrowly defined business trading unit, those involved I pricing and marketing and soliciting and sales and those supervising the performance of those activities. All other employees or personnel of the swap dealer are not prohibited from participating in the provision of clearing services.

COMMISSIONER SOMMERS: My confusion mostly stems from the fact that this is prohibited, the business trading unit of an affiliated swap dealer or major swap participant, this prohibition is in actually the FCM IB portion of the rule. But if you go to the SD MSP portion of the rule, there are a number of other prohibitions with regard to the clearing unit of the affiliated clearing member of a DCO and they're prohibited from a number of other things, but this would just go to the business unit of the swap dealer or business trading unit of the

affiliated swap dealer or MSP. It is unclear to me what we're trying to accomplish and whether or not something that I think is probably a standard business practice with regard to the kinds of fees you charge to customers and what kind of business they do with you, if that's a violation of this rule to be able to bundle those services.

MR. FISANICH: The prohibition is on influence or interference with the decision to provide clearing services or access to clearing, so as long as that decision is independent of the business trading unit of the swap dealer or major swap participant, it would not be a violation.

COMMISSIONER SOMMERS: My last question is with regard to recordkeeping for oral and written communications. The rule requires that swap dealers and MSPs keep records of all oral and written communications concerning quotes, solicitations, bids, offers, instructions, trading and prices that lead to the execution of a swap and that these records must be searchable by transaction and counterparty. Some of the

commenters let us know that the traders typically engage in ongoing dialogue with counterparties over an extended period of time and that it may be difficult to identify which communications actually lead to a single trade. I'm wondering if you can explain for us what obligation swap dealers and MSPs have with regard to how these transactions can actually in the end be searchable by counterparty and transaction.

MR. FISANICH: The obligation to keep the records by counterparty is in the statute itself so that we don't have discretion to change that. The idea here is that all of these things would be recorded and then if a request for the audit trail or request for the daily trading records pertaining to a particular counterparty or to a particular transaction, that the SD or the MSP would have internal systems in place necessary to produce those records as required.

COMMISSIONER SOMMERS: You assume that when things like LEIs are implemented, it will be a lot easier for people to have systems that are

searchable by counterparty because presumably every counterparty will have some sort of LEI. Right?

MR. FISANICH: Yes. The assumption is that those universal identifiers for swaps, for entities and for particular transactions or products will greatly assist in doing this.

COMMISSIONER SOMMERS: Will these rules and these obligations be tied to the implementation of those rules related to recordkeeping?

MR. FISANICH: Those would be covered in the swap data reporting and recordkeeping rules that were finalized in January. To the extent the identifiers come into use, then they would be required to be used for reporting to an SDR and because this rule requires that a record be kept of what's reported to an SDR, then these would be in the records as well.

COMMISSIONER SOMMERS: My concern with regard to a lot of these recordkeeping requirements as you know is because of the way the

conforming amendments took up some of these requirements for FCMs and IBs in the futures context and what kind of requirements will be imposed on those market participants versus what we're doing in the swaps world and whether or not this even is applicable in those sorts of situations and I hope that we're sensitive to that when it comes to the conforming amendments of these particular provisions.

CHAIRMAN GENSLER: Thank you, Commissioner Sommers. Let me say on the conforming amendments that we've gotten a lot of comments on a particular aspect. If I recall, it relates to members of designated contract markets and recording and recordkeeping. I think I share your concern that we have to address that and dial some of that back in the conforming amendments. Commissioner Chilton?

COMMISSIONER CHILTON: Thanks for the work, guys. You did a good job. I have a couple of clarifying questions. Does this rule make clear who is responsible in an organization for

the protection of segregated customer funds?

MR. FISANICH: The chief compliance officer rule covers this not specifically but more generally that the chief compliance officer is responsible for administering the compliance policies reasonably designed to ensure compliance with the CEA and Commission regulations, and to the extent that there is a segregation requirement in the rules or in the statute, then the chief compliance officer has an affirmative obligation to take reasonable steps to ensure compliance with those rules.

COMMISSIONER CHILTON: Does it further require, this rule, that there are intraday checks that are supposed to go on to make sure that rules aren't being prohibited whether or not it's segregated funds or whether it's position limits? This isn't just at the end of the day or the beginning of a day, but this an intraday accountability thing for the firms. Correct?

MR. FISANICH: To the extent segregation is required at any time during the day, they would

have to have --

COMMISSIONER CHILTON: It is required during any time of the day.

MR. FISANICH: Right. During the day the policies and procedures for compliance with that requirement would have to account for intraday checks and balances to make sure that that is the case.

COMMISSIONER CHILTON: Intraday. This issue of the firewalls in which I think you've struck a good balance, as a matter of fact, let me ask this first: do you think you've struck a good balance not just for yourself, obviously you're coming forward with the rule, but of the comments that we received looking at all of them, do you think that the rule reflects or balance? I mean, we can adopt anything that we can get three votes on. But do you think of the comments received that this rule presents a balanced approach to what they said?

MR. FISANICH: We do. We received many, many comments on this particular issue on both

sides many of which asked for even stronger firewalls between clearing and trading, including comments asking for physical separation of these entities into different buildings. We did not go quite that far. We did respond to legitimate concerns about default management and those types of things, but I think we've struck an appropriate balance here among the commenters.

COMMISSIONER CHILTON: And we have done everything that is required under the financial reform law?

MR. FISANICH: We did.

COMMISSIONER CHILTON: My last area is this issue of firewalls between clearing, research and trading interdependently. If you're a trader and maybe you don't know a lot about the Palladium market but one of your customers wants you to be in Palladium or whatever it is, there is no prohibition against your trading arm have some researchers or some people who can give expert advice. Correct? The prohibition is between the research arm of the firm and the trading unit. Do

I have that correct?

MR. FISANICH: That is correct. To the extent that a trading desk is creating its own research and is presenting that to counterparties or the public, as long as it's clearly delineated as the product of the trading desk and is basically in the form of research that's part of a solicitation for business that that would be permitted.

COMMISSIONER CHILTON: One of the concerns, and some of us have talked about this for years going back to 2008 even where some of these research arms are very successful. They're prominent. People look at them. They use those like they're leading economic indicators. In 2008 as crude oil was skyrocketing, one of these research arms came out and said crude oil is going to be $200 a barrel. Everyone was saying before they published the research did these researchers go tell the traders, by the way we're going to do this and it may move the market? They would say no, and they'd say, no, we have our internal

firewalls, but that doesn't mean that they're not in the cafeteria line together saying tomorrow watch out. It can have an impact. And by the way, these trading arms, they're self-funding a lot of times. They make money because people subscribe to their services. I'm not criticizing. They're very smart folks and they do a lot of good for markets in general. But what we're doing is saying that you can't have this sort of insidious relationship and we do have firewalls. These are firewalls that we sort of use a lot of times anyway. If the three of us are about to get in an elevator, we want to make sure there's an attorney with us to make sure we don't discuss business. So we're really asking for something that government does now, we're asking for something that is done in other places in business and I commend you for all your work and thank you and I support the rule.

CHAIRMAN GENSLER: Commissioner Chilton, it actually comes out of the Joint Harmonization Report when the President in 2009 asked this

Commission to work with the Securities and Exchange Commission on looking at all of our rules and seeing where we could have some similarities. One of the recommendations that Congress then took up is that we have some of these firewalls between research and trading similar to what's in the securities field. You may have been ahead of that in 2008, but I'm saying that the President and others joined you in 2009 maybe.

COMMISSIONER CHILTON: He doesn't often listen to me and take my advice, but I appreciate the thought of it.

CHAIRMAN GENSLER: Commissioner O'Malia?

COMMISSIONER O'MALIA: I'd like to follow-up on a question Commissioner Sommers raised regarding technology. The rule requires that all information necessary to conduct a comprehensive and accurate reconstruction of each swap including being searchable by transaction and counterparty. Can you tell me what vendors offer this package that would allow swap dealers to make all phone calls and emails or chats searchable by

trader or transaction? Do you know who offers this today and is it installed?

MR. FISANICH: There are a number of vendors that have consolidated voice recording and data recording as we understand.

COMMISSIONER O'MALIA: But will it achieve exactly to make simultaneous the conversation associated with all the trade data, et cetera, to make sure that this is seamless and searchable by both counterparty and transaction?

MR. FISANICH: I do not know.

COMMISSIONER O'MALIA: So that I suspect you don't know how much it's going to cost.

MR. FISANICH: I don't.

COMMISSIONER O'MALIA: What is the timeframe when the dealers are supposed to have this possible system in place?

MR. FISANICH: The compliance dates for all of the rules are keyed on the completion of both the entities definition and the products definition. Other than that, there is a staggered compliance regime in the adopting release that has

compliance dates that are dependent on whether or not the SD, MSP, FCM or IB has been previously regulated. So to the extent that there is an SD or MSP that has not been previously regulated, they will have a longer time to comply with all of these rules.

COMMISSIONER O'MALIA: But if the technology is not available, we still require it. We didn't offer any leniency for technological consideration.

COMMISSIONER CHILTON: That's a very good question on which people were talking with us yesterday. Let me go through this real quick. To follow-up on that, we have general authority do we not that would allow us to issue an order? If the technology is not there, certainly we shouldn't be requiring it or we should be able to make provision so that people aren't put between a rock and a hard place, but we have general authority.

COMMISSIONER O'MALIA: I'd like to go back to your original point though. If the technology is not there, we shouldn't be requiring

it which is exactly right. We can waive it later. I get that. We're good at that. But the question is, is it available today and are we mandating something today? We didn't even ask the question.

MR. GRIFFIN: It's our understanding that there is technology available. We're not sure of all the bits and pieces with that. But with respect to the requirements to make clear, separately identifiable with each swap transaction, that is actually a statutory requirement and not something that we are putting forward in the rule independently.

COMMISSIONER O'MALIA: The searchable element of that, you have set the bar extraordinarily high. I get that it requires us to keep the data. Some of my later questions will ask the question why don't we just allow them to keep the data at the SDR? That was an option too. It doesn't say they have to keep it at the firm. Why not keep it at the SDR? They will have LEIs, they'll have it all separate, but now we've got redundant sets of books and that's my frustration

with this cost-benefit analysis. We don't care. We just rejected it out of hand as not costly and I'm trying to understand how costly this technology is or if it even exists. I don't doubt that it will exist at some point, but we're mandating it today at a point where it doesn't exist that I'm aware of and you guys aren't sure either, so that's my frustration. In developing your cost-benefit analysis, did you estimate the total cost, the cumulative cost, of 4(S), F and G? What did that requirement cost us for storing?

MR. FISANICH: At the proposal stage we requested comment and quantitative data on that. To the extent that we received quantitative data, we're taken that into account in the cost-benefit analysis. But what the total cost of it is given the different sizes and implementation of the projected community of swap dealers and major swap participants; we were unable to quantify that in the cost-benefit analysis.

COMMISSIONER O'MALIA: There was some discussion about the LEI and the LEI being on

track. That's clear from our data rule and some of these other things. That's great news, but that only identifies the entity. The UPI really is the thing from a risk-management standpoint that brings together similar swaps that would give you a better risk profile of understanding what swaps are -- that is a long way off. How does that figure into any of your concerns here or any of your mandates? It's years away.

MR. FISANICH: We did not consider the UPI in formulating these rules.

COMMISSIONER O'MALIA: Commissioner Sommers made a great point about substituted compliance. The statutory provisions, preamble and the rule text presume that some percentage of SDs, MSPs and possibly IBs will have a prudential regulator other than the CFTC. Nevertheless, the final rules do not permit substituted compliance and in at least one instance specifically prohibits it. Is that correct?

MR. FISANICH: It does not prohibit it if you're talking about the business continuity

and disaster recovery. It just merely requires that any business continuity and disaster recovery plan that may be implemented in response to a prudential regulator or another regulator's requirements that it be examined to make sure that it complies with this rule as well.

COMMISSIONER O'MALIA: What is the rationale behind not providing such compliance in the regulations where regulations of a prudential regulator at issue may be demonstrably comparable?

MR. FISANICH: I think the reasoning was that because the 4(s) requirements for capital and margin require that the prudential regulator set those for entities that fall under their jurisdiction but not for any of the others, that it was assumed that the Commission would promulgate these rules so that all entities are regulated under a consistent regulatory regime.

COMMISSIONER O'MALIA: But if the other entities, other prudential regulators are constituent, what options do we have to maybe reduce the burden?

MR. FISANICH: To the extent that they're consistent; so if you're an entity that has a prudential regulator and what is required by that regulator and these rules is consistent, then there is no duplication.

COMMISSIONER O'MALIA: The statute requires SDs and MSPs to maintain a complete audit trail for conducting comprehensive and accurate trade reconstructions. This requirement is echoed in Regulation 23.202(a). What data elements are necessary for the audit trail to enable a trade reconstruction?

MR. FISANICH: We believe that that would be all of the preexecution trade information that's listed, all of the execution trade information and all of the postexecution information.

COMMISSIONER O'MALIA: So that's all of the conversations that lead up to any negotiations months, weeks, days ahead which is telephone, email, all of that?

MR. FISANICH: That is correct.

COMMISSIONER O'MALIA: And put into your technology system. How will you reconstruct an audit trail for a bespoke transaction?

MR. FISANICH: Again it would be all of the preexecution trade information, the execution information and the postexecution information should show the lead up to the execution, at the time of the execution what the terms of the deal are and then anything that happens to that particular transaction postexecution as far as changes in terms, novations to other counterparties and those types of things.

COMMISSIONER O'MALIA: Will most of this stuff be stored at the SDR?

MR. FISANICH: Some of this may be stored at the SDR. The preexecution trade information will not be.

COMMISSIONER O'MALIA: How do we deal with potentially small dealers, the little guys that are farm co- ops, et cetera? Do we make any waivers for them in terms of collecting and maintaining all of this from a technology

standpoint?

MR. FISANICH: The recordkeeping rules are consistent across all entities of all sizes.

COMMISSIONER O'MALIA: One size fits all?

MR. FISANICH: One size fits all.

COMMISSIONER O'MALIA: Under 4s(j), SDs and MSPs are required to establish a robust and professional risk- management system adequate for managing the day-to-day business of the MSP and SD. We have interpreted this goal to require several pages of prescriptive rules requiring a host of policies and procedures especially regarding the business trading unit. What is the goal to be obtained by prescribing the SDs and MSPs to have at a minimum, policies and procedures covering all 10 areas? Why didn't we just go with the statute and say policies and procedures are adequate. We're very prescriptive in this area. What was the necessity for that?

MR. FISANICH: Especially for swap dealers and major swap participants that have not

been regulated in the past it was thought that having a better roadmap to compliance with the robust professional standard would be the better way to go. All of these provisions in the risk-management program were gleaned from existing risk-management guidance and/or rules from prudential regulators and other market regulators.

COMMISSIONER O'MALIA: So we have discretion when it comes to the statutory language and even though it is statutory language we have leeway into executing it?

MR. FISANICH: What is being presented today is the view that this is a robust and professional risk-management program.

COMMISSIONER O'MALIA: Let's turn to HFTs then. In that regard we just said trading programs must have policies and procedures. We were not prescriptive in that regard. Why did we take a different approach in that regard?

MR. FISANICH: Any future rule surrounding that area would of course be more prescriptive. In this sense at the time of

formulating the proposal, it was thought to be enough to have just required the risk-management policies and procedures around the review, testing and use of these programs.

COMMISSIONER O'MALIA: Let's walk through this so that everybody can keep up here. Can you describe what the HFT requirement is? What do we call it now, trading programs?

MR. FISANICH: Using of a trading program. The swap dealer of major swap participant would be required to have written risk-management policies and procedures that lay out how they test these programs, how they review the performance of these programs and how they risk manage the use of the programs.

COMMISSIONER O'MALIA: When you say trading program, you're not talking about a trading desk. You're talking about a specific software system. Right?

MR. FISANICH: This originally as proposed was referred to as algorithmic trading programs. It was thought that that may be too

restrictive. It didn't quite describe what --

COMMISSIONER O'MALIA: Where we are today and not previously is trading programs meaning software?

MR. FISANICH: Meaning a systematic program of some sort rather run by software or not. I don't think it would be limited to just software programs.

COMMISSIONER O'MALIA: By having this in place, having these risk-management procedures, would that have stopped the May 6 flash crash?

MR. FISANICH: I do not know.

COMMISSIONER O'MALIA: If industry were to adopt a set of best practices around these trading program standards, and frankly we've touched on it on the Technology Committee. We established a report on this on pretrade functionality. Would such practices meet the requirements of 23.600(d)(9) if they are incorporated and said best practices in their written policies and procedures? Would that satisfy this or does the industry have to wait for

us to do another rulemaking in order to understand where the safe harbors are?

MR. FISANICH: Under this rule they would develop internal policies and procedures that meet the requirement for testing and review and the other --

COMMISSIONER O'MALIA: But my point is, what is the requirement for testing and review? If the industry says these are best practices, is that sufficient or do we have to actively do something else to make sure that they understand what those standards are or else it continues to be a gray area?

MR. FISANICH: I would think you would have to set standards.

COMMISSIONER O'MALIA: We need to act again to set standards? Is that what you said?

MR. FISANICH: Yes.

COMMISSIONER O'MALIA: Can you explain where you set the baseline for comparison of the costs and benefits of these rules and what analysis was used on all of this? What is the

baseline?

MR. FISANICH: Based on Section 15 of the CEA, the baseline is based on action of the Commission, the cost and benefits of actions of the Commission so that to the extent that a cost or a benefit is attributable to the acts of Congress and not the Commission and that is the baseline.

COMMISSIONER O'MALIA: So the baseline is post-Dodd- Frank, essentially? Let me read the preamble. I'll quote it. "To the extent that the new regulations reflect the statutory requirements of the Dodd-Frank Act, they will not create costs and benefits beyond those resulting from Congress's statutory mandate in Dodd-Frank. However, to the extent that the new regulations reflect the Commission's own determinations regarding implementation of the Dodd-Frank provisions, such Commission determinations may result in other costs. It is these other costs and benefits resulting from the Commission's own determinations pursuant to and accordance with the

Dodd- Frank Act that the Commission considers with respect to Section 15a." So it sounds like that language means if Congress mandated it, that's the baseline. If we did something beyond that, only the additional stuff beyond the Dodd-Frank Act is something that we would have to consider. Is that a fair characterization?

MR. GRIFFIN: That's correct; actually, not only preexisting actions by Congress but also any preexisting actions that the Commission has taken with respect to existing rules that are already in place. Section 15a requires that the Commission consider the costs and benefits of the action of the Commission and here with the rule proposed before you today that is the Commission action and the cost-benefit consideration section of the release goes through consideration of the costs and benefits of this action. So to the extent that an action of Congress imposed certain statutory requirements on registrants or others or to the extent that there are already preexisting Commission regulations, say in Part 1 for instance

where there are already requirements based on a prior Commission action, those would not be factored into the cost-benefit considerations under 15(a). It's just the action that's being taken here today or under consideration by you today.

COMMISSIONER O'MALIA: OMB Circular A-4 says that we're supposed to use the baseline approach being prestatutory action. Why did we ignore that?

MR. BERKOVITZ: Generally speaking, what Ward and Frank is correct in terms of our general approach in our interpretation of 15(a), that 15(a) requires us to consider the actions of the Commission, that this is a Commission decision and not to reweigh the congressional action. That's a separate question. It's not necessarily the same question as what is the baseline for doing that comparison. The language that you referred to in this cost-benefit is we're taken this approach generally to our rules because it is our interpretation of 15(a) that we consider the costs

and benefits of the Commission's actions and not reweigh Congress. Constructing the baseline. The baseline really goes to what's the reference against which we weight those costs and it depends on the particular rule. Sometimes the baseline of necessity will include the entire requirement and then we measure the alternatives before the Commission considering those costs and sometimes, it depends on the particular circumstances, it will be as you've said assuming that those costs are already there, what's the incremental additional cost so it really will depend on the factual circumstances in the particular rule at issue what is the baseline we adopted. That's consistent we believe, and this is what we attempted to address in our guidance, that we believe that's consistent with the A-4 guidance as to how you develop a baseline. But the baseline is really for how you consider the costs; sometimes as I said, it will include the congressional mandate and sometimes it won't. But in terms of weighing the alternatives, we don't

reweight the costs and benefits of what Congress has already done and each baseline will be determined in the context of a particular rule and OGC and OCE will work with the team to develop the appropriate baseline.

COMMISSIONER O'MALIA: I think I'm having an only- in-Washington moment. Only in Washington could we come up with a baseline that doesn't consider where we are today but considers a poststatutory change. For economic analysis, a baseline is where we are today compared to where we're mandating the change to be. Whether it's Congress of us, you have to show the difference in where we are today to where we're going and we just don't. That's frustrating to me and it's got to be frustrating to everybody who has to pay for that change in cost because I don't think they care whether it was Congress that mandated it or the discretionary difference that we mandated based on congressional action. The fact is they have to install technology systems that are expensive and may not even exist today in order to

comply with our rules. They don't get to say my baseline is post-Dodd-Frank. I shouldn't complain so much about it. The reality is, the reality, is that you should look at it from a pre-Dodd-Frank analysis. Where in 15(a) does it say the term "reasonably feasible" and what do those words mean?

MR. BERKOVITZ: What we have done is interpreting 15(a) and the requirement as well as there are three basic statutes that cover our rulemaking. There's Dodd-Frank which is the requirement and now part of the Commodity Exchange Act. There's 15(a), the underlying cost-benefit and then --

COMMISSIONER O'MALIA: From the CEA.

MR. BERKOVITZ: From the CEA so that it's really the CEA, then there's the Administrative Procedure Act and it's both what the Administrative Procedure Act requires in terms of reasoned decision making as applied to the underlying statutory requirements that we're interpreting here and giving meaning to. The

"reasonably feasible" is our guidance in terms of looking at judicial precedent, what the courts will look to in terms of agencies and reasoned decision making and applying statutes in the Administrative Procedure Act.

COMMISSIONER O'MALIA: Does "reasonably feasible" appear in the APA?

MR. BERKOVITZ: "Reasonably feasible," I don't have it in front of me, I believe that "reasonably feasible" comes out of the case law applying these requirements.

COMMISSIONER O'MALIA: Does it have any relationship to financial resources; that if it's just too difficult for us to look or expensive, we just are excused from looking?

MR. BERKOVITZ: I think the case law generally interpreting what agencies are required to do in terms of reasoned decision making indicates that agencies can only do what's reasonably feasible, that technical perfection is not required, that certainly is not always required. The agencies are given a charge by

Congress and the case law and the courts will say did the agency do a reasonable job in applying these requirements and certainty and absolute perfection is never required.

COMMISSIONER O'MALIA: Would you think it would be reasonably feasible to call a technology company to find out if what we're mandating is actually available?

MR. BERKOVITZ: What's reasonably feasible obviously will depend on the precise circumstances at issue.

COMMISSIONER O'MALIA: I'd like to go back to the SDR question. Thank you, Dan. We were confronted with the decision for these SDs and MSPs to rely on the SDRs to meet the recordkeeping obligations and we made the decision, no, we want redundant books and records, we want everything to go to the SDR but we also want SDs and MSPs to keep everything, a complete duplicate of everything we're mandating being sent to the SDR. What's astounding, and I raised this in my opening statement, is that in the

cost-benefit analysis it states that it's premature to permit SDs and MSPs to rely solely on SDRs to meet the recordkeeping because they have no track record of operations, yet we've published hundreds of pages of very specific and detailed rules mandating exactly what we want to see. Why do we contradict the effectiveness in the use of these things when we've created this regulatory Frankenstein and now we're not going to use it?

MR. FISANICH: There are two reasons stated in the preamble. One is that they need this information for their own risk-management purposes, their own purposes, and an SDR is not going to have all of this information, it's limited to some fields but not all fields or some information but not all information and, again, because SDRs have no track record at this point.

COMMISSIONER O'MALIA: What fields are we missing that they are not going to have? And it doesn't discuss it in the preamble. So I'm not sure what we're missing. I get the pretrade stuff, the pretrade execution that we're going to

mandate that and your technology system. You can set that aside, but why would we want two books. How are we going to enforce two sets of books? What are we supposed to do with that? Running back and forth between two entities to reconcile? Is that our job? Do we have the resources for that? Why doesn't everybody agree to keep one set of books and we all agree that it's in the SDR? Then we have it. We regulate the SDR. We see it. We can get any piece of data we want at any point and they'll be using the same data we're using. Why would we want to be caught in this? And how much is it going to cost to keep another set of books?

CHAIRMAN GENSLER: Commissioner O'Malia, may I answer?

COMMISSIONER O'MALIA: Give it a shot.

CHAIRMAN GENSLER: Because a swap dealer has a set of books that is not at the SDR, the general ledger and subledger that keeps all of their transactions, which is important to risk-management; their daily mark to markets;

their daily risk-management which is involved in monitoring not just the risk but the profits and losses of that entity by trade or by desk. That in fact is what they do now.

COMMISSIONER O'MALIA: But won't all that data be -- why won't all the data be in the SDR?

CHAIRMAN GENSLER: No, actually all of that data wouldn't be in there. Beyond the pretrade that you rightly pointed out, the orders and the conversations, that's not at the SDR.

COMMISSIONER O'MALIA: Correct.

CHAIRMAN GENSLER: But actually the profit and loss and the risk-management that goes around that is in a general ledger and subledgers which most swap dealers or soon-to-be swap dealers already keep because that's part of prudent risk-management to keep books and records and subledgers on our transactions.

COMMISSIONER O'MALIA: Then why didn't we cost that out? We had the option to determine -- and let me just make one final point because it

doesn't cost it out here. We just ignore it and say inconsistent with the OMB guidance which requires us to look at alternatives and price them. We ignored that and we just said, no, even though entities said it was going to be expensive. The keeping-of-the-books concern, I don't you're not following this, but everybody now knows that MF Global's books were a disaster, so I'm not so sure that raises my confidence.

CHAIRMAN GENSLER: But the swap data repository is not keeping -- nor have we required them to do the old thing of debits and credits and actual subledgers and general ledgers. We've not. We've just said it's an important regulatory tool, absolutely the swap data repository, but it's not keeping the records of a general ledger, profits, losses, risk-management, that --

COMMISSIONER O'MALIA: I don't think anybody was asking to get out of that. They were saying all the trades that you're going to see, that let's agree to use the SDR for those set of trades and we said no.

CHAIRMAN GENSLER: Because how a trade is entered into a general ledger or into a subledger in an actual dealer is different than the information that's over at the swap data repository.

COMMISSIONER O'MALIA: I think we should have done a most robust job to answer the concerns of the market, done the proper analysis required by OMB Circular A-4 to evaluate the cost of this decision and then actually explore whether this is -- we just ignore it out of hand in this document.

CHAIRMAN GENSLER: I think we have done the analysis that's proper under 15(a) of the Commodity Exchange Act.

COMMISSIONER O'MALIA: There is no analysis. Let's find out what kind of analysis. This is a major rule according to the OIRA rules under the Congressional Research Act. It apparently is $100 million of economic impact. How does that $100 million annually break out in this rule? What makes up $100 million?

MR. GRIFFIN: First of all, it's not an

annual. It's an aggregate impact.

COMMISSIONER O'MALIA: In the OIRA thing it says annual.

MR. GRIFFIN: We have not broken down specifically from a numerical standpoint what the costs and what the benefits are of this particular rule. I think there's an expectation with respect to again not just the cost that would be inherent in putting together these systems, but also the benefits that are to be derived from having robust risk- management, recordkeeping and reporting and all the other requirements set forth in this rule before you.

COMMISSIONER O'MALIA: So we didn't run the numbers. Is the $100 million a net number or gross number in terms of cost?

MR. GRIFFIN: Gross. If I may, it's gross costs and benefits so that it's not net of the two, it's what are the costs, what are the benefits, what is the gross of those two numbers.

COMMISSIONER O'MALIA: How much were the benefits?

MR. GRIFFIN: I'm sorry?

COMMISSIONER O'MALIA: How much were the benefits?

MR. GRIFFIN: Again, we have not numerically broken this down. I'm sorry to be so tough on you on this one. I'm very frustrated with our cost-benefit analysis as you can tell. I don't mean to take it out on you. I know you guys worked very hard and tried to answer all my questions and I appreciate that and I'm sorry if you detect tone.

CHAIRMAN GENSLER: Thank you, Commissioner O'Malia? Before we turn to Commissioner Wetjen, I want to ask David Meister who's the head of our Division of Enforcement a question which goes to one of the questions that Commissioner was reviewing, searchability of voice records. You're the head of the Division of Enforcement. How searchable are voice records? What do you know about technology in the search of voice records and so forth?

COMMISSIONER O'MALIA: Before you answer

that, I'm fully aware that you can search voice records after the fact. The question is how do you put them together during the transaction? That's what my concern is. This assumes that magically all of this stuff turns into searchable by trade and transaction. How does that happen? I get it that you can go after the fact and review and start tagging stuff. I get that. That's a manpower issue because you have to go after the fact to do it. This doesn't distinguish. It says you make this available and I wonder if there is some magic technology out there at this point that would automatically allow you to tag as you're having a conversation what pretrade and trade transaction is it associated with. I assume afterwards you're going to have to go back and piece this all together.

CHAIRMAN GENSLER: Let's take it a question at a time because you're raising a separate question which might be for Frank about whether it's simultaneous. But my question for David or anyone on the team is how familiar are

you with an ability to search voice recordings? We must be involved in this already.

MR. MEISTER: There are software vendors that provide the ability to search digital audio recordings by words very effectively as I understand it. As a matter of fact, a number of government agencies use these programs. I think the FTC, the Department of Defense, Homeland have programs. I won't say the name of the program that's used a lot by the government, but you could do a search on the internet which is what the internet is for to goggle that sort of capability.

COMMISSIONER O'MALIA: Is that what this rule provides for?

MR. MEISTER: I don't know.

COMMISSIONER O'MALIA: Frank?

MR. MEISTER: I think you had asked what would be a vendor that could do that.

COMMISSIONER O'MALIA: And I agree with you.

MR. MEISTER: The way it searches, Commissioner O'Malia, is it does digitally so that

for example if you wanted to search for the word "meister" in a tape, it will cross as I understand it a huge volume of recording. It will do that and pull up all the times that "meister" was mentioned over a long period of time, pull out those records and the slice of those recordings so that they can be listened to.

COMMISSIONER O'MALIA: Frank and Ward, do you want to answer? Is that adequate for this rule that they can set aside a whole bunch of voice recordings and say that's sufficient? Because what they don't want to have a visit from Meister to show up later and say I want to see all of our transactions, because it says to sort by trader. So is it allowed to say you can go look and here is our closet full of tapes. Knock yourself out. Go digitally sort it. Is that adequate? Is that what this rule provides is what David just said?

MR. FISANICH: Yes, that would be adequate. At the proposal stage we had required that these be bundled into separate electronic

files for transaction and counterparty and that was removed in this final stage.

CHAIRMAN GENSLER: Frank, I'm suspecting that Commissioner O'Malia would accept this amendment but I would have to vote it here. Can you come up with language to clarify that what David just said is acceptable and put that in the preamble? It might not get you to vote the whole rule, I know, because I think that's a very important exchange between David Meister, Frank, Commissioner O'Malia and myself that it would be good to capture that that is acceptable; that that's what really this is about, this searchable.

MR. FISANICH: That would have to store these things and them they'd be searchable upon request.

CHAIRMAN GENSLER: Upon request the way that Mr. Meister described.

MR. FISANICH: Right.

COMMISSIONER O'MALIA: And that includes email, all of that stuff you can store separately.

MR. FISANICH: Right, by removing the

requirement that it be stored in a separate electronic file, that's what we were doing in the finalization.

CHAIRMAN GENSLER: Because what we did, just to bring the public into this, we proposed that even the voice recordings had to be stored in separate electronic files and a lot of commenters said that would be a burden. We did take that into consideration and backed away from that and said, no, you don't have to do that. You don't have to make a voice recording electronic, but you still have to be able to search it. And I think you've raised the question what does it mean to search it? And I think what I'm hearing from Frank is it's upon request and just clarifying in essence what David said is what that is meant to be. I'm doing this a little improperly.

MR. MEISTER: May I propose something? Perhaps to the extent that the rule doesn't already cover what I'm talking about, the preamble could be clarified. That's just a suggestion.

CHAIRMAN GENSLER: That's what I'm

saying. That's what I'm saying.

COMMISSIONER O'MALIA: I think it may the difference in what the rule says and what the preamble says so that it's got to be clear and I look forward to reviewing the language.

CHAIRMAN GENSLER: I'm going to add two pieces to this if I might and then you'll have questions. I'm going to add something, that which was the exchange between Frank, David, Commissioner O'Malia and me that that be clarified in the preamble that it's about searchability along the key words of who the counterparty is or key words upon request. But I think it would also be worthwhile to have a delegation similar to what we did in large trader reporting, a delegation to the Division Director of DSIO that if swap dealers need more time just like in large trader reporting I think we delegated to that a DMO six more months or something, but to allow more time on the searchability issue.

MR. FISANICH: If I may, the preamble states, "The Commission believes that this

modification will make the requirement less burdensome for SDs and MSPs because it will allow such registrants to maintain searchable databases of the required records without the added cost and time needed to compile records into individual electronic files" so that I think this is covered.

CHAIRMAN GENSLER: Commissioner Wetjen?

COMMISSIONER WETJEN: Thanks, Mister Chairman. Switching gears just a little bit here, I want to turn back to the section on conflicts. There were some questions raised that were understandable. But my understanding of some of the changes made in the rule text comparing the proposal to the final was in fact to clarify things and not to make it less clear. Focusing for a moment on some of the language in the rule that deals with the conflicts between the trading business unit and the clearing unit, in the original proposal there were other sections of the proposal and other sections of the final that speak to various activities that aren't going to be permitted. But focusing for a moment on

paragraph (i) under Section 2 and this is in Section (d), Clearing Activities under the first part, originally the language read, "No employee of a business trading unit of an affiliate swap dealer or major swap participant may review or approve the provision of clearing services and activities by clearing unit personnel of the futures commission merchant, make any determination regarding whether the futures commission merchant accepts clearing customers or participate in any way with the provision of clearing services and activities by the futures commission merchant." That's how the proposal read. Now looking at the final, it now reads, and I'll just focus on that last clause, "or in any way condition or tie the provision of trading services upon or to the provision of clearing services or otherwise participate in the provision of clearing services by improperly incentivizing or encouraging the use of the affiliated futures commission merchant," and then it goes on, but leaving that for now. The question for staff is

isn't it the case that again comparing how the proposal read with the final, aren't the operative words here "improperly incentivizing or encouraging the use of the affiliated futures commission merchant" which now modifies the words "participate in the provision of clearing services"?

MR. FISANICH: Yes, we would agree with that statement that this is a clarification of the original in the proposal that was participate in any way. We received many comments and questions on what exactly that meant and have listened to those objections to the broad scope of that language and it is now much more narrowly focused on improper participation influencing clearing decisions.

COMMISSIONER WETJEN: I think this question has an obvious answer, but certainly we're not prohibiting a firm that has an affiliated trading business unit and a clearing unit from providing the two services that those two separate units provide. Correct?

MR. FISANICH: No, it would not.

COMMISSIONER SOMMERS: Will you yield, Commissioner Wetjen?

COMMISSIONER WETJEN: Sure.

COMMISSIONER SOMMERS: I don't understand what improperly incentivizing means, which was my question earlier. What is properly incentivizing versus improperly incentivizing? I don't get it.

MR. GRIFFIN: I can take a stab at trying to answer that, but maybe you guys should start with an answer.

MR. FISANICH: Again this is only narrowly limited to the business trading unit so that it would be incentivizing through offering --

COMMISSIONER WETJEN: If I can interrupt, what I would say is that again the focus should be on the word "improperly." It's not saying that there can be no incentivizing or encouraging necessarily. The focus is on improper. We're getting at improper conduct here, which is to say that the trading business unit and

the clearing unit can decide at what price to offer their services to their customers and the Commission is not trying to interfere with that. What we're trying to prevent is any improper behavior that might relate to pricing.

MR. FISANICH: And as I had stated earlier in response to your question, this is meant to maintain the independence of the decisions of the affiliated clearing member in offering clearing services, pricing their clearing services, accepting customers for clearing, to make sure that those decisions remain independent in order to ensure to the extent practicable that there is open access to clearing.

COMMISSIONER WETJEN: So I would reiterate that I think what staff was trying to do with this change is to in fact clarify things and not to muddy the waters. I hope that that's going to be the consensus view when folks have a chance to analyze the language.

The question I had related to the chief compliance officer. You'd mentioned that in a

case of a registrant that has a board of directors that the chief compliance officer would report directly to the board. And I believe the rule also says that if the registrant does not have a board that it's the senior officer. Is that correct?

MR. FISANICH: We followed the statutory construction which is that they could report to either the board or to the senior officer. We did not further restrict that from the statutory requirement.

COMMISSIONER WETJEN: What about a compliance officer who works for an affiliate of a consolidated company? Who would be the senior officer?

MR. FISANICH: It would be the senior officer or the board of the entity that is the registrant, so that if the chief compliance officer for whatever reason is not an employee of the registrant, they would still be required to report to the board of the registrant or the senior officer of the registrant.

COMMISSIONER WETJEN: That's all I have.

CHAIRMAN GENSLER: Dave, before you call the roll if I'm going to offer a motion and have some amendments, unless I do it by unanimous consent on the first one. My first one is I want to make sure as to the clarity that you, Frank, and David spoke to Commissioner O'Malia's last question, that the public have it clearly in this preamble that where we're talking about having records to search upon request because we'd have to request is over these key words, key terms and so forth.

MR. FISANICH: I will clarify that.

CHAIRMAN GENSLER: Maybe I'm asking without objection for unanimous consent to make that. Also I'll make the motion that the head of DSIO be delegated, just as we did in the large trader reporting thing, additional -- you wouldn't want them to be able to give additional time?

COMMISSIONER O'MALIA: I know we're looking at this. The question I think in my opinion is why are we delegating it?

CHAIRMAN GENSLER: To give additional time?

COMMISSIONER O'MALIA: That's what everybody is discussing, if you could give us some more time on this. I think another feature of this is to consider the cost of the product. If it's technically not feasible or if it is technically feasible --

CHAIRMAN GENSLER: To do the search?

COMMISSIONER O'MALIA: I thought we were on to the next issue, this preamble language.

CHAIRMAN GENSLER: I was talking about the search thing.

COMMISSIONER O'MALIA: The search thing I'm fine with.

CHAIRMAN GENSLER: I'm not sure what piece of paper you just raised.

COMMISSIONER O'MALIA: Something your staff handed around.

CHAIRMAN GENSLER: No. I didn't produce this thing. I don't know. It could be another Commissioner who produced that. I don't know.

COMMISSIONER O'MALIA: I'm sorry. It's Commissioner Chilton's.

MR. MEISTER: Mister Chairman?

CHAIRMAN GENSLER: I'm going to take a short recess because it was Commissioner Chilton's document and he's not here. So why don't we take a 5- to 10-minute recess?

(Recess)

CHAIRMAN GENSLER: We're back in session. May I ask a question of Frank? On the dialogue that you just had before we recessed with Commissioner Wetjen and I think Commissioner Sommers about improper or improperly, I think it would be helpful to add some words to the preamble, you'll have to write them, to clarify that improper as you said earlier which I think the transcript will show is a narrow thing. Do you want to tell us how you might be able to clarify and maybe I could then ask for unanimous consent that you write a sentence to clarify that?

MR. FISANICH: We would add a footnote or another sentence to that part of the preamble

to clarify that improper in this context means encouraging the use of an affiliated FCM that would wrongfully interfere or influence the decision by the FCM to provide clearing services and activities to a particular customer in violation of 1.71(d)(i) which is the preceding section that has the general rule that an affiliated swap dealer or MSP shall not interfere or influence the provision of clearing services or activities so that the improper refers back to the previous section and only the interference or influence on the provision of clearing services or activities.

CHAIRMAN GENSLER: In essence that it doesn't mean something else.

MR. FISANICH: Not something else; right, narrowly defined.

CHAIRMAN GENSLER: I don't know what the others think. Commissioner Wetjen, I think it would be helpful to narrow that.

COMMISSIONER WETJEN: I think it would be helpful to narrow it, and just to be clear, the

consent request is that we do something along these lines, we're not committing to that precise language, that we'd need to work with the language a little bit?

CHAIRMAN GENSLER: Because I'd normally also ask for consent to take technical corrections, but, yes, I think it would be helpful to clarify that improper is only really referencing back to as you said something like wrongfully influencing under whatever the rule text is and not something else that people have to guess about; so, unanimous consent.

I think the recess was largely about an amendment that Commissioner Chilton and his staff had suggested on a delegation addressing concerns that if a registrant needed more time because it was technologically challenging or there are words in this amendment about technological issues including cost considerations for that particular registrant, that the Director of the Division of Swaps and Intermediary Oversight could grant extensions of time for compliance with the daily

trading records. Do you want to offer your amendment?

COMMISSIONER CHILTON: Yes. You described it aptly. There would be a 30-day period in which once an entity petitions the agency that we would have 30 days to respond to them to consider whether or not they had these technological challenges, and as part of that we would look at the cost, we'd consider the cost. This would in no way impact their registration with the National Futures Association so that it's a pretty concise and clear amendment ultimately.

CHAIRMAN GENSLER: So you're making that motion on the piece of paper?

COMMISSIONER CHILTON: I move the amendment.

COMMISSIONER O'MALIA: Second.

CHAIRMAN GENSLER: Do we do amendments by roll call?

MR. STAWICK: Do you mean do it by unanimous consent or by voice?

CHAIRMAN GENSLER: By unanimous consent

Commissioner Chilton's amendment as seconded by Commissioner O'Malia.

COMMISSIONER CHILTON: Aye.

COMMISSIONER O'MALIA: Aye.

CHAIRMAN GENSLER: Aye.

MR. STAWICK: Are we doing a roll call vote there?

CHAIRMAN GENSLER: No, I guess without objection. So now we have the staff recommendations with two preamble clarifications and Commissioner Chilton's amendment. Mr. Stawick?

MR. STAWICK: Commissioner Wetjen?

COMMISSIONER WETJEN: Aye.

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

COMMISSIONER O'MALIA: No.

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

COMMISSIONER CHILTON: Aye.

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

COMMISSIONER SOMMERS: No.

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

CHAIRMAN GENSLER: Aye.

MR. STAWICK: Mister Chairman, aye. Mister Chairman, on this question the yeas are three, the nays are two.

CHAIRMAN GENSLER: The yeas having it, the staff recommendation is accepted and will be sent to the Federal Register. Should I take unanimous consent on technical corrections now too? Why don't I do unanimous consent on technical corrections particularly given what we just said? Without objection so moved. Thank you, Ward, Frank, Gary Barnett and the many others who have worked on those rules. Thank you. I think it's now block time. As the team is coming up to the table, let me introduce and welcome Carl Kennedy from the Office of General Counsel, George Pullen, Lynn Riggs and Rick Shilts of the Division of Market Oversight and Esen, I'm going to mispronounce your last name, Onur, from the Office

of Chief Economist. They will present the proposed rule on block trading. I hand it over to you.

MR. KENNEDY: Good afternoon, Commissioners. Thank you, Chairman Gensler, for the opportunity to present. Before I begin I would like to thank each member of my team and former team members for their assistance in preparing the block trade proposal that we present to you today for your consideration and vote. To provide context, I would like to provide relevant background on why the Commission is now considering today's proposal.

Section 727 of the Dodd-Frank Act created Section 2a(13) of the Commodity Exchange Act. Section 2a(13) requires that the Commission issue rules regarding the real-time public reporting of swap transaction and pricing data. This section also requires the Commission to do three things relevant to this proposal. First, specify criteria for determining what constitutes a large notional swap transaction or block trade

for the purposes of applying time delays for public reporting of such transactions. Second, to ensure that the public dissemination of swap data does not reveal the identities or business transactions of swap counterparties. And most important, third, ensure market liquidity is not hampered.

In December 2001, the Commission published a real- time reporting proposal which included a methodology that swap data repositories would set block sizes. The methodology provided that block sizes would be equal to the greater of a so-called social size multiple test and a distribution test. Both of those tests focused on the number of swap transactions or trades and would likely have resulted in only 5 to 1 percent of all swaps being traded as blocks. The real-time proposal also included a generalized approach for grouping swaps with similar characteristics. This approach did not provide much detail on how swaps would be grouped, however. Instead, the real-time proposal set out

a few examples. The real-time proposal also set out a 15-minute time delay for swaps that are executed on a swap execution facility or designated contract market and asked questions regarding the appropriate time delays for bilateral swaps. Finally, the real-time proposal included two requirements that SDRs protect the identities of swap counterparties first by limiting disclosure of the notional sizes of swap data so that notional sizes above 250 million would be masked. And second, by including a general requirement tracking the statutory language of 2(a)(13) that SDRs protect the identities of swap counterparties.

In December 2011, the Commission adopted as final the real-time rule in Part 43 of its regulations. In the final rule the Commission provided several definitions relevant to today's proposal including the definition of the terms asset class, block trade, appropriate minimum block size, among others. It also established a series of time delays for the public dissemination

of swap data. It put forth a list of interim cap sizes that varied by asset class to mask the notional sizes of large swaps and it excluded from public reporting certain commodity swaps because the publication of swap data detail relating to the geographic delivery locations for those swaps might reveal the identities of swap counterparties. Because the Commission has not yet established a block size methodology, all swaps will be treated like blocks and will be subject to time delays as set out in the final rule.

Today's proposal picks up where the final rule left off. As the Chairman mentioned in his opening remarks, in drafting this proposal the team was informed by and was responsive to comments received by commenters to the real-time proposal. In addition, we were able to collect and review relevant data for two asset classes, interest rates and credit. The team has spent over 18 months reviewing these comments and relevant market data. Based on this review we are

proposing detailed criteria for grouping swaps which are both tailored to the primary economic indicators within each asset class, tailored and measured methodologies for determining appropriate minimum block sizes in a two-step phased approach and additional measures to protect anonymity related to the public dissemination of swap data. I will briefly explain the major components of the block trade proposal followed by an explanation of the additional anonymity measures.

With respect to blocks, the proposal further breaks down the five asset classes previously established by the real-time rule into swap categories of groups of swaps. The five asset classes are interest rates, credit, equity, foreign exchange and other commodities. Swaps within each asset class are generally grouped based on common risk and liquidity profiles. For swaps in the interest rate asset class, the proposed rules would establish 24 swap categories based on eight tenor band groups and three currency groups. For swaps in the credit asset

class, the proposed rules establish 18 swap categories based on six tenor banks and three conventional spread groups. For the FOREX asset class, the proposed rules establish over 450 swap categories based on unique currency combinations. For the other commodity asset class, the proposed rules establish 120 categories based on whether those swaps are economically related to futures or swap contracts. If a swap is not economically related to those contracts, staff is proposing a system for group swaps in the other commodity asset class based on 60 product types. In establishing methodologies, staff sought to balance the goals of price discovery and protecting market liquidity. Staff also sought to develop methodologies that were an improvement from the methodology provided in the real-time proposal and was not as complex.

As I noted previously, the Commission would prescribe appropriate minimum block sizes for the swap categories within each asset class in a two-period phased-in approach. The first phase

called the initial period includes different methodologies based on the availability of reliable data. As mentioned before, staff was able to spend 18 months reviewing interest rate and credit data. For the other asset classes,

staff was persuaded by commenters to the real-time proposal who suggested that the Commission be informed by DCM block sizes set for economically related futures contracts. During the initial period staff recommends that swaps be subject to static appropriate minimum block sizes which are set out in an appendix to the proposal. The initial period would last a minimum of 1 year for each asset class in accordance with the compliance schedule in Part 45 of the Commission's regulations. During that year, registered SDRs would collect robust datasets for each asset class. For interest rate and credit swaps, staff is proposing block sizes using the datasets it obtained. The sizes would be applied to each swap category based on a 67-percent notional amount calculation methodology. That methodology

determines block sizes by looking at the net notional distribution of swaps within each swap category and setting the block size based on the two-thirds mark within that distribution. Staff believes that the net notional determination methodology is a better measure of risk as compared to the number of trades which was seen in the real-time proposal. Based on the data we were able to obtain, 6 percent of all swaps in the interest rate and credit asset classes would be treated as blocks which would mean that 94-percent of the market would be transparent as soon as technologically practicable. Like the real-time methodology, this methodology uses net notional values again which focuses on the amount of the risk within a swap category. For example, a 2-year cross-currency U.S. Dollar/euro interest rate swap would have a block size of 750 million. For foreign exchange and other commodity swaps during the initial period, staff proposes an approach that would determine sizes based on the sizes set by DCMs for economically related futures

contracts. Again staff was informed by commenters that DCM block sizes are a good comparative measure for setting blocks. We agree with commenters that swaps in these asset classes are closely linked to futures markets, that tying block sizes on these two markets to their economically related futures contracts reduces opportunities for arbitrage and, lastly, that DCMs have experience in setting block sizes in such a way that maintains market liquidity. If a foreign exchange or commodity swap is not economically related to a futures contract, staff recommends that the Commission have a more nuanced approach where some but not all of the swaps would continue to be subject to a time delay because of the effectiveness of the real-time final rule. For equity swaps, staff believes that these swaps should not be treated as blocks and subject to a time delay in both the initial period and after that period because of the existence of a highly liquid cash market which is where price discovery occurs, the absence of time delays for reporting

blocks in that market, the relative size of the equity index swaps relative to futures options and cash index markets and, fourth, the goal of preventing opportunities for regulatory arbitrage.

After the initial period the Commission would establish post-initial appropriate minimum block sizes for each swap category based off the data collected by SDRs. Staff proposes that the Commission update post-initial minimum block sizes no less than once each year using a 67-percent notional amount calculation. Post-initial block sizes would be published on the Commission website and will become effective on the first day of the second month following publication.

One final point about the proposed methodologies. Staff recommends the establishment of a series of special rules to deal with complex issues such as how to determine block sizes for swaps with optionality, how to determine block sizes for swaps in other currencies and how to address the situation in which a member state is removed from the Euro Zone. In terms of process,

the proposal establishes a process for market participants to elect to treat their swaps as blocks and how notice of that election would be sent to a SEF or DCM if a swap is traded on a SEF or DCM, or if it's traded bilaterally, how the reporting parties would report that to an SDR. Also in terms of process, the proposal would allow the Division of Market Oversight to undertake all responsibilities related to the setting of block sizes and cap sizes.

Finally, for convenience purposes, the proposal includes a helpful example where market participants can see how the Commission would undertake the determination process. As I mentioned, this proposal not only addresses block trade rules and it also includes additional measures to protect anonymity related to swap data. Specifically, staff proposes that the Commission adopt two measures to protect anonymity. First, the Commission would amend Part 43 of its regulations to establish a permanent system establishing cap sizes for masking notional

and principal amounts of swap data that is reported to the public. During the post-initial period cap sizes would be used setting a 75-percent notional amount calculation which is similar to the methodology for setting block sizes. And second, the proposal would require the remaining commodity swaps not currently subject to public reporting under the final real-time rule that these swaps would be publicly reported as a result of the establishment of a system to mask the specific geographic delivery and pricing detail related to those swaps.

Before I conclude, I would like to note that staff has included a myriad of variations and alternatives to the proposed approach in its proposal. For example, one variation would change the calculation methodology from 67 percent to 50 percent. We ask over 108 questions, many of which have several subquestions. Commenters are encouraged to submit comments in response to the particular questions by number. This concludes my prepared marks on the block trade proposal. Thank

you for your time, and my colleagues and I are happy to answer your questions.

CHAIRMAN GENSLER: Carl, thank you. I will now entertain a motion to accept this staff recommendation on this proposed rule.

COMMISSIONER SOMMERS: So moved.

COMMISSIONER CHILTON: Second.

CHAIRMAN GENSLER: Thank you. Carl, on that last point I have a few questions. When you said a myriad of alternatives, I thought it was about five or six. Is that what you're referring to?

MR. KENNEDY: Yes. We do ask a number of alternatives not only in terms of how we determine the block sizes but also in the way group them, as well as a number of alternatives to the way we set cap sizes.

CHAIRMAN GENSLER: I have a question for you and the team and maybe Dan as well. If during the comment period people come back and say we think this 67 percent of net notional works for this asset classes, but there are other asset

classes, maybe there really should be something different. Do we have the flexibility in the final based on the comments and based on the record to finalize with different approaches again if it's based on comments?

MR. KENNEDY: Absolutely. We have specific questions that we ask as to particular asset classes, if one approach is better than the other.

CHAIRMAN GENSLER: The nature of my question is do we have the flexibility not only to change from the 67-percent approach but to possibly have one approach for interest rates and a different approach for oil swaps based on the comment record?

MR. KENNEDY: Yes, I believe that we do.

CHAIRMAN GENSLER: I see Harold is shaking his head. Even if it's within the interest rate market, is it possible that if commenters were to come back and say this is a good approach for possibly the high-volume transactions, the ones with more volume or

liquidity but maybe a different approach is more appropriate for those that are less standardized, is that possible?

MR. KENNEDY: Yes, that is possible. We asked that specific question as well.

CHAIRMAN GENSLER: Dan and Harold, are we all right on that too? That's a yes, Dan?

MR. BERKOVITZ: Yes.

CHAIRMAN GENSLER: I just might hold you to that. Do you want to get a mike?

MR. BERKOVITZ: With just the clarification when you say different approach, one of the approaches identified in the questions or suggested in the questions --

CHAIRMAN GENSLER: I meant there are about five or six approaches, the two principle ones, 67 percent of net notional versus 50 percent of net notional.

MR. BERKOVITZ: Correct.

CHAIRMAN GENSLER: But there is also one that looks at using the depth of the book and the order book and some others, so I'm asking if it's

one of those four or five --

MR. BERKOVITZ: Exactly.

CHAIRMAN GENSLER: But then the commenters came back and said this 67 works maybe for a 2-year interest rate swap but it doesn't work as well for more of an esoteric oil swap or something.

MR. BERKOVITZ: There is sufficient notice for the Commission to adopt that.

CHAIRMAN GENSLER: Maybe I'll walk through why I support the rule, but I'm going to have a couple of questions in the middle of it. I do support this rule because I think it's so inherent in promoting pretrade transparency and posttrade transparency because some portion of the market Congress said should be reported as soon as technologically practicable, the nonblocks so to speak. As I gather here, what this comes down to is that two-thirds of the volume in the market, the net notional volume of the market, would benefit from pretrade transparency and shorter delays if was both a clearable swap, mandatorily

cleared and of course has some made available for trading designation. Do I have that about right?

MR. KENNEDY: You have it right, Mister Chairman.

CHAIRMAN GENSLER: So that in the cleared swap and made available for trading if this were the final rule, two- thirds of the volume by net notional would benefit from the pretrade transparency.

MR. KENNEDY: That is correct.

CHAIRMAN GENSLER: To me that benefits the whole economy. Ninety-four percent of the economic is the real economic, private-sector jobs, it also benefits the mutual funds, pension funds, the buy side of the financial community, but it does shift some of the information advantage over to the buy side representing all of those pensioners and mutual fund investors and I think it shifts some of the information advantage over to the end user community that so inherently needs these products. How did you address Congress's mandate to still promote liquidity and

protect liquidity in the market?

MR. KENNEDY: The method in which we grouped swaps with similar risk and liquidity profiles so that we would apply a block size to those swaps with that same liquidity and risk profile. That's the way we are seeking to ensure we protect anonymity. I'm sorry, that we protect liquidity. I misspoke.

CHAIRMAN GENSLER: But I gather also, and maybe Esen this might come from the Chief Economist's office, you think that this approach, about two-thirds of the volume, gets pretrade transparency and one-third doesn't in essence, that that still protects liquidity as Congress identified?

MR. ONUR: Yes. As to the discussions that we had at the OCE, we do believe that the way we set the 67-percent notional would bring enough transparency to the market but still protect liquidity.

CHAIRMAN GENSLER: I don't mean to just focus on this but I'm allowed to, one commenter in

the original rule had sent in something that talked about setting block sizes with regard to the dollar value of a 1 basis point move in the marketplace or what market call a DVO1. Do you know in the interest rate markets for these supermajors what is the dollar value of the O1 that this now roughly is? Then I can keep in mind the arithmetic.

MR. PULLEN: I believe that the comment letter came from Blackrock and their DVO1 was 300,000 for the value. For the 2-year interest rate swaps for supermajors our DVO1 would be about half that. So if we had gone with the 300,000 DVO1 they requested, our block sizes would be in fact higher for that particular swap category.

CHAIRMAN GENSLER: My question was not so much how they commented, that their letter reminded me to ask this question. But you're saying our number is roughly $150,000 for a 1 basis point year in the 2 year?

MR. PULLEN: That's correct, in the 2 year. It does change across swap categories, but

just to give a snapshot view, that is the 2 year.

CHAIRMAN GENSLER: One of the things that I support about this rule that I think is important is that we've learned from the commenters that the original rule that we put out there had a lot of complexity and we've in essence simplified it. It no longer has what was called the social size network.

MR. KENNEDY: Social size multiple test.

CHAIRMAN GENSLER: Social size multiple test of five times the mean median. So that it's far simpler. Is that correct?

MR. KENNEDY: Correct. It is a lot simpler.

CHAIRMAN GENSLER: And a lot of commenters had raised that. Is that right?

MR. KENNEDY: Yes.

CHAIRMAN GENSLER: Another thing that it does is it's far more tailored. I can remember more than one congressional hearing when a member of Congress said to me your rules seem to be one-size-fits-all. Is it correct that our

original proposal might have been one category?

MR. KENNEDY: Yes. The way the swap category was described is that you could possibly group swaps into a fewer number of swap groupings, yes.

CHAIRMAN GENSLER: Not that I think that's what we would have finalized that there was only one interest rate category, but commenters had said they were worried about that.

MR. KENNEDY: Right. They were worried about that. Absolutely.

CHAIRMAN GENSLER: So now we have 24 categories in with interest rates, but we've asked sufficient questions that if commenters said, no, 24 is not right, we should only have 16 or 30 we can --

MR. KENNEDY: Correct. Or if commenters feel as though we need more, we certainly can do that as well. We've asked those specific questions.

CHAIRMAN GENSLER: I think this rule benefits from that. I think the other thing it

benefits from is that we've gotten data albeit as I think Commissioner O'Malia said, it might have been Commissioner Sommers, that it was only 3 months of data for the interest rate markets and the credit markets. Is that correct?

MR. KENNEDY: That is correct.

CHAIRMAN GENSLER: But that's a big step forward from when we proposed the first rule. Right?

MR. KENNEDY: Yes, certainly it is.

CHAIRMAN GENSLER: Then we've moved from a transaction approach to a volume approach.

MR. KENNEDY: Yes.

CHAIRMAN GENSLER: So those are all I think positive steps forward from the comment file and what people had raised in the comment file. One other thing. Could you describe something? In the commodity space I think there is a very important set of questions that we have in this re-proposal about keeping the anonymity for transactions whether it's in the natural gas market, the oil market, the electricity market.

There were a lot of commenters who were concerned and I complement the staff in that I think you've come up with a really good set of suggestions here that I support. I think that it would be helpful for those listening from the energy markets how you've proposed that we make transactions particularly when it's in a location and people don't want to let their anonymity loose that they're trying to get natural gas or electricity at a certain place.

MS. RIGGS: For a subset of the other commodity swaps, we are limiting the geographic detail of the U.S. Delivery or pricing points. For natural gas and related products, we are using the five FERC natural gas markets. For petroleum end products we're using the seven PAD regions. For electricity end sources we're using the 10 FERC electric power markets. And for the remaining other commodities we're using the 10 federal regions. We are also proposing international regions for non-U.S. delivery or pricing points.

CHAIRMAN GENSLER: Lynn, as I understand, if somebody entered into a natural gas swap, it wouldn't necessary say that it was at the Rocky Mountains, it would say whatever that region is. Is that right?

MS. RIGGS: That is correct.

CHAIRMAN GENSLER: For example, if somebody did a jet fuel swap at Baltimore-Washington's Thurgood Marshall International Airport, it wouldn't say that it was at BWI, I guess that's probably one of, did you say 10 or eight regions?

MR. KENNEDY: Seven.

CHAIRMAN GENSLER: Seven federal regions.

MR. KENNEDY: Yes.

CHAIRMAN GENSLER: To mask the geographic situations?

MS. RIGGS: Again I think a lot of commenters asked about this, that's constructive and we'll see what feedback we get. I'm going to support the rule, but I turn to Commissioner

Sommers.

COMMISSIONER SOMMERS: Thank you so much for all of your work on this rule. As I said in my opening comments, I appreciate the complexity of trying to get this right. It is a balance and I think the questions and the different alternatives that you have in the proposal are a reasoned approach, but I do have a couple of questions. My first question is with regard to the 50-percent notional amount calculation that was in the proposal until last night. Obviously it was something that staff had recommended to us and then was changed at the last minute. I'm trying to figure out what kind of calculations we did in the proposal that's before us today to differentiate between the two, 50 and 67 percent, and why not 75? Why not 85? How did we land on 67?

MR. KENNEDY: We considered a number of alternatives before presenting the recommended approach. In fact, some of our alternatives would go lower than 50 percent and some would go higher,

as high as 95 percent of number of trades within a particular swap category. We ultimately settled on 76 percent and we were going back and forth between 50 and 67 percent, but we ultimately decided on 67 percent because we think that it still would capture the vast majority of transactions that would be subject to real-time reporting and we would still balance liquidity. Comparing it to the initial proposal, we think that it would better take into account the potential effects on market liquidity. So although we ultimately are coming out with a 67-percent test, it was one of the possibilities that we considered before the recommended approach that we shared with the Commissioners a couple of weeks ago.

COMMISSIONER SOMMERS: The 50-percent approach that was in the proposal before, what effect would it have on market liquidity?

MR. KENNEDY: In terms of the absolute effect on market liquidity, we believe that the number of transactions that would be subject to

real-time reporting would be 86 percent, that the difference between the 86 percent and the 94 percent now with the 67-percent notional test that we're going out with, we believe that that difference is something that we're certainly aware of. We're hoping that by asking a number of questions on our rule that market participants will tell us whether that is significant. Again this is a proposal and we're not saying that we have all of the answers. We do have a limited amount of data, but we think it's robust data enough that we were able to come out with 67 percent as a proposed approach.

COMMISSIONER SOMMERS: I couldn't agree more that it is going to be incumbent upon market participants to comment on what is reasonable for this proposal and for us to consider as we go final, but my next question is with regard to the process. There is some language in the preamble that talks about if we determine that block sizes are having an adverse effect on liquidity, the Commission may take action on its own initiative

via rule or order to mitigate the impact. Can you explain to me a little bit what that process would entail, rule or order to be able to dampen the effect on market liquidity and whether or not we would actually be able to take action in any sort of expedited way?

MR. KENNEDY: Certainly the Commission has the authority to take action by emergency rule or order, so that if we were able to determine market participants, the provision in the preamble or the statement in the preamble says that even if market participants were to provide data to us to say that our sizes would adversely affect market liquidity, we could take expedited action, perhaps issue an interim final rule or something or change order to change those block sizes. Of course also the provision in our rule says that we set appropriate minimum block sizes no less than once a year so that we could through that same process change those block sizes.

COMMISSIONER SOMMERS: In the interim before the year is up if we feel that they have

been set incorrectly?

MR. KENNEDY: Yes.

COMMISSIONER SOMMERS: And we would take emergency action in a market? That's typically not something that we do.

MR. KENNEDY: The provision provides that the Director of the Division of Market Oversight can set block sizes no less than once a year. We would have to of course use the formula or methodology that we finalize, but the Division Director could take action. But the statement that you're referring to in the rule refers to the authority of the Commission to take action by rule or order in emergency action.

COMMISSIONER SOMMERS: I think it would be helpful as we move forward with this proposal to think about what that kind of process would be and if it's actually emergency action I think that would be an interesting dynamic. Thanks.

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

COMMISSIONER CHILTON: I don't have

questions. I commend you all for the good work. Thank you.

CHAIRMAN GENSLER: Commissioner O'Malia?

COMMISSIONER O'MALIA: Cost-benefit. What's the baseline you're using? So that I don't get confused, is it a prestatute or poststatute baseline?

MR. KENNEDY: The baseline that we're using would start the period of time following the effective implementation of the real-time public reporting rule because as I mentioned before, our rule is an incremental step over and above that rule, so that's our baseline.

COMMISSIONER O'MALIA: For the other commodities, the methodology for setting block sizes is for the initial and post-initial since you didn't work off of actual market data. The final rule divides its approach for the other commodities into five baskets plus a few special cases. Why in the initial period do you rely on DCM block sizes for a number of swaps?

MR. KENNEDY: Currently we don't have

actual market data for equity, foreign exchange and commodity swaps. We do have a set of robust data for interests and credit. As I mentioned in my opening statement, we were persuaded by some of the commenters who suggested that DCM block sizes are a good comparative measure to use and it may be prudent during the initial period to use those sizes to prevent opportunities for regulatory arbitrate.

COMMISSIONER O'MALIA: The DCM core principles obviously changed the block rules. Core Principle Nine has an 85-percent test in the proposal and hopefully that changes, but that's all you have to go off of at this point. How does that work with setting a block size on a moving target?

MR. KENNEDY: During the initial period we recognized too that the sizes that we would set during the initial period are static so that they wouldn't be dynamic and if sizes were to change because a DCM were to change their sizes after 6 months we recognized that the initial size is a

static number. However, because we're trying to take a measured approach and not adversely impact markets I think by providing certainty in having a static number, I think market participants will know how to trade and will trade according to that initial size. And then once we have more data after that initial period, obviously things would change. We would no longer rely on DCM block sizes.

COMMISSIONER O'MALIA: What are they supposed to comment on right now with a moving target? Do you ask a question related to the changing DCM core principle?

MR. KENNEDY: We do. We ask should we change the sizes during the initial period at some sort of set interval.

COMMISSIONER O'MALIA: Thank you. On the way in this morning I was reading Chairman Shapiro's discussion about high-frequency traders which made me think of the May 6 episode and the research that came out of that and our Chief Economist Andre Kirilenko talked about volume

versus liquidity in some of this trading and if we tie some of this trading volume what impact will that have on your data if you're having some relationship to futures markets? Is there any impact at all? I'm curious. I can't put the pieces together. Do you think it will make a difference at all?

MR. KENNEDY: George, that's yours.

COMMISSIONER O'MALIA: Your test is liquidity. Right? You're supposed to check for liquidity?

MR. KENNEDY: Correct.

COMMISSIONER O'MALIA: And Dr. Kirilenko found that not all liquidity is created equal. What did you measure it against?

MR. PULLEN: For other commodity swaps as mentioned in the initial period will go with the DCM sizes where they are submitting those. There are definitely interactions between the pools of liquidity for economically equivalent futures contracts when they have swap lookalikes or similar swaps. Those characteristics do align

and the risks that are moved back and forth across portfolios are definitely in synch in many cases. But the purpose for introducing this in the swaps market is to have a measured approach so that we're slowly introducing these levels of transparency. So if a long-term goal is to synch up our understanding of these pools of liquidity and then come up with overarching block numbers, that's larger than our current goal to introduce transparency for swaps in general. It's a great long-term goal though. I think it's a great long-term goal to synch these up, and I think in terms of a measured approach to introduce this I think that we're going at it the right way.

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

COMMISSIONER WETJEN: Thanks, Mister Chairman. Thanks to the team for all your work on this rule and for the briefing you provided a couple of weeks ago. I found that very helpful. One of the questions in the proposal is question 35-A which asks whether a methodology based on

market depth and breadth might be an appropriate methodology. Perhaps more for the benefit of the folks listening and here today, could you explain a little bit that methodology and what the thinking is behind it?

MR. PULLEN: Certainly. That's one of our alternatives. As we've said, there are many alternatives there. The idea of a market breadth, market depth test would be to look at this market in a more holistic approach in that instead of only looking at the volumes which are executed on, we'd also look at the availability of bids and offers as another measure of liquidity. There is no one measure of liquidity. If you get 20 economists in a room, you'll get 20 different measures of liquidity. But market breadth and market depth is certainly one of those measures.

COMMISSIONER WETJEN: As we approach a final rule, I presume that it's possible to even have a combination of different methodologies.

MR. PULLEN: Yes. One of the questions does involve would a composite approach be more

appropriate which, for example, might have a 67- or 50-percent level interacting with a market depth, market breadth test or interacting with another test that we've proposed and that could in fact be the way that we turn out based on --

MR. KENNEDY: I'll add to what George has said. We certainly could take a number of factors and in the market- depth question we do ask that question. But in our view we think that it may be a little bit more challenging to capture the type of data that that question would require. We do recognize we have special call authority to collect that data, but the amount of data that we would have to collect may be a little difficult. We would have to consider the effects on the Paperwork Reduction Act type costs and burdens and also cost-benefit considerations. But we do ask questions about those things as well.

COMMISSIONER WETJEN: I think this has an obvious answer, but certainly the comments could come in, and you'd mentioned the option of the Commission of using a composite methodology.

But certainly the comments could come in in a way where it's convincing that there is one particular methodology that is the very best test of liquidity.

MR. KENNEDY: Correct.

COMMISSIONER WETJEN: That's all I have.

CHAIRMAN GENSLER: Before we do the vote, I have one question. On the other commodity classes, oil, natural gas, et cetera, I couldn't find the questions fast enough. I think it's in here. If the commenters came in and said 67 percent is a good idea for oil, that's a pretty liquid market, but over here in livestock you should stay with the same number that the DCM has. I could envision that. I could envision that there are certain parts in this market that might go to a measured formula approach, and I'm particularly sensitive to some of the smaller markets like livestock. Do we have that flexibility in here as well?

MR. KENNEDY: We do. We ask that specific question, should we take some of the

approaches that we're using in the initial period, should we carry them forward?

CHAIRMAN GENSLER: For instance, if the commenters all said on livestock we should make sure we're exactly the same as the designated contract market, and I don't know the number in livestock, but $3 million, it's not going to be some formula, we could finalize?

MR. KENNEDY: Yes. We can finalize with that.

CHAIRMAN GENSLER: Thank you. Mr. Stawick?

MR. STAWICK: Commissioner Wetjen?

COMMISSIONER WETJEN: Aye.

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

COMMISSIONER O'MALIA: No.

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

COMMISSIONER CHILTON: Aye.

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

COMMISSIONER SOMMERS: No.

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

CHAIRMAN GENSLER: Aye.

MR. STAWICK: Mister Chairman, aye. Mister Chairman, on this question the yeas are three, the nays are two.

CHAIRMAN GENSLER: The yeas have it and the staff recommendation is accepted. The thing I did on technical corrections earlier covers both of these. I just wanted to make sure of that. Our next scheduled meeting looks like it's going to be March 9 is what this book says. We'll publish of course a week in advance what we're going to do then hopefully in consultation with the Securities and Exchange Commission. With that, I think I will if there is no other business take a motion to adjourn the meeting.

COMMISSIONER SOMMERS: So moved.

CHAIRMAN GENSLER: All in favor?

(Chorus of ayes.)

CHAIRMAN GENSLER: The meeting is

adjourned. Thank you so much to both teams.

(Whereupon, at 11:59 a.m., the PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

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

Notary Public, in and for the District of Columbia

My Commission Expires: January 14, 2013