Testimony on Dodd-Frank Act Implementation
by
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Chairwoman Stabenow, Ranking Member Roberts, and members of the Committee:

Thank you for inviting me to testify today regarding the implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Act") by the Securities and Exchange Commission ("SEC").[1] As you know, Title VII primarily relates to the regulation of over-the-counter ("OTC") derivatives, creates an entirely new regulatory regime for OTC derivatives, and directs the SEC to write a large number of rules necessary to implement the Act. Since its enactment in July 2010, the SEC has proposed more than three-fourths of the rules required by the Act. While we have accomplished much over the last year and a half, we are continuing to work diligently to implement all provisions of Title VII.

My testimony today will focus on the SEC's efforts to implement Title VII of the Dodd-Frank Act since its enactment.

Background

OTC Derivatives Marketplace

As I have testified previously before this Committee, the growth of the OTC derivatives marketplace has been dramatic over the past three decades. From its beginnings in the early 1980s, when the first swap agreements were negotiated, the notional value of these markets has grown to over $700 trillion globally.[2] However, OTC derivatives were largely excluded from the financial regulatory framework by the Commodity Futures Modernization Act of 2000. As a securities and capital markets regulator, the SEC has been particularly concerned about OTC derivatives products that are related to, or based on, securities or securities issuers, and as such are connected with the markets the SEC is charged with overseeing.

Dodd-Frank Act

Title VII of the Dodd-Frank Act mandates the oversight of the OTC derivatives marketplace and requires that the SEC and Commodity Futures Trading Commission ("CFTC") write rules that

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[1] The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the full Commission.

[2] See Bank for Int'l Settlements, OTC derivatives market activity in the first half of 2011 (November 2011) at 1, available at http://www.bis.org/publ/otc_hy1111.pdf (noting that total notional amounts outstanding of OTC derivatives rose by 18% in the first half of 2011, reaching $708 trillion by the end of June 2011).

address, among other things, mandatory clearing, the operation of security-based swap and swap execution facilities and data repositories, capital and margin requirements and business conduct standards for security-based swap and swap dealers and major participants, and regulatory access to and public transparency for information regarding security-based swap and swap transactions. This series of rulemakings is designed to improve transparency and facilitate the centralized clearing of security-based swaps, helping, among other things, to reduce counterparty risk. It should also enhance investor protection by increasing disclosure regarding security-based swap transactions and helping to mitigate conflicts of interest involving security-based swaps. By promoting transparency, efficiency, and stability, this framework should help foster a more nimble and competitive market.

Public Consultation

The implementation of Title VII is a substantial undertaking and raises a number of challenges. Accordingly, we have been engaging in an open and transparent implementation process, seeking input on the various rulemakings from interested parties even before issuing formal rule proposals. As we complete the rule proposal phase and move into the rule adoption phase of implementation, we will continue to seek input on each rule proposal with the goal of producing effective and workable regulation of derivatives activities.

In addition, our staff has sought the views of affected stakeholders through meetings with a broad cross-section of interested parties. To further this public outreach effort, the SEC staff has held a number of joint public roundtables and hearings with the CFTC staff on select key topics. Through these processes, we have received a wide variety of views and information that is useful to us in proposing and, ultimately, adopting rules that are appropriate for these markets.

Ongoing Regulatory Coordination with the CFTC and Other Regulators

In implementing Title VII, our staff is in regular contact, both formal and informal, with the staffs of the CFTC, Federal Reserve Board, and other financial regulators. In particular, SEC staff has consulted and coordinated extensively with CFTC staff in the development of the proposed rules arising under Title VII, including joint rules further defining key terms relating to the products covered by Title VII and certain categories of market intermediaries and participants. Although the timing and sequencing of the CFTC's and SEC's proposed rules vary, they are the subject of extensive interagency discussions and, to the extent practicable, a coordinated approach. As we move toward adoption, the objective of consistent and comparable requirements will continue to guide our efforts.

The Dodd-Frank Act also specifically requires that the SEC, the CFTC, and the prudential regulators "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards" with respect to the regulation of OTC derivatives. Accordingly, the SEC has actively entered into bilateral and multilateral discussions with foreign regulators addressing the regulation of OTC derivatives. Through these discussions and our participation in various international task forces and working groups, we have gathered information about foreign regulatory reform efforts, identified potential gaps, overlaps and conflicts between U.S. and foreign regulatory regimes, and encouraged foreign regulators to

develop rules and standards complementary to our own under the Dodd-Frank Act. Such efforts include frequent calls and meetings with the European Union and other major foreign regulatory jurisdictions in Asia and North America. In addition, the SEC participates in the Financial Stability Board's Working Group on OTC Derivatives Regulation, of which the SEC serves as one of the co-chairs on behalf of the International Organization of Securities Commissions ("IOSCO"), and serves as one of the four co-chairs of the IOSCO Task Force on OTC Derivatives Regulation. In addition, we are convening, with the CFTC and European Securities and Markets Authority ("ESMA"), a meeting next week of international regulators to talk through the status of derivatives regulation implementation and cross border issues.

As we progress toward the adoption of our Title VII rules, we will continue to consult with our regulatory counterparts abroad in an effort to foster the development of common frameworks, and to help ensure a level playing field for market participants and prevent opportunities for regulatory arbitrage.

Title VII Implementation to Date

The SEC has taken significant steps in implementing Title VII of the Act, proposing rules in thirteen areas.

Initially, we proposed rules to mitigate conflicts of interest involving security-based swaps. These proposed rules seek to address conflicts of interest at security-based swap clearing agencies, security-based swap execution facilities, and exchanges that trade security-based swaps.

We then proposed anti-fraud and anti-manipulation rules for security-based swaps that would subject market conduct in connection with the offer, purchase, or sale of any security-based swap to the same general anti-fraud provisions that apply to all securities and reach misconduct in connection with ongoing payments and deliveries under a security-based swap. We also proposed rules regarding trade reporting, data elements, and real-time public dissemination of trade information for security-based swaps. Those rules lay out who must report security-based swap transactions, what information must be reported, and where and when it must be reported. In addition, we have proposed rules regarding the obligations of security-based swap data repositories, which would require security-based swap data repositories to register with the SEC and specify other requirements with which security-based swap data repositories must comply.

Thereafter, we proposed rules relating to mandatory clearing of security-based swaps. These rules would set out the way in which clearing agencies would provide information to the SEC about security-based swaps that the clearing agencies plan to accept for clearing. We also proposed rules relating to the exception to the mandatory clearing requirement for end users. These rules would specify the steps that end users must follow, as required under the Act, to notify the SEC of how they generally meet their financial obligations when engaging in security-based swap transactions exempt from the mandatory clearing requirement. In addition, we proposed joint rules with the CFTC regarding the definitions of swap and security-based swap dealers, and major swap and major security-based swap participants. These rules lay out

objective criteria for these definitions and are a first step in helping the SEC appropriately address the market impacts and potential risks posed by these entities.

More recently, we have proposed rules regarding the confirmation of security-based swap transactions, which would govern the way in which certain security-based swap transactions are acknowledged and verified by the parties who enter into them. We also proposed rules regarding the registration and regulation of security-based swap execution facilities, which would define security-based swap execution facilities, specify their registration requirements, and establish the duties and core principles for security-based swap execution facilities specified in the Act. These rules are focused on moving the trading of security-based swaps onto these newly regulated trading platforms, which are intended to provide more transparency and reduce systemic risk within the security-based swaps market.

In addition, we proposed rules to establish minimum standards concerning the operation, governance, and risk management of clearing agencies. At the same time, we reopened the comment period for our earlier proposal regarding conflicts of interest at security-based swap clearing agencies, security-based swap execution facilities, and exchanges that trade security-based swaps.

We also proposed joint rules with the CFTC regarding further definitions of the terms "swap", "security-based swap", and "security-based swap agreement" and proposed rules regarding the regulation of mixed swaps and books and records for security-based swap agreements.

We then proposed rules that would impose certain minimum business conduct standards upon security-based swap dealers and major security-based swap participants when those parties engage in security-based swap transactions. The proposed rules include business conduct standards arising in connection with security-based swap dealers' and major security-based swap participants' dealings with "special entities", which include municipalities, pension plans, endowments, and similar entities.

Most recently, we proposed rules that establish the process by which security-based swap dealers and major security-based swap participants must register with the SEC.

In addition, we adopted an interim final rule in October 2010 regarding the reporting of outstanding security-based swaps entered into prior to the date of enactment of the Dodd-Frank Act. This interim final rule notifies certain security-based swap dealers and other parties of the need to preserve and report to the SEC or a registered security-based swap data repository certain information pertaining to any security-based swap entered into prior to the July 21, 2010 passage of the Dodd-Frank Act and whose terms had not expired as of that date.

In order to facilitate the clearing of security-based swaps, the SEC also proposed rules providing exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for security-based swaps transactions involving certain clearing agencies satisfying certain conditions. We also readopted certain of our beneficial ownership rules to preserve their application to persons who purchase or sell security-based swaps.

Moreover, the SEC has taken a number of steps to provide legal certainty and avoid unnecessary market disruption that might otherwise have arisen as a result of the final rules arising under Title VII not having been enacted by the July 16, 2011 effective date of Title VII. Specifically, we:

- Provided guidance regarding which provisions in Title VII governing security-based swaps became operable as of the July 16, 2011 effective date and provided temporary relief from several of these provisions;
- Provided guidance regarding – and where appropriate, interim exemptions from – the various pre-Dodd-Frank Act provisions that would otherwise have applied to security-based swaps on July 16; and
- Took other actions to address the effective date, including extending certain existing temporary rules and relief to continue to facilitate the clearing of certain credit default swaps by clearing agencies functioning as central counterparties.

Next Steps for the Implementation of Title VII

While the SEC has made significant progress to date, much remains to be done to fully implement Title VII. First, we need to complete the core elements of our proposal phase, focusing in particular on rules related to the financial responsibility of security-based swap dealers and major security-based swap participants.

In addition, because the OTC derivatives market is a global market, we will continue to evaluate carefully the international implications of Title VII. Rather than deal with these implications piecemeal, we intend to address the relevant international issues holistically in a single rule proposal. The publication of such a proposal will give investors, market participants, foreign regulators, and other interested parties an opportunity to consider as an integrated whole our proposed approach to the registration and regulation of foreign entities engaged in cross-border transactions involving U.S. parties. The comprehensive and detailed dialogues we have had with the European Union and other major jurisdictions described earlier have informed our thinking about how to address the international implications of Title VII.

After proposing all of the key rules under Title VII, we intend to seek public comment on an implementation plan that will facilitate a roll-out of the new securities-based swap requirements in a logical, progressive, and efficient manner that minimizes unnecessary disruption and costs to the markets. Many market participants have advocated that the SEC adopt a phased-in approach, whereby compliance with Title VII's requirements would be sequenced in an appropriate manner. We are actively engaged in developing an implementation proposal that takes into consideration market participants' recommendations with regard to such sequencing.

Impact of Rulemaking on Existing Markets and Competitiveness

There are unique challenges involved in imposing a comprehensive regulatory regime on existing markets, particularly ones that until now have been almost completely unregulated. In doing so, we have been considering the potential impact of Title VII's rules on the global competitiveness of U.S. companies. U.S. markets have been global leaders in part because of a

legal framework that promotes firms and markets that are a benchmark for strength, resilience and transparency.

To this end, we have been carefully considering the potential impact of Title VII's requirements upon the ability of U.S. market participants to compete effectively with foreign market participants that may not be subject to the Dodd-Frank Act. One area where these issues arise acutely is in the differing margin standards for U.S. and foreign market participants, where U.S. regulators seek strong standards to maximize safety and soundness, but U.S. firms are concerned that these rules could place their overseas operations at a competitive disadvantage to foreign-owned firms that meet different standards. To address these and other issues, U.S. regulators are working closely with foreign regulators, as noted above, to adopt consistent approaches to the regulation of the OTC derivatives market that will reduce risk more broadly and address competitiveness concerns.

Conclusion

The Dodd-Frank Act provides the SEC with important tools to better meet the challenges of today's financial marketplace and fulfill our mission to protect investors, maintain fair, orderly, and efficient markets, promote the prompt and accurate clearance and settlement of securities transactions, and facilitate capital formation. As we proceed with implementation of Title VII, we look forward to continuing to work closely with Congress, our fellow regulators, and members of the financial and investing public. Thank you for inviting me to share with you our progress on the implementation of Title VII. I look forward to answering your questions.