S. HRG. 113–246

OVERSIGHT OF THE COMMODITY FUTURES TRADING COMMISSION

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

FEBRUARY 27, 2013

Printed for the use of the
Committee on Agriculture, Nutrition and Forestry

Available via the World Wide Web: http://www.fdsys.gov/

U.S. GOVERNMENT PRINTING OFFICE

87–564 PDF WASHINGTON : 2014

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

DEBBIE STABENOW, Michigan, *Chairwoman*

PATRICK J. LEAHY, Vermont	THAD COCHRAN, Mississippi
TOM HARKIN, Iowa	MITCH McCONNELL, Kentucky
MAX BAUCUS, Montana	PAT ROBERTS, Kansas
SHERROD BROWN, Ohio	SAXBY CHAMBLISS, Georgia
AMY KLOBUCHAR, Minnesota	JOHN BOOZMAN, Arkansas
MICHAEL BENNET, Colorado	JOHN HOEVEN, North Dakota
KIRSTEN GILLIBRAND, New York	MIKE JOHANNS, Nebraska
JOE DONNELLY, Indiana	CHARLES E. GRASSLEY, Iowa
HEITKAMP, HEIDI, North Dakota	JOHN THUNE, South Dakota
COWAN, WILLIAM "MO", Massachusetts	

CHRISTOPHER J. ADAMO, *Majority Staff Director*
JONATHAN W. COPPESS, *Majority Chief Counsel*
JESSICA L. WILLIAMS, *Chief Clerk*
THOMAS ALLEN HAWKS, *Minority Staff Director*
ANNE C. HAZLETT, *Minority Chief Counsel*

CONTENTS

OVERSIGHT OF THE COMMODITY FUTURES TRADING COMMISSION

Wednesday, February 27, 2013

UNITED STATES SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY,
Washington, DC

The Committee met, pursuant to notice, at 2:36 p.m., in room 328A, Russell Senate Office Building, Hon. Debbie Stabenow, Chairwoman of the Committee, presiding.

Present: Senators Stabenow, Klobuchar, Gillibrand, Donnelly, Heitkamp, Cowan, Cochran, Roberts, Chambliss, Boozman, Hoeven, and Johanns.

STATEMENT OF HON. DEBBIE STABENOW, U.S. SENATOR FROM THE STATE OF MICHIGAN, CHAIRWOMAN, COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

Chairwoman STABENOW. Well, good afternoon, and we will call to order the Senate Committee on Agriculture, Nutrition, and Forestry, and we very much appreciate Chairman Gensler joining us today. This is a very important oversight hearing on the Commodity Futures Trading Commission, and we are looking forward to the opportunity to talk about some very important issues.

This hearing will look at the agency's agenda for this year, its implementation of Wall Street reform, its efforts to protect customers since the failures of MF Global and Peregrine, and lay out this Committee's plans for the agency's 2013 reauthorization. The CFTC is responsible for making sure derivatives markets are safe for trading and free of manipulation, as we all know.

American farmers and co-ops, manufacturers, utilities, and businesses rely on these markets to manage their risk and shield consumers from price swings. In fact, more than 38 million Americans work at companies that use derivatives, a number that underscores the importance of the agency to our daily lives. That is why the Wall Street Reform and Consumer Protection Act is so important.

While the CFTC is further ahead than other agencies in implementing this law—and we appreciate that—there are still many outstanding issues to address, including a final rule on swaps execution facilities, cross-border guidance, and compliance with the law. It is also important to get a progress report on the issues surrounding the failures at MF Global and Peregrine Financial Group.

I would like to take a couple of moments to make a couple of points on cross-border issues, which I think are so important.

It is imperative that the agency uses its authority on extraterritoriality wisely. It is critical that we prioritize safety and soundness, particularly in such interconnected markets, but the CFTC must also take into consideration the importance of global harmonization and international cooperation and find creative ways to meet and merge these goals. A failure to meet this objective invites congressional action or, worse, global retaliation.

With so many critical issues before the agency, I also want to acknowledge the serious budget constraints that the CFTC is experiencing, including the uncertainty of sequestration. I continue to be concerned that if the agency does not have the tools it needs to implement reform and oversee these markets, we are asking for a repeat of the crisis that cost us so many jobs.

Finally, we will begin the discussion about reauthorization of the CFTC today. Senator Cochran and I will work closely on this issue. The process will be open and bipartisan, with any product being consensus driven.

To that end, Senator Cochran and I will release a joint letter in the coming days that will invite the public's input by May 1. These comments and recommendations will become part of the public conversation, particularly about commodity market oversight generally and the need for additional customer protections in the wake of failures at MF Global and Peregrine Financial. These markets, whether for physical goods or financial products, must be orderly, transparent, competitive, and safe for trading.

We must have markets that allow farmers, small businesses, and others to manage risk without fear. That also means we need our cops on the beat to have the resources they need to do their jobs.

Thank you again, Chairman Gensler, for being here today. We look forward, as always, to working with you and the rest of the Commission on these very important issues.

I will now turn to my friend and Ranking Member, Senator Cochran.

STATEMENT OF HON. THAD COCHRAN, U.S. SENATOR FROM THE STATE OF MISSISSIPPI

Senator COCHRAN. Thank you, Madam Chairwoman. We appreciate your convening this hearing today.

We understand the CFTC has been busy. They have completed 43 rules covering approximately 80 percent of the CFTC's Dodd-Frank reforms. There have also been issued by the agency no-action letters, which are used to exempt entities from the regulations if they do not apply.

We understand our role is to determine whether in these instances their actions have been consistent with the provisions of the Dodd-Frank Act, Title VII in particular, and whether or not there has been any overreaching of congressional intent or interpretation of the law.

So, with that in mind, Madam Chair, we join you in welcoming our witnesses and thanking them for their good efforts, and we look forward to hearing their testimony.

Chairwoman STABENOW. Thank you very much, Senator Cochran.

We have a lot to discuss today, and in the interest of time, I will ask members to submit opening statements for the record. And, of course, as always, for questions we will recognize Senators based on order of appearance, alternating sides.

I am pleased once again to welcome someone who is no stranger to this Committee. We appreciate your work and the tasks that you and the Commission have been given.

Mr. Gensler is the Chairman, as we know, of the Commodity Futures Trading Commission and has been a leader in the effort to implement Title VII of Dodd-Frank. Prior to his appointment, Mr. Gensler had two positions with U.S. Treasury under the Clinton administration, and there he served as Under Secretary of Treasury for Domestic Finance and Assistant Secretary of the Treasury for Financial Markets.

We welcome you back, and as you know, we ask for 5 minutes of verbal testimony, and we certainly welcome anything you would like to give us in writing, and then we will open it up to questions. Welcome.

STATEMENT OF HON. GARY GENSLER, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, DC

Mr. GENSLER. Thank you, Chairwoman Stabenow, Ranking Member Cochran, and members of the Committee, the new members. Good to be before you. I think this is the tenth time, I am told, that I have testified in front of your Committee, and it is always an honor to be here.

This hearing is occurring at a historic time in the markets. With your direction, this Committee's and the whole Congress, the CFTC now oversees the derivatives marketplace, both the futures marketplace but also the swaps marketplace.

As Senator Cochran noted, our agency has completed about 80 percent of the rules that Congress tasked us with, and the marketplace is increasingly shifting to implementation of these commonsense rules of the road.

So what does it mean? For the first time, the public is benefitting from actually seeing the price and volume of each swap transaction as it occurs, with some time delay to benefit the market. But this information is available free of charge on a website just like a modern-day ticker tape.

Secondly, for the first time the public will benefit from greater access to the swaps market and risk reduction that comes from centralized clearing that will be phased in between March and September of this year. We are one of two nations, along with Japan, that met the 2012 deadline to do this, but Europe is just within months behind us.

And for the first time, the public is benefitting from the oversight of swap dealers. More than 70 have actually registered, and this means they would adhere to sales practice and business conduct standards to help lower risks to the overall economy. These are the reforms that are already in place and are being implemented this year.

The swaps market reforms ultimately benefit end users. End users in our economy make up over 94 percent of private sector jobs. This is the non-financial side of the economy. These reforms benefit end users by greater transparency, which then tends to shift the information advantage from Wall Street to Main Street.

And we have completed rules to ensure, as you directed us to, that non-financial end users are not required to participate in clearing; furthermore, that the CFTC's proposed margin rules provide that end users will not be caught up to have to post margin for uncleared swaps, and we are advocating internationally for that as well, both here domestically with the Federal Reserve as well as internationally with bank regulators in Europe and elsewhere.

And to smooth the market's transition to reform, the Commission has consistently been committed to phase in compliance based upon input from market participants, and that has led, as Senator Cochran mentioned, to sometimes granting no-action relief to try to phase the compliance, give people more time to phase this in.

In 2013, we still need to finish rules in two key areas. As the Chairwoman mentioned, pre-trade transparency benefits the market, and this is accomplished through the swap execution facilities and the block rule.

Secondly, ensuring that cross-border application of swaps market reform appropriately covers risks that can come back here, and I think the key here is that we cover the U.S. affiliates overseas if they are guaranteed here. We recognize that they might be regulated there. If they are regulated comparably and consistently, then we would be all right with that. But I think Congress recognized the basic lessons of the 2008 crisis, that during a default risk knows no geographic boundary and it can come crashing back here, as it did in Lehman Brothers and AIG and elsewhere. And I think failing to incorporate those basic lessons of modern finance into our oversight would not only fall short of your direction but also leave the public at risk that jobs might move offshore in these large U.S. financial institutions, but the risk would still certainly be able to come right back here.

I would like to just mention something on customer protection and on the LIBOR situation in my 50 seconds left. We have worked closely with the industry and market participants to enhance customer protection. The NFA adopted rules last year and so forth, but we put further proposals out to public comment, and we have gotten 125 good comment letters on it. We had three public roundtables. And so part of our 2013 agenda is to finish up on the customer protection agenda.

Also part of our 2013 agenda relates to the international rates called LIBOR and related rates, and though the Treasury Department did collect $2 billion in fines between the Justice Department and our fines, the really main issue is not the fines. It is about ensuring that these are reliable and honest rates that the rest of the market can reference.

I would like to just close by noting on resources, as the Chairwoman said, the CFTC has been asked to take on a market that is vast in size, actually 8 times the size of the futures market, and the futures market itself has grown considerably since the 1990s, and yet we still stand about 10 percent larger than we were 20 years ago. We are an agency that is not sized appropriately to the new tasks that Congress has given us, and I would look forward to working with everyone in Congress on that issue as well.

I thank you.

[The prepared statement of Mr. Gensler can be found on page 34 in the appendix.]

Chairwoman STABENOW. Thank you very much.

It is our intent to do two rounds of 5 minutes each on questions today, and we can determine from there if we wish to go any further. But thank you again for coming before the Committee.

Mr. Chairman, we all know that the Wall Street reform addressed the opaque risk taking that crippled the economy, and in Title VII this involved requiring standardized swaps to be centrally cleared. Next month, the clearing mandate will begin for many swaps, and major clearinghouses will grow in size and importance. Clearinghouses should not become new points of systemic risk.

So can you expand on your testimony? What specifically is the CFTC doing to ensure that derivatives clearing organizations properly value and manage risk and have adequate resources to meet the evolving needs of the clearinghouses?

Mr. GENSLER. Clearinghouses, which have existed actually since the 1890s to help lower risk, are not without risk. I think they are a better model than leaving those risks inside the banking system, but they still have risk.

Core to the rules that we finalized at your direction— and we finalized these about a year and a half ago—we took the international standards, and we put them in our rules to make sure that every day the derivatives, futures, or swaps are valued and every day something called collateral is posted on these transactions. And in the futures world, that has worked well over many decades, but the swaps world was a new piece of that.

We have consulted with the Federal Reserve closely as well, as Congress directed us that we should, and the SEC and the international arena as well.

Chairwoman STABENOW. Would you talk a little bit more about swaps and futures? Because there is a lot of concern there. Some have argued that different margin standards for certain swaps and futures are a concern; in particular, that higher minimum margin standards for certain cleared swaps discriminate unnecessarily against swaps markets, and that if a margin requirement were risk based, this would not be the case. Could you talk about—do you believe that cleared swaps are riskier than cleared futures?

Mr. GENSLER. Well, where we settled out in a rule that we finalized in the fall of 2011 is that the margin posted for cleared swaps in the energy markets, in the agricultural markets, and the metals markets would be identical to the margin posted for cleared futures and agricultural, energy, and metals.

The one place where we differed, where we thought that the margins for cleared swaps should be higher, was in the interest rate swaps market and in the credit derivatives. There are no futures really right now for credit derivatives, so actually the only real difference is in this interest rate market. And the reason we settled out there was because the market actually said we should be at something called a minimum 5 days, meaning it might take 5 days to liquidate an interest rate swap.

The similar product in the futures market is called the eurodollar future, which is highly liquid—it is traded on the Chicago Mercantile Exchange—and we did not think it was appropriate to move that to 5 days. But these interest rate swaps, which are generally cleared currently—the actual current practice was 5-day minimum margining, is what we adopted. And so that is one difference. But we thought it was appropriate given the current market structure.

Chairwoman STABENOW. Thank you.

Let me talk about cross-border issues, which we know are very challenging here to get this right. As the Commission finalizes the cross-border guidance, you really have the challenging job of regulating in a global marketplace. This highlights the importance of cooperation with world regulators to harmonize rules. We have talked about this every time that you have joined us. It also highlights the importance of the CFTC's cross-border authority and how best to utilize it.

The CFTC's cross-border guidance has not been completed. Could you talk about the reasons for the delay, the differences, points of disagreements at this point in time? Also, the agency extended time-limited, exemptive relief on cross-border matters until mid-2013. It is important for companies to know what their roles will look like, to be able to make decisions and build compliance systems. Can you assure the Committee that you will give enough time and certainty for global companies to comply with the final guidance?

Mr. GENSLER. We have been committed throughout this process to phase compliance. We are nearly 3 years after the passage of Dodd-Frank, and we continue to use the authorities you have granted us to do that.

On the cross-border side, we have made tremendous progress. Europe has passed the laws, Canada and Japan have passed laws for central clearing and data reporting. Europe is still considering laws on what I would call public market reporting.

In terms of our cross-border guidance, we have used the authority that you have given us to say that if a U.S. financial institution is operating overseas, we are comfortable with looking to comparable and consistent home country—whether it is in London or Frankfurt or in Tokyo. And so we are working with those international regulators to establish what is called "substituted compliance."

But I do think we have to remember the lessons of 2008 that risk can come back here, and if it is not at least comparable and consistent regimes over there, then Dodd-Frank should apply to protect our taxpayers.

Chairwoman STABENOW. This is, I think, a very challenging line that we are trying to find, particularly as we are working with other countries and the difference in timelines, even though they are beginning to move in Europe and so on. But I think there are some real challenges here on how we do that. But my time is up——

Mr. GENSLER. I do agree with you. I do agree with you there.

Chairwoman STABENOW. My time is up. Senator Cochran?

Senator COCHRAN. I have been advised that there is some concern among some groups that margin requirements may be increased dramatically by the Commission in response to some of the changes that are in this legislation.

What is your reaction to that?

Mr. GENSLER. Senator, I am not entirely sure what they are referencing. I do know it could be one of two things.

In Europe—not here in the U.S. but in Europe—they have finalized a rule that margining clearinghouses need to go from 1-day margining to 2-day margining. And we have not done that here. This 1-day means how much money you have to put up in the circumstance of a U.S.-listed futures product. So that may be what they are raising with you, and I think that might actually end up shifting some people to want to trade here rather than there.

Secondly, in our customer protection rules, we have said very clearly that one customer's margin or money should not be used to benefit or back up another customer's position. And it has been interesting how we have gotten these 125 comment letters on that one provision, because I thought that was just consistent with the law, that you should not use one customer's money to benefit another. And yet we have gotten a lot of comments on it that we have to look seriously at, in circumstances in the middle of the day has been sometimes used.

So on the first matter, if it is about Europe, it is correct that Europe is raising some of their margin standards. On the second one, on the customer margining, we are looking at these 120 comment letters on this matter.

Senator COCHRAN. Do you think the provision of the law that defines the authority of the Commission needs to be amended or changed in any way that would help protect the integrity of the process and the respect for the law that we now have?

Mr. GENSLER. I think that certainly the events of the last year and a half around customer funds has led for many proposals. We have been using the authorities we have to enhance customer protection, and as I mentioned, we have worked with the National Futures Association and the self-regulatory organizations to enhance customer protection.

To the extent proposals come in front of you or us to change the law, we would address them with you. But I think that our proposals that we have right now in front of the Commission are pretty strong enhancements to customer protection.

The Peregrine situation, outright forgeries and so forth, when we look back, we see that both the NFA and we should really have direct electronic access to these accounts, and we are getting to that. The matters around both of the companies where customers lost money have shown that we have to enhance our provisions around customer protection and the accounting for those monies.

Senator COCHRAN. Thank you.

Chairwoman STABENOW. Thank you very much.

Senator Cowan.

Senator COWAN. Thank you, Madam Chair.

Mr. Chairman, how are you?

Mr. GENSLER. Terrific.

Senator COWAN. I want to talk a little bit about the provisions of Title VII of the Dodd-Frank Act that deal with excessive manipulation in the markets of a different kind of commodity, in this case, frankly, oil and oil futures. When I was home last week in the Commonwealth, running second only to questions about the sequester were questions about oil prices. And Reuters reported just last week or the week before that, I believe, that the hedge funds have doubled their bets on higher oil prices at the highest levels in a long time and certainly since December, and that this may be impacting the market and the prices for oil.

I am curious. What is your perspective on that? And what, if anything, can the Commission do or do more of in these circumstances?

Mr. GENSLER. The markets that we oversee involve both merchants and hedgers and speculators, and, in fact, in the oil markets, the financial participation is well over 80 and sometimes approaches 90 percent of the market.

I think what is critical is that we always police the markets for fraud and manipulation, but also to ensure the integrity of the markets is, as Congress directed us, to complete and put in place effective position limit regimes.

Now, we are not a price-setting agency. To me that is not what position limits are about. It is just about ensuring the integrity of the market, that no one party has too large a position in that market.

As you may know, we have finalized rules on position limits. It was challenged by some industry associations. The district court sided with the industry associations. We do not agree with that outcome, and we have appealed that to the appellate level.

Senator COWAN. Thank you, Madam Chair.

Chairwoman STABENOW. Thank you.

Senator Roberts.

Senator ROBERTS. Well, thank you, Madam Chairman, and welcome back—pardon me. Chairperson. Do not beat me with a stick, please.

Mr. Chairman, welcome back.

Mr. GENSLER. Thank you.

Senator ROBERTS. I have a few questions based on my continuing concerns over how the CFTC approaches regulation, in particular the need for a full and proper cost/benefit analysis of the regulations you are charged with implementing. This is in concert with the concerns raised by our distinguished Ranking Member.

I raise these issues because I am concerned with what those within the futures industry have told me and my staff, and they describe it as an ad hoc approach to regulation, particularly in regards to Dodd-Frank rules, thus creating uncertainty among the participants in these markets.

So based on the industry feedback, the CFTC's proposal on residual risk may be the most far-reaching and causing the most concern. It has been described in the industry as an "industry-killing rule that jeopardizes the entire existence of the model and is likely to raise the overall level of risk to all participants in the market."

To date, has the CFTC performed a cost/benefit analysis to consider the negative impacts of the residual risk rule, especially to customers in the agriculture sector?

Mr. GENSLER. We proposed in the fall a package of customer protection provisions that did include a full cost/benefit consideration section, but it was just a proposal, and we have heard—as I say, we got about 125 comment letters.

One of the provisions says that thou shalt not use one customer's money to benefit or support somebody else's. And what was interesting to me in the comments is we found that, in fact, a number of futures commission merchants actually are intraday, during the middle of the day, using one customer's money for another, and it has led to this issue, as the Senator said, of residual. That is just a word saying they might have to put some extra money up, the futures commission merchant.

So we are going to go through the 120 comment letters and take a very serious look at it with cost and benefits in mind. It comes down to who bears the risk. Is it the customers that somehow are bearing the risk of default, the futures commission merchant, and the cost of that? And I share the Senator's view. We have to see this through a lens of cost and benefit.

Senator ROBERTS. I appreciate that. In the same proposal, the CFTC would require FCMs to be in compliance with margin deficiencies at all times. However, option values and margins are currently not available in real time. In order to meet these requirements, initial margins would likely have to double. Why would the CFTC propose a rule that is practically impossible to meet that increases the cost to customers and their risk exposure?

Let me add on that the majority of Kansans in the commodity markets are not large banks but instead are small business owners, including farmers and ranchers. Many of these folks are in rural areas, and they still meet their margin calls by check. Requiring them to post margin calls more than once a day will certainly increase their transaction costs, many have said to a prohibitive level. I am sure it is not the CFTC's intent to force small clients out of the futures market, but how would you expect these customers to stay in the market?

Mr. GENSLER. I think to go to the intent, the intent of the proposal is that the futures commission merchants, the financial firm, at all times protect customer money and at all times not use one customer's surplus to benefit and cover another customer's deficit. So the focus on the customer deficits is just with an eye that the other customers with surpluses are not somehow shortchanged. And I think these two issues, both of them that you have raised, are at the heart of the comment letters that we have to sort through.

Senator ROBERTS. All right. I appreciate that.

Ever since the reporting requirements for swap transactions began, the staff at the CFTC has approved numerous no-action letters. Could you provide the Committee who is able to be relieved of these requirements, who is not, a clarification of the no-action letters in terms of where the large financial firms, brokers, exchanges, or international participants? Is there some way you could——

Mr. GENSLER. I think we could work with you and the Committee to try to summarize that. You are right that as we got close to the date, which was December 31st, for rules that had been completed 13 months earlier, industry associations and some individual firms came to us and said, you know, we really cannot do this all by December 31st, could we have more time. We generally did say yes and gave them——

Senator ROBERTS. Okay. I am out of time. If you could furnish that information to the Chairperson and the Ranking Member, and I know they will share it with us, I think that is what I would like to see happen, if possible.

Mr. GENSLER. I would be glad to do that.

Senator ROBERTS. Thank you so much.

Chairwoman STABENOW. Thank you, Mr. Chairman. We look forward to getting that information.

Let me turn now to Senator Donnelly, and let me also say that Senator Donnelly is going to be our new Chair of the Subcommittee on Commodities, Markets, Trade, and Risk Management. I think now you have worked on this in the House as well. We look forward to working with you as we delve more into these issues.

Senator DONNELLY. Thank you, Madam Chair.

Good afternoon, Chairman. When I was home, like Senator Cowan, one of the largest concerns was about rising gas prices and the effect on American families that they are making decisions as to whether to go shopping for clothes or whether to fill up their car. And they look at me and they say that the market fundamentals of supply and demand do not seem to apply anymore as to the way the prices are affected and the price of a gallon of gasoline. And when you look at this, we have at various times over 400 million plus barrels on speculation, 80 to 90 percent of it is financial speculation. It is not airlines, it is not our farmers. It is simple financial speculation.

There have been studies on both sides, some saying no effect on pricing, others saying 10 cents a barrel or more, which would be $42 a barrel that the price is increased by because of the speculation that occurs.

So part of what we tried to do with Dodd-Frank was to put position limits in place, not to eliminate speculation but to put common-sense limitation in order to cap that kind of effect of undue speculation, negative effect on American families who are trying to make ends meet.

We know what has happened with your efforts, and I was wondering if you have taken a look at or if the CFTC has taken a look at rewriting the position limit rules.

Mr. GENSLER. As the district court had vacated this rule, we have appealed that to an appellate court level. But on a parallel path, we have done, as the Senator has asked or maybe is suggesting, to look, based on the district judge's vacating the rule and his direction, can we also rewrite the rule based on that. So we actually are exploring both. Well, one, we have appealed, and we are also considering bringing a document in front of Commissioners on the second.

Senator DONNELLY. Have they given you—has the appeals court given you any idea as to when a decision would be handed down?

Mr. GENSLER. No. The briefing schedule, if I recall, runs through maybe as late as late spring or early summer, and then as you probably—I am not a lawyer, but you know better than I that an appellate court decides whenever they want.

Senator DONNELLY. By having the parallel tracks, you are in no way indicating that your first set of rules should not get the job done. What you are saying is just in case the appeals court goes the other way, you also have another opportunity to put in place.

Mr. GENSLER. We feel it is quite clear that Congress was serious in their intent that we put position limits in place and expand them to the energy markets. They are in place in the agricultural markets now, and they have worked well over the years. And that was the central issue in this litigation in front of the courts, did Congress direct us to do this, and so forth. But, yes, it is really with an eye to getting the job done, that Congress wanted us to get this done. We are appealing the decision but at the same time considering, as I said, this other approach.

Senator DONNELLY. One last question. When you look at how to conclude this, is there any other legislative action you need from Congress at this point that you can see or any suggestions that you have on this end to try to get this done?

Mr. GENSLER. Well, certainly, as you consider reauthorization and move forward, if position limits is an important component as it was in 2010, you know, this is at least one district judge that thought that maybe Congress had not directed us to do this. You could address that issue square on.

Senator DONNELLY. Thank you, Mr. Chairman.

Madam Chair, thank you very much.

Chairwoman STABENOW. Thank you very much.

Senator Chambliss.

Senator CHAMBLISS. Thanks very much, Madam Chair.

Mr. Chairman, at the conclusion of Dodd-Frank, Chairman Frank as well as others noted that a technical corrections bill was going to be a necessity. Have you and the other regulators along with the Treasury gotten together and made a list of what technical corrections you think need to be made?

Mr. GENSLER. I cannot speak for other regulators. I am not aware of any broad list. I think Title VII, we have been able to sort through with your help and with help from the other side of the Congress as well, issue by issue, rule by rule. So I actually think Title VII holds together pretty well.

Senator CHAMBLISS. Well, is that the only area of technical corrections you think are going to be necessary?

Mr. GENSLER. I actually think that Title VII holds together pretty well, so I am not recommending any particular changes. I do know that whether it is addressing specific issues to ensure that end users do not pay margin, for instance, or are not required to pay margin and other things that have been considered in each of the chambers are things that will be taken up potentially as you consider moving forward.

But, again, I think that Title VII, technically speaking, has held together pretty well, and then we have been able to navigate through Title VII with your help and direction.

Senator CHAMBLISS. So has there not been any discussion between CFTC and other regulators about corrections? Is that what I am understanding?

Mr. GENSLER. Senator, I am just not aware—there has certainly been, as we have gone rule by rule, public comment on—I could use as an example one area. On swap data repositories, there is a provision in the statute that there is a need for an indemnification.

I do not know if you remember this issue. International regulators raised it and were concerned with it. It is not so much a technical correction. It is just whether that is good public policy to require that indemnification.

Senator CHAMBLISS. During the course of the drafting of Dodd-Frank, you and I had numerous discussions about what I feared to be a result of Dodd-Frank, particularly as it applied to the international opportunities for trading of swaps and derivatives and the fact that the international markets were not at that point anywhere near as strict with their requirements as what Dodd-Frank was putting in place.

Since then, you and I have discussed it again. I have also discussed it with any number of banks, particularly across Europe, and what I feared is what I am hearing from the European side. Now, I am getting a little bit different from you, so I want to give you a chance to let us talk about that. But basically I was in—I met with some German bankers within the last month and was told, look, we have done about all we are going to do, which is not much, because our system is working pretty well. And it is pretty obvious to me that they are getting a lot of U.S. business on the London exchange, they are getting a lot of U.S. business on the Asian exchange. And if that is going to continue, then obviously it makes our markets have less of an impact on the worldwide trading scheme.

So tell me where you think we are with regard to the Europeans and others getting on board with our increased regulation of swaps and derivatives.

Mr. GENSLER. Europe passed a law last year and their rules were approved in a parliamentary process just last month for central clearing, for reporting of the data to data repositories, and for the risk mitigation piece, which is the margin and capital and so forth that we have for swap dealers. And they are actually largely consistent. Of course, when you get to the fine detail, there are some differences, and just as we had the discussion with your colleagues down to your right, Europe actually might have a stricter standard, a higher standard on margin for futures.

Where Europe is still working is on public market transparency. They have before their parliament for consideration—they think that they will finish it up this summer, but the proof will be in the pudding—a law called MIFID, that will have requirements for something similar to swap execution facilities, they call them OTFs, and also for the public reporting of the transparent afterwards.

There is a timing difference. Their clearing requirements will go into place probably 6 or 9 months after ours. But they will be very similar. The trading requirement or the public market requirement, it depends how their law is passed, and if it is passed this summer.

Senator CHAMBLISS. Thank you.

Chairwoman STABENOW. Thank you very much.

Senator Heitkamp.

Senator HEITKAMP. Thank you, Madam Chair, and thank you, Commissioner, for appearing today and answering our questions. I just have a couple quick points I want to make and a couple quick questions.

One relates to something that probably has not been raised here yet, but I understand that the swap reporting compliance date is fast approaching, April 10, 2013. On that date large and small energy companies and other commercial end users may have to report to the Commission's new swap data repository all customized physical commodity swaps.

I understand the transactions entered into since the enactment of Dodd-Frank in July of 2010 must be reported even if those transactions have been terminated. Banks and registered swap dealers are not even involved in many of these transactions. Utilities and other energy companies have been the counterparties. A large majority of these entities have no impact whatever on the global financial system. They are not interconnected with financial institutions. And I understand they have asked the Commission for a clarification of its reporting rules as they apply to these transactions to limit the requirement for end users and, more importantly, to defer the reporting deadlines for end users to end physical commodity swaps.

So a couple questions. Has the Commission provided regulatory certainty to these important American businesses? Or are these businesses rushing to comply with the deadline to deliver reports, only to have that effort be determined to be unnecessary? And does the Commission intend to provide further guidance to these businesses? And if so, when?

Mr. GENSLER. I think we have provided guidance. These are transactions where there is no swap dealer, where it is effectively two parties who are not dealers at all, which is a small part but important to any of those companies but still a small part of the market.

I think one of the questions—and I would like to see if we could follow up with your and your staff, but one of the questions I am aware of is on—you referenced historical swaps that are not even in existence anymore. And I think there is request in front of us about those, and I do not remember exactly the nature of that request, but I know it is something we were looking at closely and trying to accommodate.

The law, Dodd-Frank, actually says if you entered into a swap after the President signed the bill and even if it was terminated, it needed to get into these data repositories, and we are trying to look at these "historical swaps," especially for these end users. I think the request was could they report it just once a quarter or something. I cannot remember exactly how the request was.

Senator HEITKAMP. I think when you go back and you take a look at kind of how they have done business historically—and very many of these businesses want to be in compliance, and fear of not being in compliance, you know, requires a whole lot of energy to meet what they think might be a compliance issue for them. And so where you might think it is taken care of, the questions that come to me would imply that it has not, or at least the message has not gotten there. And obviously, as you talked about, the narrowness and the need to expand your effort, taking things off the plate that do not need to be on your plate, that are not threatening the financial markets, would be a good place to start. And so please consider that, and we will follow up with you, Commissioner, and with your staff to try and get a better answer to this question.

Thank you so much.

Chairwoman STABENOW. Thank you very much.

Senator Johanns.

Senator JOHANNS. Mr. Chairman, good to see you again.

Mr. GENSLER. Always good to see you on both committees.

Senator JOHANNS. Mr. Chairman, let me go a little further on position limits. The first thing I wanted to ask, I cannot imagine that there would be anything in a position limits rule that would drive down the price of a gallon of gasoline. It just does not register with me.

Tell me what I am missing. Tell me, if you get that rule in place, how I can guarantee to my constituents that the price of their gasoline will go down.

Mr. GENSLER. You and I might have similar views on this. I think that position limits help the integrity of markets, that no one participant in the market—no one speculator in the market has an outside position either to push the price down or up. So to me, it is just about ensuring that there is a wide range of opinions in the marketplace, a diversity of points of view.

But we are not a price-setting agency. I think position limits do help the market integrity, and that price formation comes from a diverse set of views rather than one push. But that is different than saying that it would be higher or lower.

Senator JOHANNS. That is totally different than the price of gasoline going down.

The other thing that I wanted to ask you about—and maybe I will offer a comment because this is pending litigation. I understand the reluctance about delving into this too deeply because you have appealed this district court case. But here is my thought: I do not have that exact language in front of me, but I think what Congress said to you is that you have the authority to do position limits as appropriate. We did not say you have the authority to do position limits by the seat of your pants or when you wake up in the morning and decide to do it. There has to be something there that drives that decision, which would seem to imply a cost/benefit analysis, some kind of analysis.

Was any of that done in preparation for this rule?

Mr. GENSLER. Yes, it was, and yes, you are correct that there were some words, either "as appropriate" or "as necessary." But Congress also used the word "require" I think four or six times—I cannot remember—and asked us to report directly back to Congress some number of months after we put them in place.

So our view in front of the courts was that modifier, "as necessary," "as required," was what level, do we set these at 2.5 percent or some other level, what was the appropriate level of the position limits. The district court did not necessarily see it the way we do, and we have appealed that.

Senator JOHANNS. And that is fair. I mean, that is what the system provides for.

Mr. GENSLER. That is our democracy.

Senator JOHANNS. That is why we have appellate courts. But, again, I kind of get back to this notion that I think what you are being told in the litigation is that there is a standard for action here, and we could require you to do something as necessary, but you still have the burden of establishing that it was necessary. And I will just offer my thought that is where I think this is headed.

The other thing I wanted to talk to you about, like Senator Chambliss, I have expressed to you over and over again that I think really what we are ending up with here, or too much of, is we are just making it difficult to do business in the United States.

Now, you may argue, you may say, "Mike, but we needed to do something here. This was not a good situation." But what I see happening overseas is report after report that other companies, banks, are pulling out of the marketplace here just simply because they are worried about getting all tangled up in U.S. regulation. And I do not share your optimism. I do not think there is anything out there that is going to rival the complexity of Dodd-Frank. Then I want to offer one last thought, and then I will let you comment.

When you overregulate—and I have been around this a long time, as a mayor, as a county commissioner, as an Ag Secretary, and on and on—I know who gets hammered. It is the little guy because the costs get passed on. Of course, they are going to get passed on. They do not get absorbed. The little guy is going to get hammered by regulations, and the big are going to get bigger and the small are going to get pushed out of business, and the consumer is going to take the hit.

Explain to me where I have missed something in 30 years of experience.

Mr. GENSLER. I respect your 30 years of experience, and I think we have taken it to heart in what we have done. We have drafted the final rules that end users are not going to get caught up and be defined as a swap dealer, that end users are not going to have to pay margin if they do not want to and there is no requirement for swap dealers to do that.

Where we are down to is basically, frankly, an issue of which large financial institutions are registered as swap dealers; 71 of them I think have registered, including the largest international banks from Europe and Asia. All of what is called the G–16 have registered, you know, Barclays and Societe Generale and the big ones from Japan.

And so I think we have taken to heart what you are saying in your 30 years of experience. They have actually registered to do business here in the U.S. We narrowed the definition of "U.S. person," so it is only if they are really sort of dealing with a territorial U.S. person.

I do think we need to come back and make sure we cover the U.S. financial institutions operating overseas because sometimes that risk comes back here, and if we do not cover it, the jobs will go offshore—it will probably hurt Senator Gillibrand's constituents because the jobs will go offshore, but the risk will be still back here. So I still think we have to cover the sort of Morgan Stanleys in London, so to speak, or at least do it through substituted compliance. If there is home-country rules that are comparable, that is great. That is great. But if there is not, you know, if it is in some small island somewhere where it is not, then we have got to cover it.

Senator JOHANNS. I am out of time. Thank you, Madam Chair.

Chairwoman STABENOW. Thank you.

Senator Klobuchar.

Senator KLOBUCHAR. Thank you very much, Madam Chair. Hello, Chairman. Thank you for being here.

Mr. GENSLER. Always good to see you.

Senator KLOBUCHAR. Very good.

One of the topics under debate right now is the different collateral, as you know, or margins that market parties need to set aside as a safeguard when trading swaps. Futures and options have a 1-day margin requirement, and swaps have a 5-day margin. Is that right?

Mr. GENSLER. Well, actually, all futures and all swaps for energy, metals, and agricultural products all are 1-day.

Senator KLOBUCHAR. Then what gets the 5-day margin?

Mr. GENSLER. The 5-day is only on interest rate swaps, which we felt has a very different risk component than the eurodollar contract that trades so actively and liquidly on the Chicago Mercantile Exchange, which is 1-day. So——

Senator KLOBUCHAR. Well, do you think some of the differences with the margin requirements, though, between the futures and the swaps markets, could that drive more trading to futures in any way? I just heard some concerns about this.

Mr. GENSLER. It could——

Senator KLOBUCHAR. And allow them to circumvent the safeguards that were put in place for the swaps market?

Mr. GENSLER. It could in the interest rate complex. In the rest of the complex, it is all 1-day. It could, but I would note I think the futures marketplace has some pretty good safeguards as well. I do not mean to brag about it, but, you know, over the many decades—it was not at the center of the 2008 crisis. So——

Senator KLOBUCHAR. And do you think it could lead to less transparency or increased risk in any way if that starts happening?

Mr. GENSLER. I think that the one thing that you have highlighted is less transparency. The futures marketplace has had very good public market transparency to date. But we are considering some of these changes that happened late last year where some swaps were relabeled futures, and to ensure that there continues to be the public market transparency, that somehow the transparency is not lessened because of t his.

Senator KLOBUCHAR. Then the OTC market, I have something else that farmers in Minnesota, as you know, work through their co-ops. Senator Thune and I head up the Senate Co-Op Caucus, and they use the futures or over-the-counter market to hedge their risk from national disasters and market failures. Following the MF Global failure—and we have talked about that before, but we know how important it is for farmers to have confidence that their hard-earned dollars are kept segregated.

How can you make certain that the farmers are protected in these markets from fraud while ensuring that these risk management tools remain affordable for the farmers?

Mr. GENSLER. I think that we need to do more. We have done a lot working with the self-regulatory organizations like the National Futures Association. We put out further proposals late last year. We just got 120 comment letters in. And the farmers and ranchers are the foremost, I think. It is really their money that has to be protected and that one customer's money is not used for another customer. And certainly no firm should be able to put their hand in the kitty and take it out. And we have learned a lot from these circumstances to tighten up the accounting, to tighten up the oversight of these futures commission merchants.

Senator KLOBUCHAR. And you and I have talked extensively about the differences with end users compared to some of the trading that goes on and the differences with places from Delta to Cargill that are important in my State. And as I understand it, beginning in April end users will also have to comply with the real-time reporting requirements and report their data to swap data repositories. And you know that they use the swap markets to hedge risk. That is an important planning tool for them. And I know that you have worked very hard to try to strike the balance.

I want to hear a little bit more as to why all participants in the swaps market, including end users, need to comply with the reporting requirement. How would it be helpful to regulators? And are you concerned with the ability of end users at all to have the resources to comply with these requirements?

Mr. GENSLER. Well, first, because we are complying with the law and there was no end user exception to reporting. I think why Congress included all of the trades coming into the trading repository is that regulators had a view of the whole market, and even the public reports that way.

What we did do is we gave a lot more time; whereas, the swap dealers might have, for instance, 30 minutes to report their trades this year, the end user to end user trades we gave—I cannot remember—in some circumstances 2 days, in some circumstances 3 days. And then I think over the course of a couple of years, it comes in to 1 to 2 days. So there is a different timeline of the reporting that we tried to strike a balance in this.

Senator KLOBUCHAR. Thank you.

Chairwoman STABENOW. Thank you very much.

Senator Hoeven? And, by the way, I did notice, Senator Hoeven, I think you were enjoying our chocolate mints that we have on the table from Michigan. I just want you to know, made in Michigan. So if you would like some more——

Senator HOEVEN. Madam Chairman, I only ate four because that is all I could reach.

[Laughter.]

Senator HOEVEN. Senator Johanns has left, and I am going to get that one before Boozman does.

Chairwoman STABENOW. We have a bigger stash in the back, so we will be happy to give it to you.

Senator HOEVEN. All right. Thank you, Madam Chairman.

Chairman Gensler, if you would, explain to me specifically how the rules that you are implementing pursuant to Dodd-Frank are making the commodity futures trading system more transparent to the public and how they are reducing both institutional risk and systemic risk, specifically, and tell me in a way that the public will understand.

Mr. GENSLER. For the first time, starting this January 1st, the public gets to see a modern-day ticker tape on these transactions. It is time-delayed so that there is some anonymity, but the transactions are publicly announced, and you could go, for free, to a website and see where the transactions are priced. That means any farmer or rancher or corporate treasurer could see the pricing of transactions, and in the afternoon they might say, "I want to do a similar transaction," and they could see where it was priced in the morning. Without seeing anybody's name, they would see the price and volume of a similar transaction. It is new, it is early. It will take some time for the market to start to find benefit in that, but that is transparency that did not exist before.

In terms of lowering risk to the public, one of the things that has happened and worked in the futures industry, this complex market, for over 100 years is something called "central clearing." A clearinghouse stands between buyers and sellers of these complex products in case one of them goes bankrupt, is default. Congress said bring that to this other part of the market swaps, and it will be brought to the swaps market throughout 2013 for financial institutions. Congress was very clear: Do not make end users get caught up in this, but between an insurance company and a bank or a hedge fund and another hedge fund, that we should lower risk this way. And that is happening in 2013.

Senator HOEVEN. Do we understand and have we quantified the systemic risk from financial derivatives? Do you as a regulator feel that you truly understand it, it is quantifiable, it is understood, and that you have the safeguards in place to prevent some type of system failure from large institutional failure? And what specifically is it that protects us from that type of failure?

Mr. GENSLER. It is hard to quantify. We do know in 2008 that swaps were part of the crisis. AIG, the insurance company, one of the significant reasons it needed $180 billion of taxpayer money was because of credit derivatives that they took on. And we know that the risks still are there in the system. What we have done specifically to address the AIG type of circumstance, again, is central clearing for swaps that can be brought into a clearinghouse. Not everything AIG could be brought into a clearinghouse. But also requirements for transparency to the regulators, as well as we will over time require financial institutions, not end users but financial institutions, to post what is called margin to each other to help back up the transactions that are not in clearinghouses. We will phase that over probably a number of years because there are significant costs involved.

Senator HOEVEN. Specifically, what is providing that protection against both large institutional failures and particularly those type of failures that could lead to a systemic problem?

Mr. GENSLER. I think that there has to be a freedom to fail. Large financial institutions still will fail in the future——

Senator HOEVEN. Now you are getting to it.

Mr. GENSLER. And I believe that the taxpayers should not back those large——

Senator HOEVEN. I am sorry to interrupt, but you have got to have a way for a large institution to fail for us to understand what the risk is of that institution and to be able to manage it and take appropriate action without creating a systemic risk. That is the key that I believe Dodd-Frank was supposed to get on top of, and I want to understand if you have got that accomplished and specifically how.

Mr. GENSLER. I agree with you on that goal and that there should be a freedom to fail. In Title VII, the piece that we have authority for, the way that we allow a firm to fail more readily is the swaps that can be in the clearinghouse are, and clearinghouses help because they stand between two parties in case one of them fails. And on the swaps that are not in a clearinghouse—and I know I am sounding technical, but the ones that are not in a clearinghouse, that they post collateral or margin at least between the financial institutions. One bank has to post it to another. And those two disciplines, the central clearing and the margin for the uncleared swaps between financial institutions, I think raises the chance that we can let it fail and a Treasury Secretary and a head of the Federal Reserve does not feel they have got to bail something out.

Senator HOEVEN. And, Madam Chairman, I see my time is up, but to me that is the crux of the issue. You have to be able to demonstrate in a way that the public understands that the regulators have created safeguards in the system that will allow an institution to fail and you understand the ramifications of that without triggering systemic risk and at the same time, back to Mike Johanns' point and some of the others, you know, what the impact of that is on the end user like, you know, a farmer or small business. And that is still the part that I think when you testify or in the information you put out, you have got to make that clear to people like, you know, me and the public who are not experts in this business. And that is the part I am still looking for as a result of the rules and regulations you are implementing pursuant to Dodd-Frank.

Mr. GENSLER. That is very good advice to me and to the agency.

Senator HOEVEN. Well, it is a request to see that in a specific, understandable form that we can disseminate to the public.

Thank you.

Chairwoman STABENOW. Thank you very much. I think those are very good points.

Senator Gillibrand.

Senator GILLIBRAND. Thank you, Madam Chairwoman, for your leadership in holding this hearing. I am very grateful.

Thank you, Chairman Gensler, for being here. I am going to follow up on Senator Hoeven's question because I know what he is trying to say. If you are saying that margin requirements is the protection for catastrophic failure of the system, I think what Senator Hoeven or an average American would need to understand is it is a relatively low percentage of money you are requiring for margin, so how could that relatively low percent actually save the system from failing a la AIG?

Mr. GENSLER. There are two forms of margin. One is that every single day a position is valued, and based upon that the two firms settle up. That is called "variation margin." That was not done in AIG, and AIG, when the piper, you know, came calling, there were tens of billions of dollars just to handle what was the current value or what was called "mark to market."

Senator GILLIBRAND. So to simplify this, if you could just for us do the analysis of what if AIG was trading in the same trades they were trading then and under the current system what would have been required of them, why it would not have collapsed that company and then, therefore, had the following on repercussions, I think if you give the AIG analysis under today's regulatory scheme and tell us why it would have protected the financial services industry.

Mr. GENSLER. We will do our best. One of the rules, the margin requirements for the non-cleared swaps, has not been finalized, but——

Senator GILLIBRAND. When it is, yes.

Mr. GENSLER. Based on finalizing that, we will do that.

Senator GILLIBRAND. Just basically proving out that this system of checks and balances is enough I think would be incredibly useful for our Committee.

Mr. GENSLER. Okay.

Senator GILLIBRAND. Thank you for your time. I want to talk a little about LIBOR. Obviously, manipulation of LIBOR has grave effects in the U.S. It affects our derivatives market, affects student loan rates, affects mortgages. So I want to know from you what are the lessons that you would suggest to us about how we should think about benchmarks such as LIBOR. Is there something we should be working on legislatively to protect against future manipulations? And then we can go into some of the details about your response and how you are coordinating with the European regulators and how it has changed market behavior.

Mr. GENSLER. I think that for a benchmark or index to be reliable and honest, it should be anchored in real transactions. And, unfortunately, what has happened over the years, this critical interest rate benchmark that is the mother of all benchmarks was no longer tied to real transactions. The marketplace had a fundamental change. Banks are really essentially not lending to each other on an unsecured basis in London any longer. And what we found is the rate was pervasively rigged and readily rigged by these three banks.

We are working very closely with the European regulators and international regulators around the globe, and bank regulators as well, one, to come up with a set of best practices or principles; but, two, also how to transition if there is a need to transition from this rate that is so unstable. And it is unstable right now, and I believe is actually unsustainable, long run, to have a benchmark that is not anchored in real transactions and what does it mean.

The S&P 500 references 500 stocks that trade every day. We know what that means. The American public basically does. This is not anchored in something that is real any longer.

Senator GILLIBRAND. Do you have adequate resources to be able to provide the oversight on this issue?

Mr. GENSLER. No, we absolutely do not. We are currently shelving enforcement cases. "Shelving" is not a technical term, but I will share that with you, that we just have to because of limited resources.

We are also not doing the examinations that we really should be doing of the clearinghouses or the futures commission merchants, our examinations staffs. We are basically wrong-sized for the job because we are only about 10 percent bigger than we were 20 years ago.

Senator GILLIBRAND. Well, that gets to sequestration. Obviously, with an 8-percent cut, that is going to be devastating. Is this going to affect your ability to have the appropriate level of personnel, or will it just come out of other expenses like technology or travel or other items?

Mr. GENSLER. We do not have many places to go. Nearly two-thirds of our budget is people. But it will come out of technology and people. We have been cautious and have been running a little below the head count that Congress has authorized. I just have to say as the Chairman I sort of presume that sequestration might happen, and so we have been running cautious and running a little below head count.

Senator GILLIBRAND. Do you think it is going to affect your ability to register the swap execution facilities once you enact the rule?

Mr. GENSLER. I think it will. I think that if we have registrations of 15 or 20 swap execution facilities, many of those applications will probably be sitting on the shelf for a while.

Senator GILLIBRAND. And then just one last question. Do you think the swap execution facility rules will be technology neutral? Because there is a lot of concern that there is ambiguity, uncertainty, whether it will use voice brokering or electronic trading?

Mr. GENSLER. I think it was Congress' clear words that we be technology neutral, and we will be technology neutral, whether it is by Internet, by text messaging, by telephone, by carrier pigeon.

Senator GILLIBRAND. Thank you.

Mr. GENSLER. You said by any means of interstate commerce, and we are getting that.

Senator GILLIBRAND. Thank you, Mr. Chairman. I appreciate your time.

Chairwoman STABENOW. Thank you very much.

Senator Boozman.

Senator BOOZMAN. Thank you, and thanks to the Chair and the Ranking Member for having this very important Committee hearing.

I just want to follow up a little bit because I am a little confused and I think it is important. It is my understanding that the Asia Pacific, European, and South American partner nations have all expressed serious concerns, recent concerns, regarding the CFTC proposals for regulating swaps internationally. I think the reality is not only have they criticized the process but have expressed concerns regarding overlapping and conflicting regulations that imposes unnecessary costs and burdens on individual firms, lack of eligibility for substituted compliance on transaction level requirements, and some nations have expressed concerns as to whether or not some practices can be reconciled at all.

When we began oversight on the process, many of the concerns that have been raised not only regarding the cross-border issues but also that these regulations, if taken too far, could result in discouraging participation here in the United States. Now we have all of these issues that seem to be rising out of the fact that we have had problems harmonizing these regulations with other participants in the global marketplace.

So many of the letters issuing comments regarding the cross-border issues implore more careful consideration in implementation as to not fragment the global marketplace leading to less stable regional markets.

So I guess my question is—you know, you mentioned in your statement that now you are concerned about participants routing through foreign affiliates to avoid certain clearing requirements. I guess the question is: What is to prevent participants from simply withdrawing from the U.S. market and managing their risk in a less cumbersome regulated foreign market? And, again, what have we done specifically or what are we doing to better harmonize these proposed rules with foreign partners and to roll them out to prevent withdrawal in a less regulated foreign market and the result subsequently creating more risk in our efforts to create less risk?

Mr. GENSLER. The cross-border area is one of the more challenging pieces of our rule writing. I think what you all as a Committee and what the American public expect us to do is to ensure that risk booked offshore does not just flow back here unless it is covered by some comparable regime.

I will tell you from personal experience, I was the young Assistant Secretary of the Treasury calling up the Secretary when a hedge fund called Long Term Capital Management was failing, located in Connecticut, managed out of Connecticut, a $1.2 trillion derivatives book. This was 1998. And I remember saying to Secretary Rubin on the telephone it would fail by Wednesday, and he said, "Well, what is going to happen?" I said, "Bob"—I called him "Bob." I said, "Bob, I cannot really tell you because they are all booked in the Cayman Islands." And Long Term Capital Management happened to operate out of the Caymans— not operate. They just had their legal entity there that something like 90-plus percent of hedge funds in the U.S. do. We would not want to somehow have that risk flow back here and just because it is in the Cayman Islands not cover it—unless, of course, the Caymans have comparable rules. That is I think what this Committee wants us to cover.

What the foreign regulators raised with us is they said if their banks, Deutsche Bank or Societe Generale or their banks operated offshore, would we do substituted compliance, and we have said absolutely. But the harder question was: What if they did a trade here in New York or in New Jersey or your home State, so out of Germany they did a trade in your home State, would we look to U.S. law or their law? And we have said, well, we think if it is here in the U.S., with a territorial U.S. person, that Dodd-Frank applies. We think that is the best reading of the statute.

But we have said if there is a conflict, if there is a real conflict, we want to try to sort out the conflict through some no-action relief or other technical relief. But we think if they are not covered by

U.S. law in your home State, that also would be kind of anti-competitive for the banks that operate out of New York.

Senator BOOZMAN. Thank you, Madam Chair.

Chairwoman STABENOW. Thank you very much.

Mr. Chairman, let me go back in talking about customer protections. I do not want to go back and cover ground that Senator Cochran and Senator Roberts did, but I want to underscore that I am also hearing concerns from smaller market participants about the proposals on residual interest and margin account-related capital charges and what this means for them. And I look forward to working with you on that because I know that we are not interested in putting the smaller FCMs out of business. So I think we have to—I would encourage you and ask that you take another look at that.

Mr. GENSLER. We are, but I want to first thank you for the two chocolates from Michigan. They were very good.

[Laughter.]

Mr. GENSLER. I would also say that it has actually taken me aback a little bit because what we put in the proposal I thought was just law, that you should not use one customer's money to benefit another customer. And what we have found is actually intraday, during the midst of a day, if one customer has a deficit, the other customer's surplus might actually be benefitting. So we are trying to deal with that practical circumstance.

Chairwoman STABENOW. I think that is the key, just looking at it practically. Obviously, we want to make sure that, you know, customers are covered. But there is a concern there, and you have heard that from a number of members.

Let me go back and talk a little bit more about customer protections, because when we do reauthorization, we are going to consider legislative changes to enhance customer protections in the futures and swaps markets. And I think it is important for us to know if there are laws that have limited what your agency has been able to do to protect customers. I am specifically thinking of the Bankruptcy Code as well as the Commodity Exchange Act as it relates to segregation alternatives for customers.

Are there areas that have put limitations on what you have been able to do for customers?

Mr. GENSLER. There are members of the public, particularly some pension funds, that have raised issues about the Bankruptcy Code. There is a section of the Bankruptcy Code that if there are any shortfalls, there is a pro rata sharing of that. And though we do not have any recommendations there, I would say there are some members that have raised that, and we would be looking forward to working with you if you were considering that, along with, you know, other committees.

Chairwoman STABENOW. I think it is important as we go forward. As I mentioned in my opening statement, Senator Cochran and I are going to be sending out a letter asking all those involved in these issues to give us suggestions about changes or improvements in the law. It is important that we hear from you as well, being in the middle of this, as we look at how we might strengthen what we are doing, particularly what has happened for customers, and looking at customer protections.

I also wanted to follow up on what Senator Gillibrand talked about in terms of resources, because clearly we have seen an increase in the last decade in the responsibilities of the CFTC, and we are all expressing concerns about customer funds and about what needs to be done to make sure these markets work right, what happens in terms of cross-border issues, a whole range of things that are critical, we must have integrity in the markets. And one of the things that I am concerned about, I understand but am concerned about in what you said a few moments ago, was shelving enforcement cases. Here we are talking about accountability, and I know you do not want to do that, but I wonder if you might talk more specifically about what lack of resources has meant to you. And, also, as part of all of this, how much money did the CFTC collect in civil penalties last year related to the budget? Where did those dollars go? Because that is an important piece of this as well, because if we want to have integrity in the system, there are going to have to be enough resources both for the technology and the people to be able to do the enforcement that we all want to have happen.

Mr. GENSLER. We are not sized for the task that Congress gave us, and I know that is a hard thing to raise because our Nation is so challenged by our budget deficits. And I feel it is one of the harder things in my job to even come before you and ask for more money, but I think it is a good investment. We are being asked to cover a market that is vast, that was at the center of the crisis, that 8 million people lost their jobs in.

In terms of the money that we have collected, I would ask if we can get back to you, but just even on the LIBOR cases, these three LIBOR cases between the Department of Justice and the fines that we assessed, it was $2 billion. I think $1.25 billion was our side of it, but $2 billion is probably more than has been spent on the CFTC in the last, you know, 20 years combined or something. We are only a $200 million agency, roughly, and we think we should be at $300 million.

We are shelving enforcement action, and our examination staffs are still the same size as they were a couple of years ago, and we have had these two events—Peregrine and MF Global. We know that we have to do a better job at examining futures commission merchants, and now we have a new job to help the NFA examine the swap dealers, these 70 or so swap dealers.

We know we have a new responsibility to go into the clearinghouses more regularly. We do not have staff examining clearinghouses annually for their risk management. And we are pushing, statutorily pushing all sorts of additional transactions into clearinghouses. I think we should have enough staff to at least go in and ensure the risk management of the clearinghouses.

And we do not really have enough staff to consider all the requests, because we want to be a flexible agency, when appropriate, when somebody comes to the registration request or other requests.

Chairwoman STABENOW. Thank you very much. I think we all realize that we are in a challenging time as it relates to deficits, but also economic growth is critical and confidence in the markets is critical and managing risk is critical if we are going to continue to see the investments in the economy that we need. So thank you very much.

Senator Cochran.

Senator COCHRAN. Madam Chair, I just want to clarify what I think I just heard, and that is, the request for funding, is this appropriated through the annual appropriations process? Or do you use your abilities to generate funds from your legal responsibilities in enforcing and carrying out legally authorized activities?

Mr. GENSLER. Excellent question. Any fines that are assessed go to the U.S. Department of Treasury. We are fully under congressional appropriations, and it is annual appropriations.

Senator COCHRAN. Well, I noticed that the current funding level is $207 million, and I understand from your statement that you submitted—you are saying the President has requested $308 million for fiscal year 2013. This would permit the employment of 1,015 full-time employees. Is that the current status of the request?

Mr. GENSLER. That is correct. We think we need about 40 percent more people, but we also think in technology we should grow technology more than that 40 percent to use technology to be efficient. But it is in the context of a marketplace that we are asked to oversee that is 8 times the size of what we once oversaw.

Now, we do not need 8 times the number of people, but we do think we need more people.

Senator COCHRAN. Thank you.

Mr. GENSLER. Could I for the record answer the Chair's question? In fiscal year 2012, the penalties collected were $257 million, again, to the Department of Treasury; and in fiscal year 2013, $1,030,000,000 for the CFTC. So 257 and then 1,030,000,000.

Chairwoman STABENOW. Would it be fair to say that given the fact that you are bringing in penalties and using your resources and bringing in dollars, like any enforcement agency, if you had more ability to bring enforcement cases, more dollars would be coming in? And that would sound to me like it would be a pretty good investment, not only in the economy and stability and confidence in the marketplace, but actually for the Federal Treasury. Would you want to comment on that?

Mr. GENSLER. Well, I think the most important thing is the second part you said, that it would help the economy and market integrity. I think it is a very good investment for the taxpayers to ensure for transparent markets, but also that farmers and ranchers and everybody that uses these products have better confidence in customer protection and so forth. Yes, in addition, there happens to be this flow of penalties to the U.S. Treasury.

Chairwoman STABENOW. We have this big deficit. Could you do a lot more enforcement and maybe we could offset sequester?

[Laughter.]

Chairwoman STABENOW. Senator Boozman.

Senator BOOZMAN. Thank you, Madam Chair. I am good.

Chairwoman STABENOW. Well, thank you very much. We appreciate all the members, and, Senator Cochran, thank you very much. And we appreciate your coming before the Committee again. We appreciate your work and look forward to continuing to work with you.

We would ask that any additional questions for the record be submitted to the Committee clerk 5 business days from today. That is 5:00 p.m. next Wednesday, March 6th.

If there is no further business, the Committee is adjourned.

[Whereupon, at 4:01 p.m., the Committee was adjourned.]

A P P E N D I X

FEBRUARY 27, 2013

Suggested Opening Remarks for Senator Thad Cochran
Committee Hearing on CFTC Oversight
February 27, 2013, SR-328A

Madam Chairwoman thank you for holding this hearing today and for the opportunity to provide some needed oversight to the Commodity Futures Trading Commission.

The CFTC has indicated that they have now completed 43 rules covering approximately 80 percent of the CFTC's Dodd-Frank reforms.

That's a commendable accomplishment, and I know everyone at the CFTC has been working hard to implement Dodd-Frank. While the CFTC has been busy promulgating many new regulations, there have also been numerous "no action" letters it has issued to exempt entities from these same regulations, most of them at the very last minute, just before these new regulations were to have gone into effect.

The Commission's pattern of spending months and months writing a regulation only to exempt entities from it at the last minute is creating uncertainty, which is making it difficult for firms to plan and invest in the growth of their businesses.

It is the role of this committee to determine whether there have been instances in all these rules where the Commission has overreached congressional intent in implementing Title VII of Dodd-Frank. Madam Chairwoman, I think we need to hear more from stakeholders and end-users as to whether the Commission's actions are actually providing some badly needed certainty in our derivatives markets. No entity can afford to keep spending money to hit a regulatory target that is still moving two and a half years later.

We have more than one instance where the CFTC has been sued by stakeholders because of its recent rules. One of the first examples of this is when the Securities Industry and Financial Markets Association (SIFMA) and International Swaps and Derivatives Association (ISDA) filed suit to block the position limits rule. The U.S. District Court Judge for the District of Columbia said the commission had not adequately proved the necessity of position limits in commodity markets. Despite this ruling, the Commission has indicated that it plans to appeal.

Madam Chairwoman, thank you for asking Chairman Gensler to join us here today to explain why the CFTC has come under fire by end-users, exchanges, the courts, and a wide range of international regulatory authorities.

I appreciate the chance we are going to have today to ask why the CFTC is proposing a rewrite of the futures industry business model.

I would like to understand why and under what authority this agency is proposing a MAJOR overhaul to the amount of margin money that cotton farmers and gins, and textile manufacturers and everyone all the way up and down the food and fiber chain in this country will need in order to trade the same futures contracts and manage the same risks that they have traded successfully for more than a century without the CFTC's direct intervention.

I will be eager to hear if during the review of each new regulation the CFTC has given consideration to the potential burden on the economy, such as through a cost/benefit analysis.

Chairman Gensler, the agency you have been charged with managing for nearly four years now has obviously been working hard, but I'm interested in getting further insight about these efforts.

I look forward to hearing your testimony today and reviewing where the Commission is on the task of implementing Dodd-Frank and the CFTC's focus and priorities in the months ahead. Madam Chairwoman, thank you for holding this hearing today.

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013

Senator Thune

Madam Chairwoman and Ranking Member Cochran, thank you both for holding this important hearing. I hope that this hearing will provide this Committee with insight about how the CFC is implementing Dodd-Frank provisions under its authority and the new CFTC-issued regulations covering the futures markets. I also look forward to learning how they will affect end-users especially the agricultural community in the United States.

I expect that this hearing will provide this Committee with practical information about the ways we can improve risk mitigation in the futures markets to prevent another situation with MF Global, in which customers' segregated funds were at risk. South Dakota was fortunate that very few of our citizens were directly affected by these particular events, but the integrity of the market continues to be at the forefront of investors' minds.

It is important, however, that these regulations are carefully crafted, developed in response to real threats, and implemented in such a way to impose minimal regulatory burden on the market that thousands of farmers and investors use to mitigate risk each year.

I look forward to your testimony and your responses to our questions, Chairman Gensler.

TESTIMONY OF GARY GENSLER

CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

BEFORE THE

U.S. SENATE COMMITTEE ON AGRICULTURE, NUTRITION & FORESTRY

WASHINGTON, DC

February 27, 2013

Good afternoon Chairwoman Stabenow, Ranking Member Cochran and members of the Committee. I thank you for inviting me to today's hearing on oversight of the Commodity Futures Trading Commission (CFTC). I also want to thank the CFTC Commissioners and staff for their hard work and dedication.

Introduction

I am pleased to have the opportunity to discuss with you the CFTC's efforts on behalf of the public. The agency has been directed by Congress to oversee and police the nation's derivatives markets, both in the futures and swaps markets. It strives to promote transparency, fairness and integrity in these markets. The CFTC continues to carry out its historical mission regarding the rapidly changing futures market, while developing and integrating comprehensive standards for the swaps market. The Commission has reorganized its divisions to best ensure ongoing oversight of the futures market, as well as the swaps markets. We also have implemented improvements in protections for customer funds and are developing others. We continue to engage in targeted enforcement efforts in the public interest, such as the historic actions regarding benchmark rates, including the London Interbank Offered Rate (LIBOR), a reference rate for much of the U.S. futures and swaps markets.

The New Era of Swaps Market Reform

Congress made history with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the CFTC now oversees the entire derivatives marketplace – across both futures and swaps. The common-sense rules of the road for the swaps market that Congress included in the law have taken shape and market participants are adapting to them.

For the first time, the public is benefiting from seeing the price and volume of each swap transaction. This post-trade transparency builds upon what has worked for decades in the futures and securities markets. The new swaps market information is available free of charge on a website, like a modern-day ticker tape.

For the first time, the public will benefit from the greater access to the markets and the risk reduction that comes with central clearing. Required clearing of interest rate and credit index swaps between financial entities begins next month.

For the first time, the public is benefitting from specific oversight of swap dealers. More than 70 swap dealers have provisionally registered. They are subject to standards for sales practices, recordkeeping and business conduct to help lower risk to the economy and protect the public from fraud and manipulation.

An earlier economic crisis led President Roosevelt and Congress to enact similar common-sense rules of the road for the futures and securities markets. I believe these critical reforms of the 1930s have been at the foundation of our strong capital markets and many decades of economic growth.

In the 1980s, the swaps market emerged. Until now, though, it had lacked the benefit of rules to promote transparency, lower risk and protect the public, rules that we have come to depend upon in the futures and securities markets. What followed was the 2008 financial crisis – a crisis that was due in part to swaps markets. Eight million American jobs were lost. In contrast, the futures market, supported by earlier reforms, weathered the financial crisis.

Congress and the President responded to the worst economic crisis since the Great Depression and carefully crafted the Dodd-Frank swaps provisions. They borrowed from what has worked best in the futures market for decades: transparency, clearing and oversight of intermediaries.

The CFTC has largely completed swaps market rulewriting, with 80 percent behind us. On October 12, the CFTC and Securities and Exchange Commission's (SEC) foundational definition rules went into effect. This marked the new era of swaps market reform.

The CFTC is seeking to consider and finalize the remaining Dodd-Frank Act swaps reforms this year. In addition, as Congress directed the CFTC to do, I believe it's critical that we continue our efforts to put in place aggregate speculative position limits across futures and swaps on physical commodities.

The agency has completed each of these Congressionally-directed reforms with an eye toward ensuring that the swaps market works for end-users, America's primary job providers. It's the end-users in the non-financial side of our economy that provide 94 percent of private sector jobs.

Dodd-Frank Act swaps market reforms benefit end-users by lowering costs and increasing access to the markets. They benefit end-users through greater transparency – shifting information from Wall Street to Main Street. Following Congress' direction, end-users are not required to bring swaps into central clearing. Further, the Commission's proposed rule on margin provides that end-users will not have to post margin for uncleared swaps. Also, non-financial companies, other than those genuinely making markets in swaps, will not be required to register as swap dealers. Lastly, when end-users are required to report their transactions, they are given more time to do so than other market participants.

Congress also authorized the CFTC to provide relief from the Dodd-Frank Act's swaps reforms for certain electricity and electricity-related energy transactions between rural electric cooperatives and federal, state, municipal and tribal power authorities. Similarly, Congress authorized the CFTC to provide relief for certain transactions on markets administered by regional transmission organizations and independent system operators. The CFTC is looking to soon finalize exemptive orders related to these transactions, as Congress authorized.

The CFTC has worked to complete the Dodd-Frank reforms in a deliberative way – not against a clock. We have been careful to consider public input, as well as the costs and benefits of each rule. CFTC Commissioners and staff have met more than 2,000 times with members of the public, and we have held 23 public roundtables. The agency has received more than 39,000 comment letters on matters related to reform. The rules also have benefited from close consultation with domestic and international regulators and policymakers.

Throughout this process, the Commission has sought input from market participants on appropriate schedules to phase in compliance with swaps reforms. Now, over two-and-a-half years since Dodd-Frank passed and with 80 percent of our rules finalized, the market is moving to implementation. Thus, it's the natural order of things that market participants have questions and have come to us for further guidance. The CFTC welcomes inquiries from market participants, as some fine-tuning is expected. As it is sometimes the case with human nature, the agency receives many inquiries as compliance deadlines approach.

My fellow commissioners and I, along with CFTC staff, have listened to market participants and thoughtfully sorted through issues as they were brought to our attention, as we will continue to do.

I now will go into further detail on the Commission's efforts to implement the Dodd-Frank Act's swaps market reform, our efforts to enhance protections for futures and swaps customers, and the CFTC's work with international regulators regarding benchmarks.

Transparency – Lowering Cost and Increasing Liquidity, Efficiency, Competition

Transparency – a longstanding hallmark of the futures market – both pre- and post-trade – lowers costs for investors, consumers and businesses. It increases liquidity, efficiency and competition. A key benefit of swaps reform is providing this critical pricing information to businesses and other end-users across this land that use the swaps market to lock in a price or hedge a risk.

As of December 31, 2012, provisionally registered swap dealers are reporting in real time their interest rate and credit index swap transactions to the public and to regulators through swap data repositories. These are some of the same products that were at the center of the financial crisis. Building on this, swap dealers will begin reporting swap transactions in equity, foreign exchange and other commodity asset classes tomorrow. Other market participants will begin reporting April 10.

With these transparency reforms, the public and regulators now have their first full window into the swaps marketplace.

To further enhance liquidity and price competition, the CFTC is working to finish the pre-trade transparency rules for swap execution facilities (SEFs), as well as the block rule for swaps. SEFs would allow market participants to view the prices of available bids and offers prior to making their decision on a transaction. These rules will build on the democratization of the swaps market that comes with the clearing of standardized swaps.

Clearing – Lowering Risk and Democratizing the Market

Since the late 19th century, clearinghouses have lowered risk for the public and fostered competition in the futures market. Clearing also has democratized the market by fostering access for farmers, ranchers, merchants, and other participants.

A key milestone was reached in November 2012 with the CFTC's adoption of the first clearing requirement determinations for swaps. The vast majority of interest rate and credit default index swaps will be brought into central clearing. This follows through on the U.S. commitment at the 2009 G-20 meeting that standardized swaps should be brought into central clearing by the end of 2012. Compliance will be phased in throughout this year. Swap dealers and the largest hedge funds will be required to clear March 11, and all other financial entities follow June 10. Accounts managed by third party investment managers and ERISA pension plans have until September 9 to begin clearing.

Consistent with the direction of Dodd-Frank, the Commission in the fall of 2011 adopted a comprehensive set of rules for the risk management of clearinghouses. These final rules were consistent with international standards, as evidenced by the Principles for Financial Market Infrastructures (PFMIs) consultative document that had been published by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (CPSS-IOSCO).

In April of 2012, CPSS-IOSCO issued the final Principles. The Commission's clearinghouse risk management rules cover the vast majority of those standards. Commission staff are working expeditiously to recommend the necessary steps so that the Commission may implement any remaining items from the PFMIs not yet incorporated in our clearinghouse rules. I look forward to the Commission considering action on this in 2013.

I expect that soon we will complete a rule to exempt swaps between certain affiliated entities within a corporate group from the clearing requirement. This year, the CFTC also will be considering possible clearing determinations for other commodity swaps, including energy swaps.

Swap Dealer Oversight - Promoting Market Integrity and Lowering Risk

Comprehensive oversight of swap dealers, a foundational piece of Dodd-Frank, will promote market integrity and lower risk to taxpayers and the rest of the economy. Congress directed that end-users be able to continue benefitting from customized swaps (those not brought into central clearing) while being protected through the express oversight of swap dealers. In addition, Dodd-Frank extended the CFTC's existing oversight of previously regulated intermediaries to include their swaps activity.

As the result of CFTC rules completed in the first half of last year, more than 70 swap dealers are now provisionally registered. This initial group of dealers includes the largest domestic and international financial institutions dealing in swaps with U.S. persons. It includes the 16 institutions commonly referred to as the G16 dealers. Other entities will register once they reach the de minimis threshold for swap dealing activity.

In addition to reporting trades to both regulators and the public, swap dealers will implement crucial back office standards that lower risk and increase market integrity. These include promoting the timely confirmation of trades and documentation of the trading relationship. Swap dealers also will be required to implement sales practice standards that prohibit fraud, require fair treatment of customers and improve transparency.

The CFTC is collaborating closely domestically and internationally on a global approach to margin requirements for uncleared swaps. We are working along with the Federal Reserve, the other U.S. banking regulators, the SEC and our international counterparts on a final set of standards to be published by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO). The CFTC's proposed margin rules excluded non-financial end-users from margin requirements for uncleared swaps. We have been advocating with global regulators for an approach consistent with that of the CFTC. I would anticipate that the CFTC, in consultation with European regulators, would take up final margin rules, as well as related rules on capital, in the second half of this year.

Following Congress' mandate, the CFTC also is working with our fellow domestic financial regulators to complete the Volcker Rule. In adopting the Volcker Rule, Congress prohibited banking entities from proprietary trading, an activity that may put taxpayers at risk. At the same time, Congress permitted banking entities to engage in certain activities, such as market making and risk mitigating hedging. One of the challenges in finalizing a rule is achieving these multiple objectives.

International Coordination on Swaps Market Reform

In enacting financial reform, Congress recognized the basic lessons of modern finance and the 2008 crisis. During a default or crisis, risk knows no geographic border. Risk from our housing and financial crisis contributed to economic downturns around the globe. Further, if a run starts on one part of a modern financial institution, regardless of where it is around the globe, it invariably means a funding and liquidity crisis rapidly spreads and infects the entire consolidated financial entity.

This phenomenon was true with the overseas affiliates and operations of AIG, Lehman Brothers, Citigroup and Bear Stearns.

AIG Financial Products, for instance, was a Connecticut subsidiary of the New York insurance giant that used a French bank license to basically run its swaps operations out of Mayfair in London. Its collapse nearly brought down the U.S. economy.

Last year's events at JPMorgan Chase, which executed swaps through its London branch, are a stark reminder of stark reality. Transactions may be entered into by an offshore office, but the institution here in the United States absorbs the losses. Trades being booked offshore by U.S. financial institutions should not be confused with keeping that risk offshore.

Failing to incorporate these basic lessons of modern finance into the CFTC's oversight of the swaps market would fall short of the goals of Dodd-Frank reform. It would leave the public at risk.

More specifically, I believe that Dodd-Frank reform applies to transactions entered into by overseas branches of U.S. entities with non-U.S. persons, as well as between overseas affiliates guaranteed by U.S. entities. Failing to do so would mean American jobs and markets may move offshore, but, particularly in times of crisis, risk would come crashing back to our economy.

Similar lessons of modern finance were evident, as well, with the collapse of the hedge fund Long-Term Capital Management in 1998. It was run out of Connecticut, but its

$1.2 trillion swaps were booked in its Cayman Islands affiliate. The risk from those activities, as the events of the time highlighted, had a direct and significant effect here in the United States.

The same was true when Bear Stearns in 2007 bailed out two of its sinking hedge fund affiliates, which had significant investments in subprime mortgages. They both were organized offshore. This was just the beginning of the end, as within months, the Federal Reserve provided extraordinary support for the failing Bear Stearns.

We must thus ensure that collective investment vehicles, including hedge funds, that either are managed (or otherwise have their principal place of business) in the United States or are directly or indirectly majority owned by U.S. persons are not able to avoid the clearing requirement – or any other Dodd-Frank requirement – simply due to how they might be organized.

Last July, the Commission published for public comment proposed guidance addressing market participants' obligations under the Dodd-Frank Act (and Commission regulations) with respect to their cross-border activities. In December, the Commission granted time-limited relief until this July for non-U.S. swap dealers (and foreign branches of U.S. swap dealers) from certain Dodd-Frank swap requirements. The relief is limited to transactions involving such registered non-U.S. swap dealers and was intended to facilitate their transition to the new swaps regime; it does not extend to transactions where neither counterparty is registered as a swap dealer or major swap participant. It also does not extend to transactions between U.S. swap dealers and counterparties that are not registered as swap dealers or major swap participants, such as hedge funds.

We are hearing, though, that some swap dealers may be promoting to hedge funds an idea to avoid required clearing, at least during an interim period from March until July. I would be concerned if, in an effort to avoid clearing, swap dealers route to their foreign affiliates trades with hedge funds organized offshore, even though such hedge funds are managed (or otherwise have their principal place of business) in the United States or they are majority owned by U.S. persons. Such effort is not consistent with the spirit of Dodd-Frank or the international consensus to clear all standardized swaps. The CFTC is working to ensure that this idea does not prevail and develop into a practice that leaves the American public at risk. If we don't address this, the P.O boxes may be offshore, but the risk will flow back here.

Congress understood these issues and addressed these realities of modern finance in Section 722(d) of the Dodd-Frank Act, which states that swaps reforms shall not apply to activities outside the United States unless those activities have "a direct and significant connection with activities in, or effect on, commerce of the United States." Congress provided this provision solely for swaps under the CFTC's oversight and provided a different standard for securities-based swaps under the SEC's oversight.

To give financial institutions and market participants guidance on section 722(d), the CFTC last June sought public consultation on its interpretation of this provision. The proposed guidance is a balanced, measured approach, consistent with the cross-border provisions in Dodd-Frank and Congress' recognition that risk easily crosses borders.

Pursuant to Commission guidance, foreign firms that do more than a de minimis amount of swap-dealing activity with U.S. persons would be required to register with the CFTC within about two months after crossing the de minimis threshold. A number of international financial institutions are among the swap dealers that are provisionally registered with the CFTC.

Where appropriate, we are committed to permitting foreign firms and, in certain circumstances, overseas branches and guaranteed affiliates of U.S. swap dealers, to meet Dodd-Frank requirements through compliance with comparable and comprehensive foreign rules. We call this substituted compliance.

For foreign swap dealers, the Commission would allow such substituted compliance for entity-level requirements, as well as for certain transaction-level requirements when facing overseas branches of U.S. entities and overseas affiliates guaranteed by U.S. entities. Entity-level requirements include capital, chief compliance officer and swap data recordkeeping. Transaction-level requirements include clearing, margin, real-time public reporting, trade execution, trading documentation and sales practices.

When foreign swaps dealers transact with a U.S. person, though, compliance with Dodd-Frank regulation is required.

To assist foreign swap dealers with Dodd-Frank compliance, the CFTC recently finalized an exemptive order that applies until mid-July 2013. This time-limited Final Order incorporates many suggestions from ongoing consultation on cross-border issues with foreign regulatory counterparts and market participants. For instance, the definition of "U.S. person" in the Order benefited from comments in response to the Commission's July 2012 proposal.

Under its terms, a foreign swap dealer may phase in compliance with certain entity-level requirements. In addition, foreign dealers will have time-limited relief from specified transaction-level requirements when they transact with overseas affiliates guaranteed by U.S. entities, as well as with foreign branches of U.S. swap dealers.

The Final Order provides time for the Commission to continue working with foreign regulators as they implement comparable swaps reforms and as the Commission considers substituted compliance determinations for the various foreign jurisdictions with entities that have registered as swap dealers under Dodd-Frank.

The CFTC will continue engaging with our international counterparts through bilateral and multilateral discussions on reform and cross-border swaps activity. Earlier this month, SEC Chairman Walter and I had a productive meeting with international market regulators in Brussels.

Given our different cultures, political systems and legislative mandates some differences are inevitable, but we've made great progress internationally on an aligned approach to reform. The CFTC is committed to working through any instances where we are made aware of a conflict between U.S. law and that of another jurisdiction.

Customer Protection

Dodd-Frank included provisions directing the CFTC to enhance the protection of swaps customer funds. While it was not a requirement of Dodd-Frank, in 2009 the CFTC also reviewed and updated customer protection rules for futures market customers. As a result, a number of the enhancements affect both futures and swaps market customers. I would like to review these enhancements, as well as an important customer protection proposal.

The CFTC's completed amendments to rule 1.25 regarding the investment of customer funds benefit both futures and swaps customers. The amendments include preventing in-house lending of customer money through repurchase agreements. The CFTC's gross margining rules for futures and swaps customers require clearinghouses to collect margin on a gross basis. FCMs are no longer able to offset one customer's collateral against another or to send only the net to the clearinghouse.

Swaps customers further benefit from the new so-called LSOC (legal segregation with operational comingling) rules, which ensure funds are protected individually all the way to the clearinghouse.

The Commission also worked closely with market participants on new customer protection rules adopted by the self-regulatory organization (SRO), the National Futures Association (NFA). These include requiring FCMs to hold sufficient funds for U.S. foreign futures and options customers trading on foreign contract markets (in Part 30 secured accounts). Starting last year, they must meet their total obligations to customers trading on foreign markets computed under the net liquidating equity method. In addition, withdrawals of 25 percent or more of excess segregated funds would necessitate pre-approval in writing by senior management and must be reported to the designated SRO and the CFTC.

These steps were significant, but market events have further highlighted that the Commission must do everything within our authorities and resources to strengthen oversight programs and the protection of customers and their funds.

In the fall of 2012, the Commission sought public comment on a proposal that would strengthen the controls around customer funds at FCMs. It would set new regulatory accounting requirements and would raise minimum standards for independent public accountants who audit FCMs. And it would provide regulators with daily direct electronic access to the FCMs' bank and custodial accounts for customer funds. Last week, the CFTC held a public roundtable on this proposal, the third roundtable focused on customer protection.

Further, the CFTC intends to finalize a rule this year on segregation for uncleared swaps.

Benchmark Interest Rates

I'd like to now turn to the three cases the CFTC brought against Barclays, UBS and RBS for manipulative conduct with respect to LIBOR and other benchmark interest rate submissions. The reason it's important to focus on these matters is not because there were $2.5 billion in fines, though the U.S. penalties against these three banks of more than $2 billion were significant. What this is about is the integrity of the financial markets. When a reference rate, such as LIBOR – central to borrowing, lending and hedging in our economy – has been so readily and pervasively rigged, it's critical to discuss how to best change the system. We must ensure that reference rates are honest and reliable reflections of observable transactions in real markets.

The three cases shared a number of common traits. At each institution the misconduct spanned multiple years, involved offices in multiple cities around the globe, included numerous people, and affected multiple benchmark rates and currencies. In each case, there was evidence of collusion among banks. In both the UBS and RBS cases, one or more inter-dealer brokers were asked to paint false pictures to influence submissions of other banks, i.e., to spread the falsehoods more widely. At Barclays and UBS, the banks also were reporting falsely low borrowing rates in an effort to protect their reputation.

Why does this matter?

The derivatives marketplace that the CFTC oversees started about 150 years ago. Futures contracts initially were linked to physical commodities, like corn and wheat. Such clear linkage ultimately comes from the ability of farmers, ranchers and other market participants to physically deliver the commodity at the expiration of the contract. As the markets evolved, cash-settled contracts emerged, often linked to markets for financial commodities, like the stock market or interest rates. These cash-settled derivatives generally reference indices or benchmarks.

Whether linked to physical commodities or indices, derivatives – both futures and swaps – should ultimately be anchored to observable prices established in real underlying cash markets. And it's only when there are real transactions entered into at arm's length between buyers and sellers that we can be confident that prices are discovered and set accurately.

When market participants submit for a benchmark rate that lacks observable underlying transactions, even if operating in good faith, they may stray from what real transactions would reflect. When a benchmark is separated from real transactions, it is more vulnerable to misconduct.

Today, LIBOR is the reference rate for 70 percent of the U.S. futures market, most of the swaps market and nearly half of U.S. adjustable rate mortgages. It's embedded in the wiring of our financial system.

The challenge we face is that the market for interbank, unsecured borrowing has greatly diminished over the last five years. Some say that it is essentially nonexistent. In 2008, Mervyn King, the governor of the Bank of England, said of Libor: "It is, in many ways, the rate at which banks do not lend to each other."

The number of banks willing to lend to one another on such terms has been sharply reduced because of economic turmoil, including the 2008 global financial crisis, the European debt crisis that began in 2010, and the downgrading of large banks' credit ratings. In addition, there have been other factors that have led to unsecured, interbank lending drying up, including changes to Basel capital rules and central banks providing funding directly to banks.

Fortunately, much work is occurring internationally to address these issues. I want to commend the work of Martin Wheatley and the UK Financial Services Authority (FSA) on the "Wheatley Review of LIBOR." Additionally, the CFTC and the FSA are co-chairing the International Organization of Securities Commissions (IOSCO) Task Force that is developing international principles for benchmarks and examining best mechanisms or protocols for transition, if needed. On January 11, the IOSCO Task Force published the

Consultation Report on Financial Benchmarks. The consultation report said: "The Task Force is of the view that a benchmark should as a matter of priority be anchored by observable transactions entered into at arm's length between buyers and sellers in order for it to function as a credible indicator of prices, rates or index values." It went on to say: "However, at some point, an insufficient level of actual transaction data raises concerns as to whether the benchmark continues to reflect prices or rates that have been formed by the competitive forces of supply and demand."

Among the questions for the public in the report are the following:

- What are the best practices to ensure that benchmark rates honestly reflect market prices?
- What are best practices for benchmark administrators and submitters?
- What factors should be considered in determining whether a current benchmark's underlying market is sufficiently robust? For instance, what is an insufficient level of actual transaction activity?
- And what are the best mechanisms or protocols to transition from an unreliable or obsolete benchmark?

On February 20, the IOSCO task force hosted a roundtable in London, which was followed by a second public roundtable yesterday at the CFTC to gather input from market participants and other interested parties. I expect the final report incorporating public input will be published this spring.

Resources

The CFTC's hardworking team of 690 is less than 10 percent more in numbers than at our peak in the 1990s. Yet since that time, the futures market has grown five-fold, and the swaps market is eight times larger than the futures market.

To provide for effective market implementation of swaps reforms by the CFTC requires additional resources. Investments in both technology and people are needed for effective oversight of these markets by regulators.

Though data has started to be reported to the public and to regulators, we need the staff and technology to access, review and analyze the data. Though more than 70 entities have registered as new swap dealers, we need people to answer their questions and work with the NFA on the necessary oversight to ensure market integrity. Furthermore, as market participants expand their technological sophistication, CFTC technology upgrades are critical for market surveillance and to enhance customer fund protection programs.

Without sufficient funding for the CFTC, the nation cannot be assured this agency can closely monitor for the protection of customer funds and utilize our enforcement arm to its fullest potential to go after bad actors in the futures and swaps markets. Without sufficient funding for the CFTC, the nation cannot be assured that this agency can effectively enforce essential rules that promote transparency and lower risk to the economy.

The CFTC is currently funded at $207 million. To fulfill our mission for the benefit of the public, the President requested $308 million for fiscal year 2013 and 1,015 full-time employees.

Thank you again for inviting me today, and I look forward to your questions.

CFTC Dodd-Frank Update

Final Rules & Guidance

- Agricultural Commodity Definition
- Agricultural Swaps
- Anti-Manipulation
- Business Affiliate Marketing and Disposal of Consumer Information
- Clearing Requirement Determinations
- Client Clearing Documentation, Straight Through Processing, Clearing Member Risk Management
- Commodity Options
- Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations
- Conforming Rules – Parts 1, 1.35 3 and 4
- Cross-Border Exemptive Order
- Derivatives Clearing Organization - General Provisions and Core Principles
- Designated Contract Markets – Core Principles
- End-User Exception
- External Business Conduct Standards
- Foreign Boards of Trade - Registration
- Implementation Phasing for Clearing
- Internal Business Conduct Standards (Risk Management, Recordkeeping, & CCOs)
- Internal Business Conduct (Documentation, Confirmation, & Portfolio Reconciliation)
- Investment Advisor Reporting on Form PF (Jt. with SEC)
- Investment of Customer Funds (Regulation 1.25)
- Large Trader Reporting for Physical Commodity Swaps
- Position Limits for Futures and Swaps
- Privacy of Consumer Financial Information
- Process for Review of Swaps for Mandatory Clearing
- Process for Rule Certifications for Registered Entities (Part 40)
- Real-Time Reporting for Swaps
- Registration of Intermediaries
- Removal of References to or Reliance on Credit Ratings
- Reporting Certain Post-Enactment Swap Transactions (IFR)
- Reporting of Historical Swaps
- Reporting Pre-Enactment Swap Transactions (IFR)
- Retail Commodity Transactions – Interpretive Guidance on "Actual Delivery"
- Retail Foreign Exchange Intermediaries – Regulations & Registration
- Retail Foreign Exchange Transactions – Conforming Amendments
- Segregation for Cleared Swaps
- Swap, Security-Based Swap, Security-Based Swap Agreement -- Further Definitions (Jt. with SEC)
- Swap Data Recordkeeping and Reporting Requirements
- Swap Data Repositories – Core Principles, Duties & Registration
- Swap Data Repository Indemnification Interpretation
- Swap Dealers and Major Swap Participants - Registration
- Swap Dealers, Major Swap Participants, and Eligible Contract Participants - Further Definitions (Jt. with SEC)
- Whistleblowers

CFTC Dodd-Frank Update

Proposed Rules & Guidance

- Block Rule
- Capital for Swap Dealers & Major Swap Participants
- Clearing Exemption for Cooperatives
- Cross-Border Application Guidance
- DCMs – Core Principle 9
- Disruptive Trade Practices
- Governance and Conflict of Interest (DCM, DCO, & SEF)
- Identify Theft (Jt. with SEC)
- Inter-Affiliate Clearing for Financial Entities
- Margin for Uncleared Swaps
- RTO/ISO Exemptive Relief
- Segregation for Uncleared Swaps
- Swap Execution Facilities – Core Principles, Registration, and Process for "Made Available to Trade" Determinations
- Systemically Important Clearing Organizations – Additional Provisions
- Volcker Rule
- 201(f) Exemptive Relief

Yet to be Proposed Rules & Guidance

- Stress Testing under Section 165

Final Orders

- Delegation to National Futures Association (NFA) – Certain exemptions for Commodity Pool Operators
- Delegation to NFA - Foreign Exchange Intermediary Registration function
- Delegation to NFA - Swap Dealer & MSP Registration function
- Exemptive orders – Effective Date for Swaps Regulation
- Treatment of Grandfather Relief Petitions - Exempt Boards of Trade & Exempt Commercial Markets
- Treatment of Grandfather Relief Petitions – Transactions done in Reliance on 2(h)

Studies & Reports

- Feasibility of Requiring Use of Standardized Algorithmic Descriptions for Financial Derivatives (Jt. with SEC)
- International Swap Regulation (Jt. with SEC)
- Risk Management Supervision of Designated Clearing Entities (Jt. With Board of Governors of the Federal Reserve System and the SEC)
- Study on Oversight of Carbon Markets (Jt. with various other Agencies)

QUESTIONS AND ANSWERS

FEBRUARY 27, 2013

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
Questions for the record
Chairman Gensler
February 27, 2013

Chairwoman Debbie Stabenow

1. The Board of the National Futures Association recently accepted recommendations provided by the Berkeley Research Group, LLC (BRG). NFA asked BRG to examine, in part, NFA's oversight of Peregrine Financial Group, Inc. before Peregrine's failure. The report discussed the NFA's relationship with the CFTC, recommended increased coordination between the NFA and the CFTC, and discussed NFA's oversight of market participants. The report highlighted what the NFA does well, but also made recommendations on how to improve NFA's audits.
    1. Does the CFTC have a written policy that dictates how and when information should be shared between the NFA and the CFTC, either at the staff level or otherwise? If not, why hasn't this been done? If so, please provide that policy to the Committee.
    2. What is the CFTC's role in setting or approving designated self-regulatory organizations' (DSROs') auditing standards? If the agency has the authority to dictate auditing standards for DSROs, when did the agency last use this authority?
    3. Has the agency ever formally examined the auditing standards of the NFA? If so, when is the last time this took place?
    4. What is the CFTC's relationship, formal or informal, with the Joint Audit Committee (JAC)?
    5. What division at the CFTC is responsible for ensuring that DSROs are adequately supervising Futures Commission Merchants (FCMs)? What staff resources are dedicated to oversight of the self-regulatory organizations and designated self-regulatory organizations?
    6. What more should the CFTC do to ensure that designated self-regulatory organizations are properly supervising market participants?

2. Recently, the SEC approved Exchange Traded Funds (ETFs) backed by physical holdings of copper (BlackRock's iShares Copper Trust and J.P. Morgan's XF Physical Copper Trust). The SEC argued that the fund would not drive copper prices, but others have concerns that it could.
    a. If your staff or anyone at the Commission has considered the extent to which these types of funds could have an impact on the price of physical products like copper or in CFTC-regulated markets, what have they concluded? Does the CFTC have sufficient access to data that would draw conclusions about this impact?

b. The Dodd-Frank Act included language that requires additional consultation and coordination between the CFTC and the SEC. In March 2008, the agencies signed a Memorandum of Understanding that would facilitate more cooperation on issues of mutual interest. Given part of the CFTC's mission is to preserve the integrity of the price-discovery process in the futures, swaps, and options markets, and to protect these markets from manipulation, does the agency consider these physically-backed ETF approvals an area of mutual interest? Did the CFTC have any formal or informal input in the approvals of these ETFs? If the CFTC had input at any level, what communication did the agency have with the SEC or other regulators on this subject?
c. Does the CFTC currently have any authority to directly oversee these entities?

3. In a final position limits rule published in the Federal Register on November 18, 2011 (76 FR 71626), the CFTC discussed the treatment of commodity index funds. That final rule referenced a letter that then-Chairman of the Agriculture Committee Sen. Lincoln wrote to Chairman Gensler on December 16, 2010, that asked the agency to consider the impact of position limits on certain types of investment vehicles and classes of investors. Does the CFTC intend to propose a new rule on position limits and, if so, will the CFTC consider this letter and other comments provided to it at the time of its initial rulemaking on position limits?

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the record
Senator Saxby Chambliss

Chairman Gensler:

1. In December, Mr. Masamichi Kono, Vice Commissioner for International Affairs for the Financial Services Agency of Japan testified before a House agriculture subcommittee. He noted *"In Japan, we have so far deliberately refrained from applying our rules to cross-border transactions in anticipation of an international coordination arrangement on regulation of cross-border transactions which we strongly hope to be developed soon."* On February 6th the Japanese Government again noted to you in a letter that *"We understand that the Commission intends to conduct assessment for substituted compliance with foreign regulatory requirements before the expiration date (July 12, 2013) of the final exemptive order. If, at the expiration date, substituted compliance with the Japanese regulatory requirements is not available for Japanese financial institutions which registered as swap dealers, they would be subject to the Commission's regulations after the expiration date."*

   Are the concerns of Mr. Kono reflective of the concerns other foreign regulators?

   Do you believe that by July 12th you will have cleared all of the issues the Japanese Government and other foreign regulators have brought to your attention?

Senate Committee on Agriculture, Nutrition & Forestry

Oversight of the Commodity Futures Trading Commission

Questions for the record

February 27, 2013

Ranking Member Cochran

Hon. Gensler:

1. We continue to see concerns with the CFTC's data reporting requirements that conflict with some foreign countries' privacy laws, such as France, Singapore, Spain and Korea, among others. Market participants could be put in the difficult situation of failing to comply with CFTC regulations or violating another country's laws, subjecting them to criminal or civil penalties. Conflicts like these could cause firms in the United States doing business internationally to suffer financially. Such regulatory arbitrage would stunt financial growth, disrupt the markets, and go against this Administration's pledge to streamline and make regulations less burdensome for businesses. Can you outline your plan for resolving this and other similar situations where CFTC regulations and foreign country laws are in conflict?

    a. Also, could you please explain how the CFTC has taken into consideration the Administration's pledge to streamline regulations like this so that the impact on firms is minimal?

    b. If substituted compliance is not made available to international regulators, will the CFTC be extending the time period of its final exemptive rule for international entities, and if so, for how long?

2. How many meetings has the CFTC had with stakeholders, and particularly those involved in trading agricultural commodities, about how the Commission's "residual interest" provisions contained with your proposed customer protection rule will affect Futures Commission Merchants and their customers?

    a. What are the changes in margin requirements the Commission is proposing in your proposed customer protection rule?

    b. Does the Commodity Exchange Act provide for the CFTC to set margin requirements?

    c. What is the statutory authority for the CFTC to mandate these changes?

d. While this particular provision in the Commission's rule doesn't include a cost analysis, industry estimates indicate that it may result in customers of Futures Commission Merchants needing to hold an additional $100 billion of their own funds in their margin accounts. Will the Commission be issuing a cost/benefit analysis for this specific provision of the rule?

e. Has the Office of Management and Budget indicated that the CFTC's "customer protection" rule will be a major rule?

3. During the hearing you indicated that the CFTC is actively shelving enforcement action(s) due to a lack of resources. Can you please provide a specific number of instances where this has occurred?

4. Is it the CFTC's position that the industry—specifically members of a Designated Contract Market (DCM) that are not otherwise required to be registered with the CFTC—has been required to record and archive instant messages, text messages, and other forms of digital and electronic media based on the "industry guidance" that CFTC issued in 2009? If yes, are you suggesting that CFTC's 2009 "industry guidance" has the full force and effect of a regulation?

   a. The expansion in the final rule specifically includes "voicemail" in the category of "written communication." Does this mean that the CFTC is taking the position that, if a phone call results in a voicemail, once it is recorded as a voicemail it is now a "written record" that must be maintained? Please explain the similarities and differences between the Securities and Exchange Commission's regulations and the CFTC's regulations regarding this topic.

   b. If the appropriate policy regarding members of a DCM—that are not otherwise required to be registered with the CFTC—is to not require recording of oral communications related to cash commodity sales, does it make sense to make them retain the 21st century analogs for oral conversation, such as text messages and instant messages? What is the policy goal of this distinction?

   c. In order to comply with the final rule as written, entities may have no choice but to avoid text or instant messaging, and simply go back to using the phone, which they do not have to record. Is this the intended policy outcome that the CFTC envisioned with this final rule?

   d. Would the CFTC be willing to re-open that portion of the final rule on adaptation relating to what constitutes a "written record" in order to allow further industry comment?

5. Does the Commission have enough information available to make a finding that position limits are necessary and appropriate?

6. Does the CFTC believe that the migration from swaps to futures is due to regulatory uncertainty or does this transition suggest that the Commission's rules are being promulgated in the wrong order?

7. Has the CFTC drafted any proposed technical changes or is the CFTC aware of any other federal agency that has drafted proposed changes to Title VII of Dodd-Frank? If so, can the CFTC please forward a copy of the draft to the Senate Agriculture Committee?

8. The CFTC's regulation of inter-affiliate trades is also a matter of great concern to companies in my state and across the country. Many such companies have established centralized treasury units to more efficiently manage their risk mitigation strategies. Is the CFTC considering denying end-user companies use of the clearing exception simply because they have adopted the use of inter-affiliate transactions or centralized treasury units as a type of risk mitigation? If so, can the CFTC fix this problem administratively or does Congress need to address this problem?

    a. What is the CFTC's intended use for this captured inter-affiliate transaction data?

9. Based upon the GAO's January 23, 2013 response regarding the CFTC's reprogramming of funds obtained by eliminating two administrative law judges, two questions remain:

    a. Have you reprogrammed the $800,000 of funding saved from eliminating these jobs, and if so, how? Also, have you notified the House and Senate Appropriations Committees pursuant to the Act?

    b. What authority allows you to eliminate these positions and contract judges?

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the record

Senator Charles E. Grassley

Questions for Chairman Gary Gensler

QUESTION 1

Chairman Gensler, I want to thank you for reaching out to me regarding the manipulation of LIBOR. On February 21st in an interview with Bloomberg News, you referenced your concerns regarding the integrity of LIBOR saying that some might see the rate as "too big to replace" despite concerns about its integrity.

I am also concerned that some have taken this view of LIBOR. In addition to pegging LIBOR to real transactions, what suggestions would you make to create a sustainable benchmark rate that would not be so vulnerable to manipulation?

Are you concerned that we are in danger of reverting back to LIBOR without any meaningful reforms?

QUESTION 2

In a recent final rule, the CFTC recognized the compliance burden that the oral communications recordkeeping would have on smaller futures businesses, specifically excluding the requirement for Introducing Brokers that don't exceed a certain revenue threshold. Similarly, commercial grain elevators that largely deal in purchasing cash grain, occasionally take an order from a customer to hedge in the futures markets. Because they are technically a branch operation affiliated with a farmer cooperative futures commission merchant, and not an introducing broker, they will have to record all oral phone conversations. Given the low volume of futures transactions handled by these facilities, complying with such oral recording requirements under Regulation 1.35 could be difficult both economically and from a technical standpoint.

Given this situation, would CFTC consider treating those branch operations similar to small introducing brokers and exclude them from the oral communications recordkeeping requirements?

QUESTION 3

A lot is being discussed about customer protections in terms of regulations being implemented by the CFTC and some of the Self-Regulatory entities. In addition, customer protections will certainly come up during reauthorization of the Commodity Exchange Act. As we all know, the issue of customer protections is so prevalent because of the recent failures of Peregrine Financial and MF Global. Both of those firms are still going through the bankruptcy process.

It will be good for the Agriculture Committee to carefully consider proper customer protections during reauthorization of the Commodity Exchange Act; as the ranking member on the Judiciary Committee I am also interested in whether you think there are areas of the bankruptcy law that need to be analyzed as it pertains to protecting customers of futures brokerage firms which go into bankruptcy?

QUESTION 4

I support some of the recent work the CFTC has done in regards to increasing customer protections. That being said, I have heard from farmers and their brokers that they have serious concerns with the CFTC's proposed rule that would require futures brokerages to keep so-called residual interest in their accounts at all times to cover customers' margin requirements. Farmers are concerned about how this will effect the amount of money they would be required to keep in their margin accounts to cover possible moves in the market, whereas currently they provide more funds to cover movements in the market at the end of a given day. In addition there is concern with the practicality of farmers being able to get funds to their brokers potentially on a moment's notice in the middle of the day while they are busy running their farming operations.

I would like for you to put this proposed rule in the context of the recent collapse of futures brokers. In terms of the two biggest failures in the futures industry in recent years, MF Global and Peregrine Financial, could you explain if, and how, this so-called "residual interest" rule would have helped prevent the failures at MF Global and Peregrine Financial? How would this rule have helped protect customer money in those cases? If this proposed rule would not have had much affect in protecting customer money in MF Global or Peregrine Financial, could you please explain how the CFTC decided this proposed rule was necessary?

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
2/27/13
Questions for the Record
Senator Tom Harkin

Questions for Chairman Gensler:

Question 1: At the request of the National Futures Association the Berkeley Research Group recently conducted an independent analysis of the NFAs auditing of Peregrine Financial Group, Inc. in light of the fraud perpetrated by Peregrine's CEO Russell Wasendorf Sr. The analysis included a list of recommendations that NFA has pledged to adopt.

Do you believe these changes are sufficient or that more needs to be done to ensure that the NFA is able to protect customer segregated funds and appropriately regulate the market participants that it oversees? If so, what additional steps do you believe need to be taken to fully protect customer segregated funds?

Question 2: One of the striking developments in the financial markets over the last decade is the rise of high speed trading. While there are many different views about the role that high speed trading plays in the market, in late 2012 CFTC Chief Economist Andrei Kirilenko published a study in which he found that High Frequency Traders generate their profits to the detriment of typical retail investors. This study followed on the joint report from the CFTC and SEC on the so-called "flash crash" that found high speed trading to be one of the causes of this significant market disruption that occurred on May 6, 2010. Finally the Financial Times recently noted that high speed trading is spreading into markets like bonds, currencies, and derivatives (Markets: In Search of a Fast Buck by Arash Massoudi and Michael Mackenzie, February 19, 2013).

In light of these events what do you believe the impact of high speed trading is on the safety and soundness of the financial system? What do you believe will be the impact of high speed trading in the derivatives markets?

Question 3: Title VII of the Dodd-Frank Act requires the CFTC to publicly report and take steps to protect the financial system should swaps that are required to clear not be cleared. As market participants are required to begin clearing certain swaps, what steps has the CFTC taken to implement the anti-evasion provisions of the Dodd-Frank Act?

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
Questions for the record
Chairman Gensler
February 27, 2013

Senator Patrick Leahy

Questions for Chairman Gensler

I am hearing from a number of municipal electric utilities in Vermont, these are small, government-owned utilities, that are alarmed about new CFTC regulations they believe are preventing them from hedging fuel risks using financially settled contracts. These utilities are accountable to the people they serve and deeply invested in keeping their rates low and bills affordable to help stimulate the economic prosperity of the communities they serve.

As you mentioned in your testimony, the Dodd-Frank Act swaps market reforms were put in place to benefit end-users by lowering costs and increasing access to the markets. However I am concerned that our country's municipal utilities have been swept up in an unintended consequence in these regulations and these true end-users are being excluded from the swaps market because any counterparty that does business with them will be labeled a Swap Dealer.

I have heard from Vermont municipalities that are considered a "special entity" under your regulations who believe this has scared off any non-financial counterparty from doing business with them. This is limiting the ways they are able to hedge the price of fuel compared to other cooperatives or investor-owned utilities, which is putting the utilities and the communities they serve at a disadvantage.

The Dodd-Frank Act certainly did not intend for "end-users" such as municipal utilities to be frozen out of the swaps market like this. As I understand it there is no provision in that portion of the bill that required any kind of additional protections for special entities, so my question for you is how can this be fixed so that we are not unfairly discriminating against our municipal utilities?

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
Wednesday, February 27, 2013
Questions for the record

Senator Thune

Hon. Gary Gensler

1) On the subject of the proposed customer-segregation rule, it is intended to prevent another collapse like MF Global or Peregrine Financial Group in which customer segregated funds are at risk. My concern is that the capital requirements are so stringent that smaller brokerages that cater to end-users in states like mine will not be able to survive, or at the very least will drive up costs for end-users like farmers, the very people this rule is intending to protect.

   I understand that the comment period on this rule is now closed. Assuming you heard from end-users and brokerages concerned about the impact of this proposed rule, what steps are you taking to ensure those concerns are addressed before issuing a final rulemaking?

2) We've heard U.S. regulators talk about "international harmonization" and the belief that the rest of the world will follow, which played a role in the CFTC's delay in compliance with some of its cross-border derivatives rules last year. It is difficult to see that there will be such harmonization. Will you hit the pause button again as you did in October and in December? Isn't the better way to regulate to be clear that these requirements will be put on hold until an agreement is reached?

3) There has been a lot of focus in the industry press about so-called "futurization" – that is the increased use of futures instead of swamps because of all the uncertainty surrounding the swaps rules, particularly in the energy space. It is interesting to see futurization being made out to be a bad thing, because the futures are more highly regulated. But given the uncertainty with regard to swaps, and the piecemeal approach being taken in the implementation of the swaps rule, doesn't it make sense that folks would turn toward futures, even though they are more regulated, out of a desire for regulatory certainty?

4) The Commission has said that guarantees of swaps are themselves swaps. In addition to creating a great deal of uncertainty in areas such as cross-border jurisdiction and swap dealer and major swap participant calculations, this is directly contrary to what the SEC concluded in the same rulemaking, where they said guarantees of security based swaps are not themselves security based swaps. How is this consistent with the statutory

requirement that the two agencies coordinate their rules, and can you tell me where in the swap definition guarantees appear?

5) Why did the CFTC say that all options are swaps, ignoring the fact that Congress preserved the CFTC's existing authority over options? Why doesn't the Commission clarify that an option to buy a nonfinancial commodity – purchased by a commercial business that intends to use the product in its business, and not for financial speculation of any kind – is completely outside regulation as a swap?

6) Well before the April 10 reporting deadline, will the CFTC give guidance to end users on which volumetric options must be reported as swaps? And will this guidance clarify that options in a commercial forward that are used in the ordinary course of business, and not for financial speculation, are covered by the forward exemption?

7) There has been considerable debate around the intent of Sec. 722 of Dodd-Frank and the aggressive approach being taken by the CFTC to apply derivatives rules to U.S. banks doing business overseas with foreign clients. This approach has been criticized by market participants, and, maybe most noteworthy, foreign regulators as missing the mark and potentially exacerbating rather than ameliorating the problem. Given that foreign regulators have raised concerns about the potential application of Title VII in their jurisdictions, I am concerned about similar reciprocal measures being enacted by the E.U. or other foreign regulators in response. Can you please provide the Committee with details about how the agency intends to reach an agreement with the key European countries to resolve this dispute?

8) Given developments late last year – unnecessary disruptions around Oct. 12 deadlines, last minute "no-action" letters, reports that foreign banks wouldn't do business with US firms, an interim final rule, etc. – why should Congress have any level of confidence that you're moving in the right direction and that markets won't be negatively impacted by actions of the CFTC? Also, how do you intend on getting the rest of the world to follow the U.S. when the SEC and CFTC rules currently don't align on timing, process or content in many areas? What happens later this year if there is still not international harmonization or even domestic harmonization?

9) Why are such significant reforms – like your cross-border guidance – being made through guidance and no-action letters versus a formal rulemaking process? Is it to avert Administration Procedures Act (APA) requirements? Wouldn't all parties benefit from formally proposed rules?

10) A purpose of including the formation of Swap Execution Facilities in Dodd-Frank was to encourage price transparency, but there is nothing in the statute that directs the agencies to require a certain number of trade submissions as a prerequisite to qualify for trading as a SEF. In fact, the SEC's proposal does not have this requirement, so this clearly isn't a statutory necessity. But there is significant downside to mandating this

requirement. Requiring a certain number would reduce liquidity, increase trading costs and actually could impair transparency. Shouldn't we allow the SEF landscape to develop without imposing such inflexible requirements? If, as these platforms develop, the agency learns through experience that a minimum requirement is necessary, it can always revise the standards.

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

Chairwoman Debbie Stabenow

1.) The Board of the National Futures Association recently accepted recommendations provided by the Berkeley Research Group, LLC (BRG). NFA asked BRG to examine, in part, NFA's oversight of Peregrine Financial Group, Inc. before Peregrine's failure. The report discussed the NFA's relationship with the CFTC, recommended increased coordination between the NFA and the CFTC, and discussed NFA's oversight of market participants. The report highlighted what the NFA does well, but also made recommendations on how to improve NFA's audits.

2.) Does the CFTC have a written policy that dictates how and when information should be shared between the NFA and the CFTC, either at the staff level or otherwise? If not, why hasn't this been done? If so, please provide that policy to the Committee.

Response: The CFTC and the DSROs readily share information on firms and engage in routine meetings to discuss firms. All examination reports performed by the designated self-regulatory organizations (DSROs) are provided to the CFTC, and the CFTC is in the process of obtaining real-time access to the SROs' financial and compliance examinations

a.) What is the CFTC's role in setting or approving designated self-regulatory organizations' (DSROs') auditing standards? If the agency has the authority to dictate auditing standards for DSROs, when did the agency last use this authority?

b.) Has the agency ever formally examined the auditing standards of the NFA? If so, when is the last time this took place?

Response to 2(a) and 2(b): Last October, the Commission acted to propose new rules that are directed toward enhancing protections afforded customer funds held by Futures Commission Merchants and Derivatives Clearing Organizations. The proposal makes a number of changes that are designed to ensure that the Commission does everything within its authorities and resources to strengthen oversight programs and the protection of customers and their funds. Among the proposed reforms is a provision to set standards for the SROs' examinations and the annual certified financial statement audits, including raising minimum standards for independent public accountants who audit FCMs. The agency has received public comment regarding the proposed rules and will respond to those comments in issuing final rules.

c.) What is the CFTC's relationship, formal or informal, with the Joint Audit Committee (JAC)?

Response: The CFTC is not a member of the JAC but participates in meetings at times depending on the agenda.

d.) What division at the CFTC is responsible for ensuring that DSROs are adequately supervising Futures Commission Merchants (FCMs)? What staff resources are dedicated to oversight of the self-regulatory organizations and designated self-regulatory organizations?

Response: The Division of Swap Dealer and Intermediary Oversight (DSIO) oversees the DSROs and exercises supervision over Futures Commission Merchants (FCMs). DSIO has two people dedicated full time to overseeing the DSROs. They are supplemented with other DSIO staff when the need arises to support an examination of the DSRO.

e.) What more should the CFTC do to ensure that designated self-regulatory organizations are properly supervising market participants?

Response: The CFTC's mission is to ensure the integrity of the futures and swaps markets. As part of this, we must do everything within our authorities and resources to strengthen oversight programs and the protection of customers and their funds. That's the goal of rules proposed by the Commission last year. It's about ensuring customers have confidence that the funds they post as margin or collateral are fully segregated and protected.

CFTC Commissioners and staff reached out broadly on ways to enhance customer protections. We hosted two roundtables on issues ranging from the segregation of customer funds to examining the CFTC's oversight of self-regulatory organizations (SROs). In July, the CFTC approved a National Futures Association (NFA) proposal that stemmed from a coordinated effort by the CFTC, the SROs, other financial regulators, and market participants, including from CFTC roundtables.

The CFTC's November 2012 customer protection proposal addresses several components of customer protection, including the self-regulatory organization oversight program, risk disclosures, financial reporting, and public disclosures.

With respect to the SRO financial surveillance program, the proposal would require SROs that examine FCMs, including the NFA, to establish a supervisory program that, among other things, must be based on controls testing as well as substantive testing, and must address all areas of risk that the FCM can reasonably foresee. The supervisory program also must have standards addressing such issues as the ethics of the examiner; the independence of the examiner; the supervision, review, and quality control of an examiner's work product; and the quality control procedures to ensure that the examinations maintain the level of quality expected. The SROs also would be required to engage a recognized accounting or auditing firm with substantial expertise in the audit of

FCMs, risk assessment, and internal control reviews to evaluate the SROs' supervisory program and the application of the of the supervisory program at least once every two years.

The Commission received more than 100 comment letters on the proposed customer protection rulemaking. Staff is currently reviewing the comments and the Commission will respond in a final rule.

3.) Recently, the SEC approved Exchange Traded Funds (ETFs) backed by physical holdings of copper (BlackRock's iShares Copper Trust and J.P. Morgan's XF Physical Copper Trust). The SEC argued that the fund would not drive copper prices, but others have concerns that it could.

a.) If your staff or anyone at the Commission has considered the extent to which these types of funds could have an impact on the price of physical products like copper or in CFTC-regulated markets, what have they concluded? Does the CFTC have sufficient access to data that would draw conclusions about this impact?

b.) The Dodd-Frank Act included language that requires additional consultation and coordination between the CFTC and the SEC. In March 2008, the agencies signed a Memorandum of Understanding that would facilitate more cooperation on issues of mutual interest. Given part of the CFTC's mission is to preserve the integrity of the price-discovery process in the futures, swaps, and options markets, and to protect these markets from manipulation, does the agency consider these physically-backed ETF approvals an area of mutual interest? Did the CFTC have any formal or informal input in the approvals of these ETFs? If the CFTC had input at any level, what communication did the agency have with the SEC or other regulators on this subject?

c.) Does the CFTC currently have any authority to directly oversee these entities?

<u>Response to (a), (b), and (c)</u>: **While the CFTC is not a price setting agency, the Commission has the responsibility for the oversight of commodities trading on regulated markets that are subject to the Commission's regime. The Commodity Exchange Act requires the registration of Commodity Pool Operators (CPOs) including CPOs that offer commodity pools whose shares are publicly offered and listed for trading on a national securities exchange. Like ETFs generally, these commodity ETFs may passively seek to track or replicate the performance of a specific commodity or commodity index or they may actively trade commodity interests. To the extent that such pools are fully regulated by the**

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

SEC under the Securities Act of 1933 and the Securities Exchange Act of 1934, the CFTC has recognized the SEC regime as providing investor protection and granted relief from duplicative requirements such as the manner in which required CPO disclosures are provided in connection with investor prospectuses.

Through its large trader reporting system, the CFTC obtains position information for traders whose positions in futures contracts and in options on futures contracts exceed specified levels. To the extent the ETF, as a commodity pool, has a reportable position, it is subject to the CFTC's large trader reporting regime.

Some ETFs are structured in such a way that their shares may not be securities, but cash market transactions. These "physical commodity-based ETFs" hold physical commodities, such as gold or silver, rather than futures or commodity options. To date, these ETFs have listed their shares on national securities exchanges subject to SEC regulation. National securities exchanges have also elected to list options and security futures on such shares; however, to the extent such a product is a commodity options or futures contract, it is subject to the CEA's requirement that it be traded on a CFTC-designated market. The CFTC has provided exemptive relief to such products in recognition of the fact that they are subject to the SEC's regime of customer protection. Staff from the SEC's Division of Trading and Markets (T&M) have engaged with the CFTC's Division of Market Oversight (DMO) with respect to the various viewpoints in comment letters that were submitted to the SEC on the copper ETF proposals.

4.) In a final position limits rule published in the Federal Register on November 18, 2011 (76 FR 71626), the CFTC discussed the treatment of commodity index funds. That final rule referenced a letter that then-Chairman of the Agriculture Committee Sen. Lincoln wrote to Chairman Gensler on December 16, 2010, that asked the agency to consider the impact of position limits on certain types of investment vehicles and classes of investors. Does the CFTC intend to propose a new rule on position limits and, if so, will the CFTC consider this letter and other comments provided to it at the time of its initial rulemaking on position limits?

Response: The CFTC has appealed the September 28, 2012, Order of the District Court for the District of Columbia that vacated the position limits final rule. In addition, staff is developing a draft of a new proposed rule for consideration by the Commission. The Commission will benefit from prior comments, as well as new comments that may be received.

Ranking Member Thad Cochran

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

1.) We continue to see concerns with the CFTC's data reporting requirements that conflict with some foreign countries' privacy laws, such as France, Singapore, Spain and Korea, among others. Market participants could be put in the difficult situation of failing to comply with CFTC regulations or violating another country's laws, subjecting them to criminal or civil penalties. Conflicts like these could cause firms in the United States doing business internationally to suffer financially. Such regulatory arbitrage would stunt financial growth, disrupt the markets, and go against this Administration's pledge to streamline and make regulations less burdensome for businesses. Can you outline your plan for resolving this and other similar situations where CFTC regulations and foreign country laws are in conflict?

   a.) Also, could you please explain how the CFTC has taken into consideration the Administration's pledge to streamline regulations like this so that the impact on firms is minimal?

   b.) If substituted compliance is not made available to international regulators, will the CFTC be extending the time period of its final exemptive rule for international entities, and if so, for how long?

Response: In implementing the requirements of the Dodd-Frank Act, the CFTC has engaged in discussions with foreign regulatory authorities and market participants to coordinate and promote consistent standards wherever possible. CFTC staff also shared drafts of term sheets, proposed rulemakings and interpretive guidance, and other relevant working documents with domestic and foreign authorities. CFTC Commissioners and staff have also solicited public feedback by conducting meetings, conference calls, roundtables and by participating in panels, hearings and other public events. The Commission considers such feedback carefully in order to finalize and implement its regulations and guidance. The Commission will continue to engage with foreign regulatory authorities and the public.

With respect to data reporting requirements, in a December 3, 2012 letter, the International Swaps and Derivatives Association, Inc., on behalf of its members requested targeted relief from certain requirements of the reporting rules. In the letter, ISDA stated that there exist potential conflicts between the Commission's reporting rules and the privacy laws of certain non-U.S. jurisdictions. ISDA represented that these privacy laws may, in certain circumstances, restrict or prohibit the disclosure of a non-reporting party's identity information by a reporting party. ISDA further represented that depending on the non-U.S. jurisdiction, disclosure of identity information may require non-reporting party consent, regulatory authorization, or both. The Division of Market Oversight granted ISDA's request for targeted relief from certain reporting obligations. Since then, the Commission has continued to engage with authorities and others and is considering whether or not this targeted relief should be extended. Similar discussions and

considerations extend to the duration and substance of the final exemptive order regarding compliance with certain swap regulations with respect to cross-border swaps activities.

2.) How many meetings has the CFTC had with stakeholders, and particularly those involved in trading agricultural commodities, about how the Commission's "residual interest" provisions contained with your proposed customer protection rule will affect Futures Commission Merchants and their customers?

Response: Commission staff have discussed the potential impact of the residual interest provisions with representatives from a number of organizations including the American Farm Bureau Federation, the National Grain and Feed Association, the National Council of Farmer Cooperatives, the National Pork Producers Council, the Futures Industry Association, the International Swaps and Derivatives Association, Inc., and ADM Investor Services. In addition, the Commission held a public roundtable on February 5, 2013, to discuss, among other topics, the proposed residual interest provisions. Participants on the residual interest panel included representatives from a clearinghouse, from futures commission merchants and from the buy-side, including representatives from RJ O'Brien & Associates, Inc., the National Pork Producers Council, the National Grain and Feed Association, and the Commodity Customer Coalition. Representatives from the American Feed Industry Association, the Commodity Markets Council, and New England Fuel Institute were invited but unable to participate.

a.) What are the changes in margin requirements the Commission is proposing in your proposed customer protection rule?

b.) Does the Commodity Exchange Act provide for the CFTC to set margin requirements?

c.) What is the statutory authority for the CFTC to mandate these changes?

d.) While this particular provision in the Commission's rule doesn't include a cost analysis, industry estimates indicate that it may result in customers of Futures Commission Merchants needing to hold an additional $100 billion of their own funds in their margin accounts. Will the Commission be issuing a cost/benefit analysis for this specific provision of the rule?

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

Response to (a), (b), (c) and (d): **Section 4d(a)(2) of the Commodity Exchange Act states that the money, securities, and property received by a futures commission merchant from a customer to margin, guarantee, or secure the trades or contracts of that customer "shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held." Similarly section 4d(f)(2) of the Commodity Exchange Act prohibits a futures commission merchant from using the money, securities, and property of a swaps customer to margin, guarantee, or secure any trades or contracts of "of any customer or person other than the one for whom the same are held." Finally, Commission regulation 1.22, which has existed since the 1980s, states that "No futures commission merchant shall use, or permit the use of, the futures customer funds of one futures customer to purchase, margin, or settle the trades, contracts, or commodity options of, or to secure or extend the credit of, any person other than such futures customer," and Commission regulation 22.2(d)(1) states that "No futures commission merchant shall use, or permit the use of, the Cleared Swaps Customer Collateral of one Cleared Swaps Customer to purchase, margin, or settle the Cleared Swaps or any other trade or contract of, or to secure or extend the credit of, any person other than such Cleared Swaps Customer."**

In its recent review of the Commission's customer protection regime, Commission staff realized that there were market practices that were in tension with the plain language of the Commodity Exchange Act and Commission regulations. As such, the Commission proposed a regulation to clarify acceptable practices with respect to these existing statutory and regulatory requirements. The Commission has received public comments regarding the proposed rule and will consider and respond to them in connection with the final rule.

The Commission takes very seriously the consideration of costs and benefits of the rules it considers as required under section 15(a) of the Commodity Exchange Act. The economic costs and benefits associated with regulations, especially as they pertain to commenters' concerns, are of utmost importance in the Commission's deliberation and determination of final rules.

e.) Has the Office of Management and Budget indicated that the CFTC's "customer protection" rule will be a major rule?

Response: **The OMB determination will be made in connection with the final rule.**

3.) During the hearing you indicated that the CFTC is actively shelving enforcement action(s) due to a lack of resources. Can you please provide a specific number of instances where this has occurred?

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

Response: We are constantly faced, as any law enforcement agency is, with making priorities as to which cases to pursue. But what we have found, because of the financial crisis of 2008 and because of the passage of Dodd-Frank and some of the changes in the marketplace, that we're increasingly faced with complex cases, complex investigations, and we don't have sufficient staff to address them.

4.) Is it the CFTC's position that the industry—specifically members of a Designated Contract Market (DCM) that are not otherwise required to be registered with the CFTC—has been required to record and archive instant messages, text messages, and other forms of digital and electronic media based on the "industry guidance" that CFTC issued in 2009? If yes, are you suggesting that CFTC's 2009 "industry guidance" has the full force and effect of a regulation?

Response: In 2009, the Commission's Division of Market Oversight (DMO) issued an Advisory to clarify certain Commission recordkeeping requirements pertaining to futures commission merchants (FCMs), introducing brokers (IBs), and members of a designated contract market. The Advisory was to clarify that the individuals and entities subject to the Commission's recordkeeping requirements should maintain all electronic forms of communications, including email, instant messages, and any other form of communication created or transmitted electronically for all trading. Also noted in the Advisory is that recordkeeping regulations do not distinguish between methods used to record the information covered by the regulations, including emails, instant messages, and any other form of communication created or transmitted electronically. The Commission adopted the proposed amendment to regulation 1.35(a) to clarify that the existing requirement to keep written records applies to electronic written communications, such as emails and instant messages.

a.) The expansion in the final rule specifically includes "voicemail" in the category of "written communication." Does this mean that the CFTC is taking the position that, if a phone call results in a voicemail, once it is recorded as a voicemail it is now a "written record" that must be maintained? Please explain the similarities and differences between the Securities and Exchange Commission's regulations and the CFTC's regulations regarding this topic.

Response: The amended regulation provides that among the records required to be kept are all oral and written communications provided or received concerning quotes, solicitations, bids, offers, instructions, trading, and prices that lead to the execution of a transaction in a commodity interest and related cash or forward transactions, whether communicated by telephone, voicemail, facsimile, instant messaging, chat rooms, electronic mail, mobile device, or other digital or electronic media. The final rule does not specifically include "voicemail" in the category of written communication but provides a list of

included modes of communication in the requirement that "all oral and written communications" be kept.

b.) If the appropriate policy regarding members of a DCM—that are not otherwise required to be registered with the CFTC—is to not require recording of oral communications related to cash commodity sales, does it make sense to make them retain the 21st century analogs for oral conversation, such as text messages and instant messages? What is the policy goal of this distinction?

c.) In order to comply with the final rule as written, entities may have no choice but to avoid text or instant messaging, and simply go back to using the phone, which they do not have to record. Is this the intended policy outcome that the CFTC envisioned with this final rule?

<u>Response to (b) and (c)</u>: The overarching purpose of the Commission's final rule is to promote market integrity and protect customers. Requiring the recording and retention of oral communications will serve as a disincentive for covered entities to make fraudulent or misleading communications. In response to comments asserting that the cost of implementing and maintaining an oral communication recording system would be overly burdensome for small entities and the commercial end-user, non-intermediary members of a DCM or SEF, the Commission has determined to exclude from the new oral communications requirement members that are not registered or required to be registered with the Commission in any capacity.

d.) Would the CFTC be willing to re-open that portion of the final rule on adaptation relating to what constitutes a "written record" in order to allow further industry comment?

<u>Response</u>: The Commission is not proceeding at this time to re-open the rule.

5.) Does the Commission have enough information available to make a finding that position limits are necessary and appropriate?

<u>Response</u>: The Commission interprets the meaning of section 4a(a) of the Commodity Exchange Act to mandate that the Commission impose position limits on futures contracts, options, and certain swaps in physical commodities.

6.) Does the CFTC believe that the migration from swaps to futures is due to regulatory uncertainty or does this transition suggest that the Commission's rules are being promulgated in the wrong order?

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

Response: The swaps market emerged in the 1980s, but until now, it lacked the benefit of futures and securities market rules that have served to promote transparency, lower risk and protect investors. What followed was the 2008 financial crisis, which was caused in part by the swaps markets. Eight million American jobs were lost. In contrast, the futures market, supported by earlier reforms, weathered the financial crisis. Now that the entire derivatives marketplace -- both futures and swaps – has comprehensive oversight, it's the natural order of things for some realignment to take place.

The notional open interest of the futures market ranges around $30 trillion. There are various estimates for the notional size of the U.S. swaps market, but it ranges around $250 trillion. Though the futures market trades more actively, just one-ninth or so of the combined open interest in the derivatives marketplace is futures. Approximately eight-ninths of the combined derivatives marketplace is swaps, which until recently were unregulated.

Last fall, IntercontinentalExchange converted power and natural gas-related swaps into futures contracts. In addition, the CME Group's ClearPort products, which were cleared as futures, including those that were executed bilaterally as swaps, are now being offered for trading on Globex or on the trading floor. CME also adopted new block trading rules for its ClearPort energy contracts, and it began trading a futures contract where the underlying product is an interest rate swaps contract.

Whether one calls a product a standardized swap or a future, both markets will now benefit from central clearing. In addition, transparency has been a longstanding hallmark of the futures market – both pre-trade and post-trade. Now, for the first time, the swaps market is benefitting from post-trade transparency, and the Commission has adopted pre-trade transparency rules as well.

7.) Has the CFTC drafted any proposed technical changes or is the CFTC aware of any other federal agency that has drafted proposed changes to Title VII of Dodd-Frank? If so, can the CFTC please forward a copy of the draft to the Senate Agriculture Committee?

Response: The Commission has not proposed technical changes to date but is always available to provide technical assistance.

8.) The CFTC's regulation of inter-affiliate trades is also a matter of great concern to companies in my state and across the country. Many such companies have established centralized treasury units to more efficiently manage their risk mitigation strategies. Is the CFTC considering denying end-user companies use of the clearing exception simply because they have adopted the use of inter-affiliate transactions or centralized treasury units as a type of risk mitigation? If so, can the CFTC fix this problem administratively or does Congress need to address this problem?

a.) What is the CFTC's intended use for this captured inter-affiliate transaction data?

Response: Under the Dodd-Frank Act, an end-user is exempt from the clearing requirement if it is not a financial entity, and is using swaps to hedge or mitigate commercial risk.

The Commission has approached swaps market reform with an eye toward ensuring a market that works well for end-users, America's job providers. Congress provided in Dodd-Frank that end-users should be able to choose whether or not to clear swaps that hedge or mitigate commercial risks. Last summer, the Commission finalized rules to implement this exception.

The CFTC also finalized a rule to exempt swaps between certain affiliated entities within a corporate group from the clearing requirement.

We've received many comments and had many meetings with non-financial end-users that about required clearing if they use a treasury affiliate when entering into their market facing swaps.

The staff and Commission are taking a close look at how to appropriately address these issues in the context of the Dodd-Frank Act.

9.) Based upon the GAO's January 23, 2013 response regarding the CFTC's reprogramming of funds obtained by eliminating two administrative law judges, two questions remain:

a.) Have you reprogrammed the $800,000 of funding saved from eliminating these jobs, and if so, how? Also, have you notified the House and Senate Appropriations Committees pursuant to the Act?

Response: By letter of April 15, 2013, I notified the Committees on Appropriations that the Commission intends to reprogram $755,109 in savings from the ALJ program for the Division of Enforcement's work to protect market participants and other members of the public from fraud, manipulation and other abusive practices in the commodities, futures and swaps markets.

b.) What authority allows you to eliminate these positions and contract judges?

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

Response: The following insert is the memorandum from the agency's General Counsel and the agency's Chief Human Capital Officer dated August 9, 2011:

U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5003
Facsimile: (202) 418-5530

Office of Human Resources

INFORMATION MEMORANDUM

TO: The Commission

FROM: Dan M. Berkovitz
General Counsel
Catherine McCoy
Catherine McCoy
Chief Human Capital Officer

DATE: August 9, 2011

SUBJECT: Legal authority to separate Administrative Law Judges by Reduction in Force, to remove monetary limit on the Judgment Officer's jurisdiction, and to receive services of Administrative Law Judges through details from other agencies

RESPONSIBLE STAFF: Jonathan Marcus, Deputy General Counsel
Ralph Avery, Assistant General Counsel
Vivian Jarcho, Chief of Workforce Relations
Lauren Colon, Human Resources Specialist

Introduction

The legal issues addressed in this memorandum have arisen from a prolonged, substantial decrease in the utilization of the agency's two administrative law judges ("ALJs"). This has led the agency to consider the following options for changing the organizational structure of the Office of Proceedings: (1) Reduction in Force ("RIF") with respect to the two ALJs, eliminate the current ceiling of $30,000 on non-consensual use of a Judgment Officer ("JO") to resolve reparations cases, and reorganize the Office of Proceedings, as necessary, or (2) RIF with respect to the two ALJs, retain the current ceiling of $30,000 on non-consensual use of the JO to resolve reparations cases, and retain outside ALJs on an as-needed basis to handle reparations cases above $30,000, again reorganizing the Office of Proceedings as necessary. Both options would use outside ALJs to handle other proceedings, such as enforcement cases, for which ALJs are currently available.

This memorandum only addresses the legal aspects of these options. Organizational and cost issues are addressed in a separate memorandum from the agency's Chief Financial Officer.

<u>Summary of Legal Conclusions</u>

The Commission has the legal authority to separate ALJs by RIF due to a substantial, prolonged decline in workload. The Commission has statutory discretion to specify which reparations cases will be heard by a JO, without regard to monetary amount. The Commission also has statutory authority to obtain services of other agencies' ALJs through details on an as-needed basis, a practice that is common in the federal government.

<u>Discussion</u>

1. The Reduction in Force regulations apply to Administrative Law Judges.

The appointment and continued employment of ALJs is governed by 5 CFR § 930, Subpart B. ALJs generally enjoy substantial additional employment protections, compared to non-adjudicatory personnel, to preserve their independence. For example, the hiring process for ALJs is administered by the Office of Personnel Management ("OPM") rather than individual agencies, and ALJs do not receive performance evaluations or performance awards. ALJs are, however, still subject to many of the personnel regulations applicable to federal employees in general.

Among the regulations applicable to all employees, including ALJs, are those governing RIFs at 5 CFR § 351. The employment regulations for ALJs explicitly provide for the application of the RIF regulations. 5 CFR § 930.210(a). There are only two significant variations from the RIF procedures for ALJs: (1) performance ratings are not considered in determining the retention standing of ALJs because they do not receive performance ratings, and (2) placement assistance, in addition to what the agency provides, is given by OPM. Neither of these variations diminishes the Commission's authority to implement a RIF.

2. The Commission is not required to seek the permission of the Merit Systems Protection Board before proceeding.

Among the additional protections provided to ALJs is a requirement that most adverse personnel actions be taken only for good cause as determined by the Merit Systems Protection Board ("MSPB") after an opportunity for a hearing. 5 CFR § 930.211. However, these procedures do not apply to all personnel actions against ALJs. Specifically, the MSPB has original jurisdiction over removal, suspension, reduction in grade, reduction in pay, and furloughs of 30 days or less. 5 C.F.R. § 1201.137. RIFs are not covered actions under these regulations, and ALJs are not entitled to a pre-RIF hearing and decision from the MSPB.

Separations from federal service, when effected through RIFs, are appealable to the MSPB after the personnel action is taken. 5 CFR § 1201.3(a)(10). ALJs possess the same appeal rights to the MSPB that apply to all federal employees subject to RIFs. These procedures entitle ALJs to a de novo review of the RIF, including discovery and a hearing, to ensure that the agency conducted the RIF appropriately.

3. The Commission has statutory authority to remove the monetary limit on the Judgment Officer's jurisdiction.

Section 14(b) of the Commodity Exchange Act ("CEA") authorizes the Commission to promulgate rules, regulations, and orders as it deems necessary or appropriate for the efficient and expeditious administration of its reparations program. Rule 12.26(c) currently provides that formal decisional proceedings are to be conducted by an ALJ. A formal decisional proceeding is held when the amount claimed in damages exceeds $30,000 and the parties have not elected a voluntary decisional proceeding under Subpart C of the Commission's Part 12 rules. Voluntary decisional proceedings are heard by a JO without regard to the amount in controversy under Rule 12.26(a). Cases where the amount in controversy is less than $30,000 are conducted as summary decisional proceedings by a JO under Subpart D, as provided in Rule 12.26(b).

The Commission has, from time to time, raised the ceiling for claims eligible to be heard as summary proceedings from $2,500 to $5,000 to $10,000 and then to $30,000. Rules Relating to Reparation Proceedings, 59 Fed. Reg. 9631, 9633 (Mar. 1, 1994) (increasing the ceiling to $30,000 and otherwise amending Part 12). There is nothing in the CEA requiring any monetary limit on the JO's authority, and, as noted above, the JO presently hears disputes involving matters in excess of $30,000 with the consent of the parties. The $30,000 limit is, in a certain sense, arbitrary, because the dollar value of a claim is not a reliable indicator of its legal or factual complexity.

The Administrative Procedure Act, 5 U.S.C. § 553, generally requires notice of proposed rulemaking and provides for public participation. Section 553 does, however, exempt from these requirements "rules of agency organization, procedure or practice," for which the agency has discretion not to provide notice. The Commission could determine that making this change effective immediately, without public notice and comment, would promote efficiency and facilitate the Commission's core mission without imposing a new burden on the public or on participants in the reparations program.

4. ALJs may be detailed to the agency as needed.

Section 3344 of Title 5 of the U.S. Code provides express statutory authority for ALJs assigned to one agency to provide services to another agency under a detail. *See also* 5 C.F.R. § 930.208. Authority to reimburse the lending agency for the services of an ALJ detailed to the Commission is found in the Economy Act, 31 U.S.C. § 1535. This practice is common in the federal government, as several agencies, such as the MSPB, the Coast Guard, and the Equal Employment Opportunity Commission routinely receive ALJ services under details. Thus, the Commission could simply request ALJs' services as needed for formal decisional proceedings conducted pursuant to Rule 12.26(c) as an alternative to removing the monetary limit on the JO's jurisdiction.

cc:
Eric Juzenas, Senior Counsel

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

<u>Senator Patrick Leahy</u>

1.) I am hearing from a number of municipal electric utilities in Vermont, these are small, government-owned utilities, that are alarmed about new CFTC regulations they believe are preventing them from hedging fuel risks using financially settled contracts. These utilities are accountable to the people they serve and deeply invested in keeping their rates low and bills affordable to help stimulate the economic prosperity of the communities they serve.

2.) As you mentioned in your testimony, the Dodd-Frank Act swaps market reforms were put in place to benefit end-users by lowering costs and increasing access to the markets. However I am concerned that our country's municipal utilities have been swept up in an unintended consequence in these regulations and these true end-users are being excluded from the swaps market because any counterparty that does business with them will be labeled a Swap Dealer.

3.) I have heard from Vermont municipalities that are considered a "special entity" under your regulations who believe this has scared off any non-financial counterparty from doing business with them. This is limiting the ways they are able to hedge the price of fuel compared to other cooperatives or investor-owned utilities, which is putting the utilities and the communities they serve at a disadvantage.

4.) The Dodd-Frank Act certainly did not intend for "end-users" such as municipal utilities to be frozen out of the swaps market like this. As I understand it there is no provision in that portion of the bill that required any kind of additional protections for special entities, so my question for you is how can this be fixed so that we are not unfairly discriminating against our municipal utilities?

<u>Response</u>: The final rule adopted jointly by the CFTC and the SEC to further define the term "swap dealer" provides that a person shall not be deemed a swap dealer if swap dealing activity for the preceding 12 months results in swap positions with an aggregate gross notional amount of no more than $3 billion, and an aggregate gross notional amount of no more than $25 million with regard to swaps with a "special entity" (which includes municipalities, other political subdivisions and employee benefit plans). The rule also provides for a phase-in of the de minimis threshold to facilitate orderly implementation of swap dealer requirements. During the phase-in period, the de minimis threshold would effectively be $8 billion (while the $25 million threshold for swaps with special entities would apply).

In developing the rule further defining the term "swap dealer" and other rules under the Dodd-Frank Act that may affect municipal utilities, CFTC Commissioners and

staff met with municipal utility representatives and their advisors and counterparties regarding their concerns. The final joint rule contains a provision that excludes from the calculation certain swaps entered into for the purpose of hedging physical positions. In addition, on October 12, 2012, Commission staff issued no-action relief, which states that staff will not recommend enforcement action if non-financial entities enter into swaps as part of a swap dealing business with utility special entities (such as municipal utilities) with a notional value of up to $800 million annually without registering as a swap dealer. By its terms, the no-action relief will remain in effect until Commission action is completed on a petition submitted by public utilities requesting an amendment to the rule to exclude from the special entity de minimis threshold relevant swap contracts relating to utility operations.

Congress also authorized the CFTC to provide relief from the Dodd-Frank Act's swaps reforms for certain electricity and electricity-related energy transactions between rural electric cooperatives and federal, state, municipal and tribal power authorities. Similarly, Congress authorized the CFTC to provide relief for certain transactions on markets administered by regional transmission organizations and independent system operators. The recently finalized exemptive orders related to these transactions, as Congress authorized.

Senator Tom Harkin

1.) At the request of the National Futures Association the Berkeley Research Group recently conducted an independent analysis of the NFAs auditing of Peregrine Financial Group, Inc. in light of the fraud perpetrated by Peregrine's CEO Russell Wasendorf Sr. The analysis included a list of recommendations that NFA has pledged to adopt.

   a.) Do you believe these changes are sufficient or that more needs to be done to ensure that the NFA is able to protect customer segregated funds and appropriately regulate the market participants that it oversees? If so, what additional steps do you believe need to be taken to fully protect customer segregated funds?

Response: The Berkeley Research Group (BRG) was retained by the National Futures Association (NFA) to conduct an independent review of the NFA audit practices and procedures for futures commission merchants (FCMs), and the execution of those procedures in the specific instances of Peregrine Financial Group, Inc. (PFG), to assure that adequate procedures are in place and that they are being followed properly. BRG issued its report on the investigation of NFA audit practices and procedures in January 2013.

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

BRG provided 21 recommendations designed to improve the operations of the NFA audits based upon the findings set forth in its report.

In November 2012, the Commission issued for public comment a comprehensive set of proposed amendments to its regulations to enhance protections provided to customers. The proposed amendments address several components of customer protection, including the self-regulatory organization oversight program, risk disclosures, financial reporting, and public disclosures.

With respect to the self-regulatory organization financial surveillance program, the proposal would require self-regulatory organizations that examine FCMs, including the NFA, to establish a supervisory program that, among other things, must be based on controls testing as well as substantive testing, and must address all areas of risk that the FCM can reasonably foresee. The supervisory program also must have standards addressing such issues as the ethics of the examiner; the independence of the examiner; the supervision, review, and quality control of an examiner's work product; and the quality control procedures to ensure that the examinations maintain the level of quality expected. Each self-regulatory organization also would be required to engage a recognized accounting or auditing firm with substantial expertise in the audit of FCMs, risk assessment, and internal control reviews to evaluate the SRO's supervisory program and the application of the of the supervisory program at least once every two years.

The Commission received more than 100 comment letters on the proposed customer protection rulemaking. Staff is currently reviewing the comments, and the Commission will respond in a final rule.

2.) One of the striking developments in the financial markets over the last decade is the rise of high speed trading. While there are many different views about the role that high speed trading plays in the market, in late 2012 CFTC Chief Economist Andrei Kirilenko published a study in which he found that High Frequency Traders generate their profits to the detriment of typical retail investors. This study followed on the joint report from the CFTC and SEC on the so-called "flash crash" that found high speed trading to be one of the causes of this significant market disruption that occurred on May 6, 2010. Finally the Financial Times recently noted that high speed trading is spreading into markets like bonds, currencies, and derivatives (Markets: In Search of a Fast Buck by Arash Massoudi and Michael Mackenzie, February 19, 2013).

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

a.) In light of these events what do you believe the impact of high speed trading is on the safety and soundness of the financial system? What do you believe will be the impact of high speed trading in the derivatives markets?

Response: One thing we can be quite sure of is that means of communication and technology will continue to advance and affect our markets. This was true in the 19th century when the telegraph led to the introduction of the ticker tape. This also was true in the early 20th century when telephones first allowed a central quote system where market participants could get instantaneous bid and ask prices. It was true during the last decade when the futures markets went from largely open outcry to now approximately 90 percent electronically traded.

Where market makers used to be on the floor of the exchanges, they now often sit at computers miles away or even on another continent. While market participants used to be involved in each of their trades, they now often rely on algorithms to execute their trades. Humans are much more frequently relying on the judgment programmed into machines to initiate and execute their trading strategies. The markets have evolved to where we increasingly find machines competing with each other.

To give hedgers and investors confidence in markets, our regulations have to adapt to markets that are increasingly moving from man to machine. Regulators cannot assume that the algorithms in the markets are well designed, tested or supervised. Only through adaptive regulation can hedgers and investors have confidence in the markets and market integrity. The Commission will continue working to adapt our oversight to changing market structure, including emerging trends related to electronic trading.
The Commission has already taken a number of steps, and the CFTC's Technology Advisory Committee (TAC) has been helping to inform us as we move forward. As it relates to both trading and clearing, the Commission has adopted rules for pre-trade filters to protect the markets and the clearing system. This was achieved in the final rules for designated contract markets and risk management for clearing members.

The Commission also is reviewing a rule on the reporting of ownership and control information for trading accounts. These rules would enhance the Commission's surveillance capabilities and increase the transparency of trading to the Commission.

Further, I expect the Commission to soon consider a draft concept release on risk controls and system safeguards for electronic trading platforms, automated trading systems, clearing firms and other market participants in the evolving market for U.S. derivatives trading. The concept release would offer the broader public an opportunity to give the Commission advice on technology-driven changes in Commission regulated markets.

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

3.) Title VII of the Dodd-Frank Act requires the CFTC to publicly report and take steps to protect the financial system should swaps that are required to clear not be cleared. As market participants are required to begin clearing certain swaps, what steps has the CFTC taken to implement the anti-evasion provisions of the Dodd-Frank Act?

Response: The Commission issued regulation 50.10 to prevent evasion of the clearing requirement and related provisions and abuse of any exemption or exception to the clearing requirement under the Dodd-Frank Act. Both cleared and un-cleared swaps are required to be reported to Swap Data Repositories.

Senator Saxby Chambliss

1.) In December, Mr. Masamichi Kono, Vice Commissioner for International Affairs for the Financial Services Agency of Japan testified before a House agriculture subcommittee. He noted "*In Japan, we have so far deliberately refrained from applying our rules to cross-border transactions in anticipation of an international coordination arrangement on regulation of cross-border transactions which we strongly hope to be developed soon.*" On February 6th the Japanese Government again noted to you in a letter that "*We understand that the Commission intends to conduct assessment for substituted compliance with foreign regulatory requirements before the expiration date (July 12, 2013) of the final exemptive order. If, at the expiration date, substituted compliance with the Japanese regulatory requirements is not available for Japanese financial institutions which registered as swap dealers, they would be subject to the Commission's regulations after the expiration date.*"

Are the concerns of Mr. Kono reflective of the concerns other foreign regulators?

Do you believe that by July 12th you will have cleared all of the issues the Japanese Government and other foreign regulators have brought to your attention?

Response: Japan and other jurisdictions have provided comments on the CFTC's proposed approach to the regulation of cross-border transactions, and Commissioners and staff have met on numerous occasions with foreign regulators to discuss mutual concerns.

The CFTC and the SEC have convened a series of meetings with market regulators with primary oversight responsibility for the regulation of OTC derivatives markets. These discussions include, in addition to the US and Japan, the following jurisdictions: Australia, Brazil, the European Union, Hong Kong, Japan, Ontario, Quebec, Singapore, and Switzerland.

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

Following a meeting of principals in December 2012, the group of foreign regulators prepared a statement setting forth key understandings with respect to clearing determinations; sharing of information and supervisory and enforcement cooperation; understanding on timing of application of OTC requirements; and different possible approaches to regulating persons, transactions and infrastructures with respect to cross-border activity when more than one set of rules apply.

In addition, the December 2012 statement included a list of further actions that will be taken in 2013. These include options to address identified conflicts, inconsistencies and duplicative rules; a review of the basis for determinations of comparability of regulatory regimes; informing each other of the planned timing of the finalization and implementation of rules and possible transition periods; and development of a consultation procedure in making any final determinations regarding which derivatives products will be subject to a mandatory clearing requirement.

The CFTC has registered foreign swap dealers from Australia, Canada, the European Union, Hong Kong, and Switzerland. To facilitate the registration process for the non-US swap dealers, in December 2012 the Commission granted time-limited relief until July 2013 for non-U.S. swap dealers from certain Dodd-Frank swap requirements. Under this relief, foreign swap dealers may phase in compliance with certain entity-level requirements. In addition, it provides relief for foreign dealers from specified transaction-level requirements when they transact with overseas affiliates guaranteed by U.S. entities, as well as with foreign branches of U.S. swap dealers.

The CFTC will continue to engage with domestic and foreign regulators.

<u>Senator Charles E. Grassley</u>

1.) Chairman Gensler, I want to thank you for reaching out to me regarding the manipulation of LIBOR. On February 21st in an interview with Bloomberg News, you referenced your concerns regarding the integrity of LIBOR saying that some might see the rate as "too big to replace" despite concerns about its integrity.

   a.) I am also concerned that some have taken this view of LIBOR. In addition to pegging LIBOR to real transactions, what suggestions would you make to create a sustainable benchmark rate that would not be so vulnerable to manipulation?

   b.) Are you concerned that we are in danger of reverting back to LIBOR without any meaningful reforms?

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

Response: I believe that continuing to reference benchmark rates such as LIBOR and Euribor is unsustainable in the long run. These benchmarks basically have not adapted to the significant changes in the market. Thus, the challenge we face is how the financial system adapts to this significant shift.

International regulators and market participants have begun to discuss transition. The CFTC and the FSA are co-chairing the IOSCO Task Force on Financial Market Benchmarks.

One of the key questions in the consultation with the public is: How do we address transition when a benchmark is no longer tied to sufficient transactions and may have become unreliable or obsolete?

Without transactions, the situation is similar to trying to buy a house, when the realtor cannot provide comparable transaction prices in the neighborhood – because no houses were sold in the neighborhood in years.

Moving on from LIBOR and Euribor may be challenging. Today, LIBOR is the reference rate for 70 percent of the U.S. futures market, most of the swaps market and nearly half of U.S. adjustable rate mortgages. But a reference rate has to be based on facts, not fiction.

While ongoing international efforts targeting benchmarks have focused on governance principles, these efforts cannot address the central vulnerability of LIBOR, Euribor and similar interest rate benchmarks: the lack of transactions in the underlying market.

Given the known issues with these benchmarks, their scale and effect on market integrity, it is critical that international regulators work with market participants to promptly identify alternative interest rate benchmarks anchored in observable transactions with appropriate governance, as well as determine how to best smoothly transition to such alternatives.

2.) In a recent final rule, the CFTC recognized the compliance burden that the oral communications recordkeeping would have on smaller futures businesses, specifically excluding the requirement for Introducing Brokers that don't exceed a certain revenue threshold. Similarly, commercial grain elevators that largely deal in purchasing cash grain, occasionally take an order from a customer to hedge in the futures markets. Because they are technically a branch operation affiliated with a farmer cooperative futures commission merchant, and not an introducing broker, they will have to record all oral phone conversations. Given the low volume of futures transactions handled by these facilities, complying with such oral recording requirements under Regulation 1.35 could be difficult both economically and from a technical standpoint.

a.) Given this situation, would CFTC consider treating those branch operations similar to small introducing brokers and exclude them from the oral communications recordkeeping requirements?

Response: Under the Commission's final rule, the requirement to record oral communications does not apply to an introducing broker that has generated over the preceding three years $5 million or less in aggregate gross revenues from its activities as an introducing broker. In establishing this exception, the Commission noted in the preamble, "notwithstanding the important policy [to promote market integrity and protect customers] and practical reasons for the final rules, the Commission shares many of the commenters' concerns regarding costs and the availability of relevant technology" for recording oral communications. Regarding introducing brokers in particular, the Commission noted that, "while a Small IB takes customer orders, they generally do not execute those orders, meaning that they lack a direct market interface that could affect market integrity. Further, as defined herein, a Small IB is unlikely to generate the volume of market activity that the Commission would expect could affect the integrity of the markets."

3.) A lot is being discussed about customer protections in terms of regulations being implemented by the CFTC and some of the Self-Regulatory entities. In addition, customer protections will certainly come up during reauthorization of the Commodity Exchange Act. As we all know, the issue of customer protections is so prevalent because of the recent failures of Peregrine Financial and MF Global. Both of those firms are still going through the bankruptcy process.

a.) It will be good for the Agriculture Committee to carefully consider proper customer protections during reauthorization of the Commodity Exchange Act; as the ranking member on the Judiciary Committee I am also interested in whether you think there are areas of the bankruptcy law that need to be analyzed as it pertains to protecting customers of futures brokerage firms which go into bankruptcy?

Response: The commodity broker liquidation provisions in Chapter 7 of the Bankruptcy Code are a key component of customer protection. The Commission has commodity broker bankruptcy rules in place today to assist bankruptcy courts in resolving commodity-related cases.

In the course of roundtables hosted by Commission staff, participants have generally discussed bankruptcy code modifications.

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

4.) I support some of the recent work the CFTC has done in regards to increasing customer protections. That being said, I have heard from farmers and their brokers that they have serious concerns with the CFTC's proposed rule that would require futures brokerages to keep so-called residual interest in their accounts at all times to cover customers' margin requirements. Farmers are concerned about how this will effect the amount of money they would be required to keep in their margin accounts to cover possible moves in the market, whereas currently they provide more funds to cover movements in the market at the end of a given day. In addition there is concern with the practicality of farmers being able to get funds to their brokers potentially on a moment's notice in the middle of the day while they are busy running their farming operations.

a.) I would like for you to put this proposed rule in the context of the recent collapse of futures brokers. In terms of the two biggest failures in the futures industry in recent years, MF Global and Peregrine Financial, could you explain if, and how, this so-called "residual interest" rule would have helped prevent the failures at MF Global and Peregrine Financial? How would this rule have helped protect customer money in those cases? If this proposed rule would not have had much affect in protecting customer money in MF Global or Peregrine Financial, could you please explain how the CFTC decided this proposed rule was necessary?

Response: The Dodd-Frank Act included provisions directing the CFTC to enhance the protection of swaps customer funds. While it was not a requirement of the Dodd-Frank Act, in 2009 the CFTC also reviewed and updated customer protection rules for futures market customers.

Market events have further highlighted that the Commission must do everything within our authorities and resources to strengthen oversight programs and the protection of customers and their funds.

In the fall of 2012, the Commission sought public comment on a proposal that would strengthen the controls around customer funds at FCMs. It would set new regulatory accounting requirements and would raise minimum standards for independent public accountants who audit FCMs. And it would provide regulators with daily direct electronic access to the FCMs' bank and custodial accounts for customer funds.

The proposal includes a provision on residual interest to ensure that the assets of one customer are not used to cover the positions of another customer. We are considering the comments that have been filed on this and plan to finalize the proposal consistent with the Commodity Exchange Act and the overall goal of protecting customers.

Senator John Thune

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

1.) On the subject of the proposed customer-segregation rule, it is intended to prevent another collapse like MF Global or Peregrine Financial Group in which customer segregated funds are at risk. My concern is that the capital requirements are so stringent that smaller brokerages that cater to end-users in states like mine will not be able to survive, or at the very least will drive up costs for end-users like farmers, the very people this rule is intending to protect.

   a.) I understand that the comment period on this rule is now closed. Assuming you heard from end-users and brokerages concerned about the impact of this proposed rule, what steps are you taking to ensure those concerns are addressed before issuing a final rulemaking?

Response: The Commission's proposed rule to enhance protections afforded customers and customer funds was published in the Federal Register on November 14, 2012, with a 60 day comment period. The Commission approved a 30-day extension to that comment period. During the extended period, CFTC staff hosted a public roundtable during which public participants shared their views and expertise.

The Commission received a number of comments on the proposed rule, including some related to FCM capital provisions, and will consider and respond to each of the comments in issuing a final regulation.

2.) We've heard U.S. regulators talk about "international harmonization" and the belief that the rest of the world will follow, which played a role in the CFTC's delay in compliance with some of its cross-border derivatives rules last year. It is difficult to see that there will be such harmonization. Will you hit the pause button again as you did in October and in December? Isn't the better way to regulate to be clear that these requirements will be put on hold until an agreement is reached?

Response: Foreign jurisdictions have provided comments on the CFTC's proposed approach to the regulation of cross-border transactions and Commissioners and staff have met on numerous occasions with foreign regulators to discuss mutual concerns

The CFTC and the SEC have convened a series of meetings with market regulators with primary oversight responsibility for the regulation of OTC derivatives markets. These discussions include, in addition to the US and Japan, the following jurisdictions:

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

Australia, Brazil, the European Union, Hong Kong, Japan, Ontario, Quebec, Singapore, and Switzerland.

Following a meeting of principals in December 2012, the group of foreign regulators prepared a statement setting forth key understandings with respect to clearing determinations; sharing of information and supervisory and enforcement cooperation; understanding on timing of application of OTC requirements; and different possible approaches to regulating persons, transactions and infrastructures with respect to cross-border activity when more than one set of rules apply.

In addition, the December 2012 statement included a list of further actions that will be taken in 2013. These include options to address identified conflicts, inconsistencies and duplicative rules; a review of the basis for determinations of comparability of regulatory regimes; informing each other of the planned timing of the finalization and implementation of rules and possible transition periods; and development of a consultation procedure in making any final determinations regarding which derivatives products will be subject to a mandatory clearing requirement.

The CFTC has registered foreign swap dealers from Australia, Canada, the European Union, Hong Kong, and Switzerland. To facilitate the registration process for the non-US swap dealers, in December 2012 the Commission granted time-limited relief until July 2013 for non-U.S. swap dealers from certain Dodd-Frank swap requirements. Under this time-limited relief, foreign swap dealers may phase in compliance with certain entity-level requirements. In addition, it provides relief for foreign dealers from specified transaction-level requirements when they transact with overseas affiliates guaranteed by U.S. entities, as well as with foreign branches of U.S. swap dealers.

The CFTC will continue to engage with domestic and foreign regulators.

3.) There has been a lot of focus in the industry press about so-called "futurization" – that is the increased use of futures instead of swamps because of all the uncertainty surrounding the swaps rules, particularly in the energy space. It is interesting to see futurization being made out to be a bad thing, because the futures are more highly regulated. But given the uncertainty with regard to swaps, and the piecemeal approach being taken in the implementation of the swaps rule, doesn't it make sense that folks would turn toward futures, even though they are more regulated, out of a desire for regulatory certainty?

Response: The swaps market emerged in the 1980s, but until now, it lacked the benefit of futures and securities market rules that have served to promote transparency, lower risk and protect investors. What followed was the 2008 financial crisis. Eight million American

jobs were lost. In contrast, the futures market, supported by earlier reforms, weathered the financial crisis. Now that the entire derivatives marketplace -- both futures and swaps – has comprehensive oversight, it's the natural order of things for some realignment to take place.

The notional open interest of the futures market ranges around $30 trillion. There are various estimates for the notional size of the U.S. swaps market, but it ranges around $250 trillion. Though the futures market trades more actively, just one-ninth or so of the combined open interest in the derivatives marketplace is futures. Approximately eight-ninths of the combined derivatives marketplace is swaps, which until recently were unregulated.

Last fall, IntercontinentalExchange converted power and natural gas-related swaps into futures contracts. In addition, the CME Group's ClearPort products, which were cleared as futures, including those that were executed bilaterally as swaps, are now being offered for trading on Globex or on the trading floor. CME also adopted new block trading rules for its ClearPort energy contracts, and it began trading a futures contract where the underlying product is an interest rate swaps contract.

It's important to note that whether one calls a product a standardized swap or a future, both markets will now benefit from central clearing. In addition, transparency has been a longstanding hallmark of the futures market – both pre-trade and post-trade. Now, for the first time, the swaps market is benefitting from post-trade transparency, and the Commission has adopted pre-trade transparency rules as well.

4.) The Commission has said that guarantees of swaps are themselves swaps. In addition to creating a great deal of uncertainty in areas such as cross-border jurisdiction and swap dealer and major swap participant calculations, this is directly contrary to what the SEC concluded in the same rulemaking, where they said guarantees of security based swaps are not themselves security based swaps. How is this consistent with the statutory requirement that the two agencies coordinate their rules, and can you tell me where in the swap definition guarantees appear?

Response: The final rule further defining the term "swap" that was adopted jointly by the CFTC and the SEC, provides that when a swap has the benefit of a guarantee where the counterparty would have recourse to the guarantor in connection with the position, the guarantee is price forming and an integral part of that swap. That is, when a swap has the benefit of a guarantee with recourse, the guarantee and related guaranteed swap must be analyzed together. The Commission also explained the interplay with the definitions of the terms "swap dealer" and "major swap participant" in the joint final rule by noting that if a U.S. entity that operates with a parent or holding company guarantee is already subject to

capital regulation by the CFTC, the Commission will not deem the guarantor to be a swap dealer or major swap participant.

The Dodd-Frank Act provides that, while the CFTC and SEC are to treat functionally or economically similar products similarly, they need not be treated in an identical manner. The SEC has a statutory basis for not adopting an interpretation that a guarantee of a security-based swap is part of the security-based swap. In the release of the final rule, the SEC noted that security-based swaps are included in the definition of 'security' contained in the securities statutes. Under the securities acts, a guarantee of a security is also a security and subject to Federal securities law regulation.

5.) Why did the CFTC say that all options are swaps, ignoring the fact that Congress preserved the CFTC's existing authority over options? Why doesn't the Commission clarify that an option to buy a nonfinancial commodity – purchased by a commercial business that intends to use the product in its business, and not for financial speculation of any kind – is completely outside regulation as a swap?

6.) Well before the April 10 reporting deadline, will the CFTC give guidance to end users on which volumetric options must be reported as swaps? And will this guidance clarify that options in a commercial forward that are used in the ordinary course of business, and not for financial speculation, are covered by the forward exemption?

Response to questions 5 and 6: **The final rule further defining the term "swap" that was adopted jointly by the CFTC and the SEC, notes that the statutory definition of the term "swap" enacted in the Dodd-Frank Act explicitly provides that commodity options are swaps. The statutory swap definition includes agreements, contracts, or transactions to include any put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind. The statutory definition encompasses options on both financial and nonfinancial commodities.**

The Dodd-Frank Act did not amend Section 4c(b) of the CEA, which bans options other than pursuant to such terms and conditions as the Commission shall prescribe. The Commission exercised this authority to issue its trade option exemption. Under that rule, trade option counterparties and other trade option-related service providers are exempt from much of the swap regulatory scheme, subject to certain conditions intended to limit the trade option exemption to commercial businesses.

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

After issuing the rule further defining the term "swap" and the trade option exemption, the CFTC received comment letters from, and staff met frequently with, end users and their representatives and advisors to hear their concerns. On April 5, 2013, CFTC staff issued a no-action letter, which provided further relief to entities that are neither swap dealers nor major swap participants with respect to the reporting and recordkeeping requirements relating to trade options. Transactions with volumetric optionality that are not forward contracts under the interpretation in the release are eligible for the trade option exemption and the trade option reporting and recordkeeping no-action relief.

7.) There has been considerable debate around the intent of Sec. 722 of Dodd-Frank and the aggressive approach being taken by the CFTC to apply derivatives rules to U.S. banks doing business overseas with foreign clients. This approach has been criticized by market participants, and, maybe most noteworthy, foreign regulators as missing the mark and potentially exacerbating rather than ameliorating the problem. Given that foreign regulators have raised concerns about the potential application of Title VII in their jurisdictions, I am concerned about similar reciprocal measures being enacted by the E.U. or other foreign regulators in response. Can you please provide the Committee with details about how the agency intends to reach an agreement with the key European countries to resolve this dispute?

8.) Given developments late last year – unnecessary disruptions around Oct. 12 deadlines, last minute "no-action" letters, reports that foreign banks wouldn't do business with US firms, an interim final rule, etc. – why should Congress have any level of confidence that you're moving in the right direction and that markets won't be negatively impacted by actions of the CFTC? Also, how do you intend on getting the rest of the world to follow the U.S. when the SEC and CFTC rules currently don't align on timing, process or content in many areas? What happens later this year if there is still not international harmonization or even domestic harmonization?

Response to (7) and (8): Foreign jurisdictions have provided comments on the CFTC's proposed approach to the regulation of cross-border transactions and Commissioners and staff have met on numerous occasions with foreign regulators to discuss mutual concerns

The CFTC and the SEC have convened a series of meetings with market regulators with primary oversight responsibility for the regulation of OTC derivatives markets.

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

These discussions include, in addition to the US and Japan, the following jurisdictions: Australia, Brazil, the European Union, Hong Kong, Japan, Ontario, Quebec, Singapore, and Switzerland.

Following a meeting of principals in December 2012, the group of foreign regulators prepared a statement setting forth key understandings with respect to clearing determinations, sharing of information and supervisory and enforcement cooperation, understanding on timing of application of OTC requirements and different possible approaches to regulating persons, transactions and infrastructures with respect to cross-border activity when more than one set of rules apply.

In addition, the December 2012 included a list of further actions that will be taken in 2013. These include options to address identified conflicts, inconsistencies and duplicative rules; a review of the basis for determinations of comparability of regulatory regimes; informing each other of the planned timing of the finalization and implementation of rules and possible transition periods; and development of a consultation procedure in making any final determinations regarding which derivatives products will be subject to a mandatory clearing requirement.

The CFTC has registered foreign swap dealers from Australia, Canada, the European Union, Hong Kong, and Switzerland. To facilitate the registration process for the non-US swap dealers, in December 2012 the Commission granted time-limited relief until July 2013 for non-U.S. swap dealers from certain Dodd-Frank swap requirements. Under this time-limited relief, foreign swap dealers may phase in compliance with certain entity-level requirements. In addition, it provides relief for foreign dealers from specified transaction-level requirements when they transact with overseas affiliates guaranteed by U.S. entities, as well as with foreign branches of U.S. swap dealers.

The CFTC will continue to engage with domestic and foreign regulators.

9.) Why are such significant reforms – like your cross-border guidance – being made through guidance and no-action letters versus a formal rulemaking process? Is it to avert Administration Procedures Act (APA) requirements? Wouldn't all parties benefit from formally proposed rules?

Response: Section 722(d) of the Dodd-Frank Act states that swaps reforms shall not apply to activities outside the United States unless those activities have "a direct and significant connection with activities in, or effect on, commerce of the United States." The Commission has received numerous requests from market participants with regard to the interpretation of this provision.

Senate Committee on Agriculture, Nutrition & Forestry
Oversight of the Commodity Futures Trading Commission
February 27, 2013
Questions for the Record
Chairman Gary Gensler

The Commission, consulting closely with the SEC, the Federal Reserve and the Treasury Department, issued proposed guidance interpreting this section of the law. To facilitate the registration process for the non-US swap dealers, in December 2012 the Commission granted time-limited relief until July 2013 for non-U.S. swap dealers from certain Dodd-Frank swap requirements. Under this time-limited relief, foreign swap dealers may phase in compliance with certain entity-level requirements. In addition, it provides relief for foreign dealers from specified transaction-level requirements when they transact with overseas affiliates guaranteed by U.S. entities, as well as with foreign branches of U.S. swap dealers. Such phased compliance will enable market participants to comply with the Dodd-Frank Act in an orderly fashion and allow time for the CFTC to receive and evaluate public comment on the cross-border interpretive guidance. The Commission's Global Markets Advisory Committee also addressed these matters in a public meeting. The Commission is carefully reviewing all comments submitted in connection with the proposed guidance.

Market participants have requested that Commission staff issue no-action relief from certain swap provisions of the CEA or swap rules that have been adopted by the Commission. After careful consideration of the issues raised, the staff, in appropriate circumstances, has granted such relief and agreed not to recommend an enforcement action to the Commission, provided that any appropriate conditions are satisfied.

10.) A purpose of including the formation of Swap Execution Facilities in Dodd-Frank was to encourage price transparency, but there is nothing in the statute that directs the agencies to require a certain number of trade submissions as a prerequisite to qualify for trading as a SEF. In fact, the SEC's proposal does not have this requirement, so this clearly isn't a statutory necessity. But there is significant downside to mandating this requirement. Requiring a certain number would reduce liquidity, increase trading costs and actually could impair transparency. Shouldn't we allow the SEF landscape to develop without imposing such inflexible requirements? If, as these platforms develop, the agency learns through experience that a minimum requirement is necessary, it can always revise the standards.

Response: On May 16, 2013, the Commission approved the final rulemaking on swap execution facilities (SEFs). This rule is key to fulfilling transparency reforms that Congress mandated in the Dodd-Frank Act.

The Dodd-Frank Act included a trade execution requirement for swaps. Swaps subject to mandatory clearing and made available to trade were to move to transparent trading platforms. Market participants will benefit from the price competition that comes

from trading platforms where multiple participants have the ability to trade swaps by accepting bids and offers made by multiple participants. Congress also said that the market participants must have impartial access to these platforms.

Farmers, ranchers, producers and commercial companies that want to hedge a risk by locking in a future price or rate will get the benefit of the competition and transparency that trading platforms, both SEFs and designated contract markets (DCMs), will provide.

These transparent platforms will give everyone looking to compete in the marketplace the ability to see the prices of available bids and offers prior to making a decision on a transaction. By the end of this year, a significant portion of interest rate and credit derivative index swaps will be in full view to the marketplace before transactions occur. This is a significant shift toward market transparency from the status quo.

Such common-sense transparency has existed in the securities and futures markets since the historic reforms of the 1930s. Transparency lowers costs for investors, businesses and consumers, as it shifts information from dealers to the broader public. It promotes competition and increases liquidity.

As Congress made clear in the law, trading on SEFs and DCMs would be required only when financial institutions transact with financial institutions. End-users would benefit from access to the information on these platforms, but would not be required to use them.

Further, companies would be able to continue relying on customized transactions – those not required to be cleared – to meet their particular needs, as well as to enter into large block trades.

Consistent with Congress' directive that multiple parties have the ability to trade with multiple parties on these transparent platforms, these reforms require that market participants trade through an order book, and provide the flexibility as well to seek requests for quotes.

To be a registered SEF, the trading platform will be required to provide an order book to all its market participants. This is significant, as for the first time, the broad public will be able to gain access and compete in this market with the assurance that their bids or offers will be communicated to the rest of the market. This provision alone will significantly enhance transparency and competition in the market.

SEFs also will have the flexibility to offer trading through requests for quotes. The rule provides that such requests will have to go out to a minimum of three unaffiliated market participants before a swap that is cleared, made available to trade and less than a

block could be executed. There will be an initial phase-in period with a minimum of two participants to smooth the transition.

As long as the minimum functionality is met, as detailed in the rule, and the SEF complies with these rules and the core principles, the SEF can conduct business through any means of interstate commerce, such as the Internet, telephone or even the mail. In this way, the rule is technology neutral.

Under these transparency reforms coupled with the Commission's rule on making swaps available for trading, the trade execution requirement will be phased in for market participants, giving them time to comply.

These reforms benefited from extensive public comments. Moving forward, the CFTC will work with SEF applicants on implementation.

○