UNITED STATES OF AMERICA COMMODITY FUTURES TRADING COMMISSION

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

Washington, D.C.

Thursday, February 24, 2011

1	PARTICIPANTS:
2	Commission Members:
3	GARY GENSLER, Chairman
4	BART CHILTON, Commissioner
5	MICHAEL V. DUNN, Commissioner
6	JILL SOMMERS, Commissioner
7	SCOTT D. O'MALIA, Commissioner
8	Division of Clearing and Intermediary Oversight:
9	oversignt.
10	JOHN LAWTON
11	PHYLLIS DIETZ
12	ANANDA RADHAKRISHNAN
13	BARBARA GOLD
14	CHRISTOPHER CUMMINGS
15	ANDREW CHAPIN
16	CLAIRE NOAKES
17	Division of Enforcement:
18	ROBERT PEACE
19	VINCE MCGONAGLE
20	Office of the Secretariat:
21	DAVID STAWICK
22	

1	PARTICIPANTS (CONT'D):
2	Office of General Counsel:
3	DAN BERKOVITZ
4	STEVE SEITZ
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1	PROCEEDINGS
2	(9:34 a.m.)
3	CHAIRMAN GENSLER: Good morning. This
4	meeting will come to order. This is a public
5	meeting of the Commodity Futures Trading
6	Commission to consider issuance of proposed
7	rulemakings under Dodd-Frank, the Wall Street
8	Reform and Consumer Protection Act. We'll be
9	taking up today requirements for prompt and
10	efficient processing for clearing and for the
11	transfer of customer positions. I know that
12	Ananda, Phyllis and John are prepared to address
13	that for me. And there are two sets of conforming
14	amendments, conforming amendments to Part of 4 of
15	Commission regulations and these regard commodity
16	pool operators and commodity trading advisers.
17	Then also conforming amendments to Part 3 of
18	Commission regulations and these are with regard
19	to intermediaries. We are in process where staff
20	is reviewing many of the different parts to
21	conform with Dodd-Frank and will also later in the
22	year try to take up looking at the whole Rule

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1 Book, but we'll be taking up more conforming
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- amendments in the month of March and possibly into
- 3 the spring.
- 4 The Commission will not consider a
- 5 proposed rulemaking today related to swap data
- 6 recordkeeping and reporting requirements for
- 7 preenactment and transition swaps as was
- 8 originally advised in the meeting agenda and on
- 9 our website, looking at the document we need a
- 10 little more time and we're not ready. In addition
- 11 to the proposed rulemakings, the Commission will
- 12 consider an interpretive order regarding
- disruptive trading practices authority. The
- 14 proposed interpretive order is one more step in a
- process with regard to this area that Congress
- 16 addressed. Staff also is working on a
- 17 recommendation of a proposed rule concerning
- 18 testing and supervision requirements related to
- 19 algorithmic trading based in part on the
- 20 recommendations of the SEC-CFTC Joint Advisory and
- on recommendations from the CFTC's Technology
- 22 Advisory Committee as well as many comments

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1 received by the public and through various
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- 2 roundtables and the like.
- 3 Before we hear from staff I'd like to
- 4 once again thank Commissioners Mike Dunn, Jill
- 5 Sommers, Bart Chilton and Scott O'Malia for all of
- 6 their thoughtful work on implementing Dodd-Frank.
- 7 I'd like to welcome members of the public, market
- 8 participants and members of the media to today's
- 9 meeting as well as welcome those listening to the
- 10 meeting on the phone and watching this live on the
- 11 webcast. I think this is our twelfth public
- meeting to consider Dodd-Frank rulemakings. We
- will be scheduling additional meetings for March
- 14 mostly toward the end of March given the various
- travel schedules of the five of us, and we'll
- 16 announce the agenda for those meetings on our
- 17 website at least a week in advance.
- 18 Each of the teams have worked very hard
- on the rulemakings that the Commission is
- 20 considering today. They will present their
- 21 recommendations for how the Commission can best
- 22 apply the statutory obligations of Dodd-Frank and

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1 we look forward to receiving public comment on the
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- 2 proposed rules we're considering. I think now
- 3 I'll turn to Commissioner Dunn and other
- 4 Commissioners for opening statements.
- 5 COMMISSIONER DUNN: Thank you, Mister
- 6 Chairman and I thank all of those who have joined
- 7 us today for this important meeting regarding the
- 8 implementation of the Dodd- Frank Act.
- 9 I'm particularly interested in the
- 10 proposed interpretive order regarding the
- 11 Commission's antidisruptive trading practices
- 12 authority. In reading the comments and letters we
- 13 received in response to our Advanced Notice of
- 14 Proposed Rulemaking, two things stood out to me.
- 15 First, there was widespread support for the goal
- of eliminating disruptive trading practices from
- 17 our markets. And second, most commentators called
- 18 for greater clarity to help them understand how we
- 19 interpret the concept of disruptive practices. I
- look forward to receiving the public's comments to
- 21 see if the proposed interpretive order adequate
- 22 addresses those concerns.

1	As I've mentioned in previous open
2	meetings, the CFTC is under serious strain at its
3	current funding level. We lack staff and
4	technological resources to implement Dodd-Frank
5	and continue to fulfill our pre-Dodd-Frank duties
6	under the Commodity Exchange Act. Our staff's
7	performance during this difficult time has been
8	truly remarkable. They have worked long hours to
9	essentially do two very big jobs at once.
10	However, without additional funding the strain
11	will only become worse in July when much of the
12	Dodd-Frank goes into effect. At that point in
13	addition to our traditional oversight of the
14	futures industry, we will also begin regulating
15	the swaps market, a market that has been estimated
16	to be nine times larger than the futures market.
17	Even at the Administration's requested funding
18	level and with increased assistance from the SROs,
19	this would be an Herculean task. More troublesome
20	is the potential that the Commission may suffer a
21	decrease in funding at this critical period. The
22	House spending bill would cut the Commission's

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1 already tight budget by nearly a third. The
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- 2 Commission is faced with the very hard choices of
- 3 how to use your limited resources to enforce both
- 4 Dodd- Frank and the Commodity Exchange Act. With
- further cuts in our budget, the Commission will
- 6 have to abandon its principle-based regulatory
- 7 regime and adopt a prescriptive or even a
- 8 restrictive regime. I am fearful that this will
- 9 have a negative impact on both the futures and
- 10 swap industries in the United States. There would
- 11 essentially be no cop on the beat and no one to
- 12 ensure that our industry which was largely
- 13 untarnished by the financial meltdown would not be
- 14 blamed if another meltdown occurs. I would like
- once again to thank the staff of the CFTC for
- 16 their hard work in regards to these very important
- 17 proposed rules. Their dedication to our important
- 18 work during this difficult time is what government
- 19 service is all about. Thank you.
- 20 CHAIRMAN GENSLER: Thank you,
- 21 Commissioner Dunn. Commissioner Sommers?
- 22 COMMISSIONER SOMMERS: Thank you, Mister

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1 Chairman. Good morning. I want to say thank you
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- 2 to all the teams that have put in a lot of hard
- 3 work for the proposals that we have in front of us
- 4 today.
- 5 Before I address the specific proposals,
- 6 I'd like to talk about an issue that has become an
- 7 increasing concern of me and that is our failure
- 8 to conduct a thorough and meaningful cost-benefit
- 9 analysis when we issue a proposed rule. The
- 10 proposals are voting on today and the proposals we
- 11 have voted on over the last several months contain
- 12 very short, boilerplate cost-benefit analysis
- 13 sections. The cost-benefit analysis section of
- 14 each proposal states that we have not attempted to
- quantify the cost of the proposal because Section
- 16 (a) of the Commodity Exchange Act does not require
- 17 us to quantify the cost. Moreover, the
- 18 cost-benefit analysis section of each proposal
- 19 points out that all the Commission must do is
- 20 consider the costs and benefits and we need not
- 21 determine whether the benefits outweigh the costs.
- 22 At the outset I ask how can we

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1 appropriately consider the costs and benefits if
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- we make no attempt to quantify what the costs are?
- 3 But more importantly from a good government
- perspective, while it is true that 15(a) of the
- 5 Commodity Exchange Act does not require the
- 6 Commission to quantify the costs of a proposal or
- 7 to determine whether the benefits outweigh the
- 8 costs, Section 15(a) certainly does not prohibit
- 9 the Commission from doing so. We have just simply
- 10 chosen not to.
- 11 Clearly when comes to cost-benefit
- 12 analysis, the Commission is merely complying with
- 13 the absolute minimum requirements of the Commodity
- 14 Exchange Act. In my opinion that is not keeping
- with the spirit of the President's recent
- 16 Executive Order on improving regulation and
- 17 regulatory review. We owe the American public
- more than the absolute minimum. As we add layer
- 19 upon layer of rules and regulations, restrictions
- and new duties, we should be attempting to
- 21 quantify the costs of what we are proposing. And
- we should most certainly attempt to determine

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1 whether the costs outweigh the benefits. The
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- 2 public deserves this information and deserves the
- 3 opportunity to comment on our analysis. That is
- 4 good government. Our failure to conduct a
- 5 critical analysis of costs and benefits simply
- 6 because we are not required to is not good
- 7 government.
- 8 Of the proposals we are considering
- 9 today, I am most concerned about the proposed
- 10 interpretive order relating to disruptive trading
- 11 practices. When it was first suggested that
- 12 Dodd-Frank would contain a section that outlawed
- disruptive trading practices, I and others at the
- 14 Commission believed it was unnecessary because the
- 15 Commission already had the authority to prosecute
- such activity and in fact had prosecuted such
- 17 activity successfully in the past. When the draft
- 18 language of Section 747 was first discussed among
- 19 Commission staff, it was my view and the view of
- others in the building that the language was too
- vague. We suggested that in order to remedy the
- 22 vagueness, the Commission would need to promulgate

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1 rules to put the public and market participants on
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- 2 notice of what conduct was prohibited. I believed
- 3 that we had consensus in the building around the
- 4 view that if draft language was included in the
- final legislation, clarifying rules would be
- 6 necessary and appropriate. That's also the
- 7 message we received from the public in response to
- 8 the ANPR and the roundtable that we held on this
- 9 subject. I'm disappointed that we do not have
- 10 proposed rules before us today and I do not
- 11 believe that the proposed interpretive order is
- 12 sufficient to take the place of rules. Disruptive
- 13 trading practices statutory language is vague and
- 14 this proposed does not cure that vagueness. And
- in many areas the order raises more questions than
- it answers and in my view when issuing rules or
- 17 guidance related to prohibited conduct, the
- 18 Commission's first priority must always be to
- 19 provide the public and market participants with
- 20 clear parameters distinguishing prohibited conduct
- 21 from legitimate trading activity. The goal should
- 22 not be to retain maximum flexibility for

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1 Commission staff to investigate and prosecute
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- 2 alleged wrongdoing. This is what this order does
- 3 and I cannot support that approach.
- 4 Again I want to acknowledge all the
- 5 teams that have worked on these proposals today.
- 6 I think we all understand the kind of work and
- 7 time and effort that you all put in extra hours to
- 8 get these proposals ready for us and I want all of
- 9 you to know how much we appreciate your work.
- 10 Thank you.
- 11 CHAIRMAN GENSLER: Thank you,
- 12 Commissioner Sommers. Commissioner Chilton?
- 13 COMMISSIONER CHILTON: Thanks, Mister
- 14 Chairman. I don't disagree with what Commissioner
- Sommers said. I think it's important that we have
- 16 these cost-benefit analyses. But particularly
- when we go to final you got to know what it's
- 18 going to cost folks and whether or not it's
- 19 justified. It did make me think while you were
- 20 talking though, yesterday a group came in and at
- 21 the end of their presentation they gave a list of
- 22 all the things that we weren't required to do but

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were going to do, two or three pages. I guess
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- they were trying to impress me with we were
- 3 overreaching. So these are things that we are
- 4 choosing to do, at least three of the five of us,
- 5 that we're not required to do. This however is
- 6 something that we have chosen not to do so far,
- 7 but I think you're right that we need to do it
- 8 ultimately and I think probably all of us agree we
- 9 know what this is going to cost before we
- 10 certainly pass the final rule. I wouldn't mind
- 11 having the stuff right now. I agree with you.
- 12 I'm pleased we're doing the interpretive
- order, and without saying anything specific, I am
- 14 pleased that the Chairman is such an excellent
- staffer today on another issue. He has found
- 16 something that was very important for all of us
- and I commend you for that. But one of the
- 18 questions we ask in our antidisruptive trading
- 19 practice in the original proposal we had was about
- 20 high-frequency traders, what I call cheetah
- 21 traders they are so fast, and I don't mean cheetah
- 22 with a Boston accent, and algo trading. We're not

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addressing that in this interpretive order, we're
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- only addressing the three things that were
- 3 specified in the statute, but we do need I think
- 4 to address in an additional rule at some point,
- 5 I'm hopeful it will be at this meeting that we
- 6 have in March, but at some point in the
- 7 not-too-distant future, rules and regulations with
- 8 regard to HFTs. I know Commissioner O'Malia's TAC
- 9 committee is going to be talking about some of
- 10 these things next week, but I think there needs to
- 11 be some sort of basic testing, sort of a Jiffy
- 12 Lube inspection if you will, to make sure that the
- 13 10 points or whatever it is of HFTs, the cheetah
- 14 traders and the algos, that they need some basic
- standard that these things are going to work when
- they put them into play and they don't roil
- 17 markets. I also think there need to be some
- 18 specific parameters for the cheetah traders with
- 19 regard to the limit-up/limit-down rule. And
- 20 thirdly, and I this is what the TAC is going to
- 21 talk about next week, at least the subcommittee
- has been talking about, and that is pretrade

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1 internal in-house transparency issues to ensure
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- that they're playing by the rules. So I look
- 3 forward to getting those things done in the
- 4 future.
- 5 But all of these things, all of the
- 6 rules and regulations we've been working on now,
- 7 maybe the thirteenth meeting actually, maybe they
- 8 didn't mention it like they don't have a
- 9 thirteenth floor, but the thirteenth meeting, all
- of the things that we've been doing and today on
- 11 antidisruptive will mean nothing, they will mean
- 12 squat, they will mean diddly if we don't do what
- 13 Commissioner Dunn said and get the resources to do
- 14 the job. We had this economic calamity. It was
- due in part to lax regulation. No individual
- 16 person's fault, but lax regulation in general.
- 17 And then the entities out there took advantage of
- it and we had this hideous bailout and we're just
- 19 crawling our way of an economic mess and we got
- 20 the bill that was passed by Congress and signed by
- 21 the President but without the funds to look at
- this market. We're going from roughly \$5 trillion

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in annualized exchange trading to $600 trillion,
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- and we're not going to get all of the \$600
- 3 trillion, but it's hundreds of trillions of
- dollars in oversight. To think that we can do
- 5 that with not another cent is crazy. One of the
- 6 things I need to point out because I don't it
- 7 enough is that the regulated exchanges that
- 8 Commissioner Dunn talked about have operated very
- 9 well. There are a few little issues, speculation
- and we have differences on some of these things,
- 11 but by and large nobody went down because of the
- 12 regulated exchanges. So they have done a good job
- 13 and we can oversee those markets. Under current
- 14 funding we can continue to do that. But the OTC
- markets, the \$600 trillion, we can't do unless we
- 16 get additional resources.
- 17 And now we find out with the House the
- other day that we would actually be cut by a
- 19 third. That's very risky business. I want to be
- 20 real clear. Commissioner Dunn talks about this
- 21 all the time and I want to echo what he said and
- 22 what the Chairman said. We will be particularly

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1 vulnerable in the regulated futures markets to
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- 2 fraud, abuse and manipulation if we don't receive
- 3 at least the current funding. If we get cut, we
- 4 are going to be in a world of hurt. That won't be
- 5 good for markets, it won't be good for consumers
- and it won't be good for the economic engine of
- our democracy. Thanks, Mister Chairman.
- 8 CHAIRMAN GENSLER: Thank you,
- 9 Commissioner Chilton. Commissioner O'Malia?
- 10 COMMISSIONER O'MALIA: Thank you, Mister
- 11 Chairman. Let me thank the teams for their hard
- work in developing the four rulemakings and
- 13 interpretive guidance before us today. Staff here
- 14 at the CFTC is definitely working hard. As of
- today the Commission will put out 40 various
- 16 proposals since August totaling over 975 pages in
- 17 the Federal Register pages and those are those
- 9-point fonts everybody enjoys reading. If you
- 19 lay those pages end to end lengthwise, it would
- 20 stretch over 892 feet. That's more than the
- 21 height of the Statute of Liberty tip to torch and
- the Washington Monument balanced on top.

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                 I remain concerned that we are moving at
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       a pace that makes it very difficult if not
       impossible to dig out of the mountain of paper and
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       piece all of these new requirements together in a
       meaningful way. For example, the proposal before
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       us today regarding the requirements for
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       processing, clearing and transferring customer
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       positions illustrates how difficult it is for us
       to put out rulemakings at this punishing pace and
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       get it right. At the end of January, just a
       little over a month ago, the Commission put
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       forward a rule proposal that addressed Core
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       Principle F for designated clearing organizations.
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       Today's rulemaking reproposes a regulation
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       interpreting Core Principle F to supplement the
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       proposals made in January even though the comment
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       period on the original proposal will not close
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       until March 21. To comment on both proposals, the
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       public will have to read both rules together and
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       submit comments on both. Also the comment period
       for the proposed rulemaking before us today is
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       only 30 days instead of 60 days. None of this
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1 seems to make sense, nor does it seem to be
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- 2 keeping in pace with the spirit of the President's
- 3 Executive Order on regulation that reminds us to
- 4 seek meaningful public participation and afford
- 5 comment period that should generally be at least
- 6 60 days.
- 7 As we come to the end of this stage of
- 8 the Dodd- Frank rulemaking process, we are putting
- 9 forward the Commission proposals. I think back
- 10 over the past months and I've asked that moving
- 11 forward we give thought to organizing the
- 12 rulemaking process in a more responsible, cohesive
- 13 fashion. The last time I raised the rulemaking
- 14 process in the middle of December, I suggested an
- order for considering final rules and that we
- should receive feedback from the public on how we
- 17 put that process together. I reiterate my
- 18 concerns and desire to have the Commission put
- 19 forth a public comment period for which the rules
- 20 will be considered and how we're going to proceed
- in the spring.
- It is very important that we have a

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1 roadmap for going forward and the public has the
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- 2 benefit of knowing which direction we are going.
- 3 I'll be posting a list of all our proposed rules
- 4 so that the public might sort through this list.
- 5 I have handed out this list and I've included it
- in my statement today and I'll put on my website.
- 7 For the last couple of weeks at every meeting I've
- 8 handed this out and asked everybody to take a shot
- 9 at reordering in their opinion which rule should
- 10 come first and which should come second and I
- 11 think I've been beginning to receive some positive
- 12 feedback that people have been provided. I'm
- going to ask everybody today if you have an
- opinion about our rulemaking process, please
- 15 comment on it. You can get the form on my website
- and please send us your comments. We'd like to
- 17 have your thoughts on how we should proceed and
- 18 what makes sense to the market. I do appreciate
- 19 the efforts that the Chairman has made to have us
- 20 all work together on the rulemaking process during
- 21 the proposal stage and I look forward to
- 22 continuing that work together through the next

1 stage.

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With regard to disruptive trading
       practices, we are issuing a proposed interpretive
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       order to provide guidance on the scope of the
       statutory prohibitions set forth in antidisruptive
 5
       trading practices in new Section 4(c)(A)(V) of the
       Commodity Exchange Act. The admittedly vague
 8
       statutory prohibitions have presented some tough
       issues and we have spent long hours debating the
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       appropriate course of action. We can do nothing
       and leave the statutory interpretation to market
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       participants versus issuing regulations
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       interpreting the statutory language to bind us all
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       to concepts that we may not yet appreciate given
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       changes in market structures and trade practices
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       going forward. After one round of comments in a
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       roundtable we have taken the middle ground and are
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       issuing a proposed interpretive order to provide
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       guidance as to the type of trading, conduct and
       practices that will constitute violations in the
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       new 4(c)(A)(V). I am pleased that the Commission
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       is recognizing the vital role that the exchanges
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1 and self-regulatory organizations will play in the
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- 2 surveillance and enforcement of these practices.
- 3 The Commission is simply not technologically
- 4 equipped to monitor the markets at this time and
- 5 as the markets and trade practices evolve, it is
- 6 imperative that we work cooperatively with the
- 7 individuals and entities on the frontlines. I
- 8 believe staff has worked to respond to the many
- 9 comments and concerns raised thus far and while
- 10 this proposal may not be perfect, it is a modest
- 11 step to seek additional comment on a more specific
- 12 proposal. This especially so because market
- 13 participants and the public will now have the
- 14 opportunity to tell us whether interpretive
- 15 guidance is simply enough.
- I identify with the desire to have
- 17 clear-cut rules and definitions and I've come to
- 18 understand that there is value in providing some
- 19 flexibility. For example, the rule makes clear
- that the onus is on market participants to "assess
- 21 market conditions and consider how their trade
- 22 practices and conduct affect the orderly execution

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of transactions during the closing period." This
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- 2 seems pretty basic. However, how will this apply
- 3 to market participants using a trading algorithm?
- 4 If the algorithm is not programmed to asses market
- 5 conditions in the manner that we believe is
- 6 necessary, who will be liable if we have another
- 7 May 6? I'd like for staff to answer that question
- 8 today and I have a few more questions for them to
- 9 answer before I commit to a vote on this.
- 10 Finally, I know that all the teams have spent long
- 11 hours working on these proposals and I'm grateful
- 12 for their efforts. Thank you.
- 13 CHAIRMAN GENSLER: Thank you,
- 14 Commissioner O'Malia. Now staff will present
- their proposals. I think the public knows Ananda,
- 16 Phyllis and John who have been here a number of
- 17 times in the past.
- MS. DIETZ: Thank you, and good morning,
- 19 Mister Chairman and Commissioners. I'm pleased to
- 20 recommend for publication in the Federal Register
- 21 a proposed rulemaking that would establish
- 22 requirements for processing and clearing

1 transactions and the transfer of customer

- 2 positions.
- This proposed rulemaking has two primary
- 4 objectives. The first objective is to establish
- 5 appropriate timeframes for the submission and
- 6 acceptance for clearing of swap transactions that
- 7 are eligible to be cleared by a derivatives
- 8 clearing organization which I will refer to for
- 9 simplicity as a DCO. The second objective is to
- 10 require a DCO to carry out the prompt and seamless
- 11 transfer of customer positions from one clearing
- member of the DCO to another clearing member of
- 13 the DCO upon customer request. These proposals
- 14 supplement earlier proposed rulemakings approved
- for publication by the Commission. While the
- 16 proposed rules before you would establish
- 17 requirements for swap dealers, major swap
- 18 participants, FCMs, swap execution facilities and
- 19 designated contract markets. The primary focus is
- 20 on DCOs and the rules to implement core principles
- 21 applicable to DCOs regarding participant and
- 22 product eligibility and treatment of funds.

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                 I would note as has already been
       mentioned the earlier proposed rulemaking for
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       these Core Principle regulations is still open for
       comment until March 21 and the comment periods for
       the original and the supplemental rulemakings will
       therefore overlap. Hopefully this will enable
       commentors to consider both proposals at the same
       time and consolidate their comments.
                 Turning to the substance of the rules,
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       there are two components that we've considered in
       proposing appropriate timeframes for clearing.
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       They relate to, first, the timing for submission
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       of a transaction and, second, the timing for a
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       DCO's acceptance of a transaction for clearing.
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       In developing proposed timing standards for
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       submission of transactions, staff has attempted to
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       take into account the different factual
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       circumstances under which transactions,
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       particularly swaps, are going to be cleared.
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       we propose three different timeframe requirements.
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First, for SEFs, swap execution facilities and

DCMs, designated contract markets, they would have

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1 to submit swaps for clearing immediately upon
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- execution. Second, for swaps not executed or
- 3 subject to the rule of the SEF or DCM but subject
- 4 to mandatory clearing, a swap dealer, major swap
- 5 participant or FCM would have to submit the swap
- 6 for clearing as soon as technologically
- 7 practicable following execution but not later than
- 8 the close of business on the day of execution.
- 9 Then third for swaps not executed on or subject to
- 10 the rules of a SEF or a DCM and not subject to
- 11 mandatory clearing, if these swaps are going to be
- 12 cleared, the swaps would have to be submitted for
- 13 clearing not later than the next business day
- 14 after execution of the swap or the next business
- day after the agreement to clear if that's later
- 16 than execution.
- 17 The regulations that would apply to DCOs
- 18 again would make a distinction between different
- 19 factual circumstances. First, for transactions
- 20 executed on or subject to the rule of a SEF or a
- 21 DCM, a DCO would have to accept for clearing
- 22 immediately upon execution all transactions listed

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for clearing by the DCO. For swaps not executed
on or subject to the rules of a SEF or DCM but
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- 3 subject to mandatory clearing, a DCO would have to
- 4 accept for clearing upon submission to the DCO all
- 5 swaps that are listed for clearing by the DCO.
- 6 Then last, swaps that are not executed on or
- 7 subject to the rules of the SEF or DCM and not
- 8 subject to mandatory clearing, a DCO would have to
- 9 accept for clearing not later than the close of
- 10 business on the day of submission to the DCO all
- swaps that are listed for clearing by the DCO.
- 12 Before moving to our next topic for
- 13 rulemaking, I would like to note briefly that
- 14 there are other provisions relating to DCOs that
- are covered by the supplement. For example, staff
- is recommending approval of a proposed regulation
- 17 that would prohibit a DCO from requiring that one
- of the original executing parts to a swap must be
- 19 a clearing member in order for the transaction to
- 20 be eligible for clearing. This is a proposed rule
- 21 that would further implement core principles for
- 22 participant and product eligibility. Lastly, the

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1 issue of prompt transfer of customers positions
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- 2 and related funds upon customer request. In
- 3 response to industry concerns about portability,
- 4 staff is recommending that the Commission propose
- 5 a rule to implement DCO Core Principle F,
- 6 treatment of Funds, requiring a DCO to have rules
- 7 providing that upon the request of a customer and
- 8 subject to the consent of the receiving clearing
- 9 member, a DCO must promptly transfer customer
- 10 positions and related funds from the carrying
- 11 clearing member of the DCO to another clearing
- member of the DCO without requiring closeout and
- 13 rebooking of the positions prior to the transfer.
- 14 The requirement that the DCO not require closeout
- and rebooking eliminates a source of unnecessary
- delay and market disruption and conforms with
- 17 current futures industry practices.
- This concludes my formal presentation
- and my colleagues and I will be happy to answer
- 20 any questions. Thank you.
- 21 CHAIRMAN GENSLER: Thank you to the team
- that's worked on this, and Phyllis for your

1 presentation. I had a question as to how clearing

- works right now in the futures marketplace. Are
- 3 there provisions for the exchanges or
- 4 clearinghouses to do this prompt and efficient
- 5 clearing that we're recommending here in the swaps
- 6 marketplace?
- 7 MS. DIETZ: Yes. This would be subject
- 8 to the DCO rules and we are aware of at least one
- 9 DCO that has rules relating to this, so this is
- 10 the standard practice.
- 11 MR. LAWTON: I would add that on some of
- 12 the electronic trading systems they would have
- what they call open offer which means that the
- 14 clearing arrangements are set up in advance so
- that when the trade is executed it immediately
- goes to clearing, that the arrangement has already
- 17 been set up as to who the clearing member is going
- 18 to be.
- 19 CHAIRMAN GENSLER: I will be in support
- of this rule because as I understand it it lowers
- 21 risk in the system that transactions will not be
- 22 batched and wait until the end of the week to

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1 clearing, but if they're on a swap execution
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- 2 facility or on a designated contract market, that
- 3 those SEFs and DCMs would have a arrangements with
- 4 the clearinghouses to in essence have
- 5 straight-through processing or send the
- 6 transactions directly to be novated to the
- 7 clearinghouses. Is that right?
- 8 MS. DIETZ: That's correct.
- 9 CHAIRMAN GENSLER: I gather that it is
- 10 staff's view that it lowers risk. I think it's at
- 11 the core of what Dodd-Frank was doing in lowering
- 12 risk was to send transactions to clearinghouses.
- MR. RADHAKRISHNAN: That's our view,
- 14 yes.
- 15 CHAIRMAN GENSLER: Thanks. Commissioner
- 16 Dunn?
- 17 COMMISSIONER DUNN: Thank you, Mister
- 18 Chairman, and I look forward to hearing how this
- 19 affects current clearing from comments from the
- 20 public on this. I note, and if I can get our
- 21 General Counsel to respond here because this is
- 22 something I had asked in the past, Phyllis, you

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1 note that there is an overlapping regulation that
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- is out there and I want to have assurance here
- 3 that when folks write in a comment on a regulation
- 4 if it is pertinent to other regulations that we
- will treat it as if it is a comment on the other
- 6 regulation.
- 7 MR. BERKOVITZ: Yes, Commissioner.
- 8 Staff has been directed to do exactly that, that
- 9 if a comment comes in on one rulemaking that
- 10 refers to another rulemaking that is pending that
- 11 that comment should be sent over to the other
- 12 rulemaking team for their consideration so that
- that is a matter of staff practice.
- 14 CHAIRMAN GENSLER: I didn't ask for a
- motion for this and I was supposed. Is there a
- 16 motion to accept staff recommendation on
- 17 straight-through processing?
- 18 COMMISSIONER DUNN: So moved.
- 19 COMMISSIONER SOMMERS: Second.
- 20 COMMISSIONER DUNN: For final
- 21 clarification. Even if that comment period on
- 22 that other proposed regulation is closed, it will

1 still be accepted as if it came in in a timely

- 2 manner?
- 3 MR. BERKOVITZ: If the comment in an
- 4 open comment period refers to a proposed rule for
- 5 which the comment period is closed, as a general
- 6 matter it would still go over to the other
- 7 rulemaking team for their consideration. The
- 8 teams have the discretion to consider late-filed
- 9 comments so they would have the discretion to
- 10 consider it. The Chairman has indicated with
- 11 respect to the swaps entities definition proposed
- 12 rule making that if commentors are commenting on
- 13 the entity's definition and the comment related to
- 14 a prior rulemaking that had closed that was
- dependent or related to an entity definition such
- 16 as some of the perhaps business conduct standards
- or another rulemaking period that had closed to
- 18 the closure of the entity's definition rulemaking
- 19 that staff should exercise its discretion and
- 20 consider that comment so that in those cases those
- 21 comments will be considered under staff's
- 22 discretion. In the future with respect to other

1 rulemakings, it will be within staff's exercise of

- 2 discretion to consider such comments in the other
- 3 rules.
- 4 COMMISSIONER DUNN: I don't know if that
- 5 completely satisfies me or not. I would like it
- to be something very uniform and maybe we can
- 7 discuss this later as a procedural.
- 8 CHAIRMAN GENSLER: I concur with you,
- 9 Commissioner Dunn. I think that we're in a
- 10 natural pause right now. We have whatever work we
- do today and will put out for proposal. Our next
- 12 public meeting of the Commission is likely to be
- toward the end of March. Of the 30 original
- teams, 27 have been here and the thirty-first team
- is now here too for the conforming amendments.
- But we have a natural pause and that if the public
- has comments on a rule that's closed, they've been
- 18 still sending them in. There have been meetings.
- 19 I'm sure all five of us have been asked to take
- 20 meetings and I certainly know that in the meetings
- 21 I'm in I try to have somebody take the ex parte
- 22 notes and put them in the comment file and make

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1 sure that all five Commissioners have the benefit
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- of what I'm hearing in those meetings. As General
- 3 Counsel Berkovitz has said, I've said this to the
- 4 public that if they have a comment and it comes in
- 5 and it's during this pause right now, and this
- 6 pause is not going to be just a few days. We just
- 7 naturally have a period of time where staff is
- 8 looking through I think we've gotten probably
- 9 somewhere between 1,300 and 1,500 comments already
- 10 and staff is looking through those comments
- 11 summarizing them. They done a lot of work to
- 12 summarize those comments, make staff
- 13 recommendations and then this Commission will work
- 14 as Commissioner O'Malia said to think of a
- schedule as to how to take these up in the spring
- and summer. And as I've often noted, we're human
- and some of these things will be passed the July
- 18 15 date because we want to get these right and
- 19 balanced and that's what's important. As to the
- 20 pendency, I think I agree with Commissioner Dunn.
- 21 Staff and we have some discretion to continue to
- get these comments in the right files.

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1 COMMISSIONER DUNN: With that, Mister
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- 2 Chairman, I have no further questions. I would
- 3 ask the public to send in their comments on this.
- 4 I will keep an open mind and review those comments
- 5 accordingly.
- 6 CHAIRMAN GENSLER: Thank you.
- 7 Commissioner Sommers?
- 8 COMMISSIONER SOMMERS: I'd like to
- 9 follow-up on this conversation if I can with
- 10 regard to staff's discretion. What will the
- 11 process be if staff decides not to consider a
- 12 comment letter? Do they notify the party that
- they have decided not to consider it? I guess I'm
- 14 a little confused at staff's discretion.
- MR. BERKOVITZ: When the Commission sets
- 16 forth a deadline in the proposed rule, the agency
- must consider the comments before the deadline,
- 18 and as I mentioned and you referred to in the
- 19 question, it is within staff's discretion that it
- 20 may be considered and it may not be considered.
- 21 There is not a process for notifying a commentor
- 22 saying we are considering your comments. If the

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1 comment is considered and the commentor raises an
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- issue, at that point the agency has an obligation
- 3 to respond in the rulemaking to that comment. So
- 4 ultimately when the agency publishes a final rule,
- 5 it must address all the comments in the final rule
- 6 so that at that point the commentor could read the
- 7 final rule and see whether that comment was
- 8 addressed or not. But there is actually no
- 9 process of notification that says we're
- 10 considering your comments presently.
- 11 COMMISSIONER SOMMERS: Thank you. I
- 12 would say that it would be my hope that if there
- is not a process for notifying the party if
- 14 they've commented after the comment period has
- 15 closed and staff makes a determination that we're
- 16 not considering that comment that maybe then there
- would be a process for at least the Commission to
- 18 be notified that we have decided to not consider
- 19 those comments because they're after the comment
- has ended.
- 21 MR. BERKOVITZ: I think that's something
- 22 we certainly can do. I'd also note that although

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there isn't a formal process for notifying people
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- 2 whether their comments are considered or not, it's
- 3 been my experience with a number of these
- 4 instances so far, and I can't speak for all the
- 5 rulemaking teams on this, often times commentors
- 6 who are either anticipating they will be late who
- 7 actually are late will call up and say we're going
- 8 to be filing late. Will you consider our
- 9 comments? So that there is an informal discussion
- 10 between staff back and forth and sometimes the
- 11 commentors are informed that, yes, we will
- 12 consider their comment. So it's not necessarily a
- 13 black box and although there isn't a formal
- 14 notification process, there is that informal
- discussion back and forth on this. But we can
- 16 certainly notify when there is a date that staff
- 17 says here is the cutoff date. We're just not
- 18 going to be accepting any. It's beyond the point
- where if we take more comments it's going to
- 20 interfere with the promulgation of the final rule
- or something like that. We could do that if
- that's what the Commission would like.

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1 COMMISSIONER SOMMERS: Thank you, Dan.
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- I have a couple of different questions to clarify
- 3 to make sure you've clarified for me but making
- sure that the public is aware that the transfer of
- 5 customer funds that is dealt with in this proposal
- is within a single DCO, not between DCOs.
- 7 MR. RADHAKRISHNAN: That is correct,
- 8 Commissioner. It's meant to make sure that if I
- 9 am a customer and I have an account with Phyllis
- 10 who is the clearing FCM and I have positions at X
- 11 DCO and I want to transfer my positions to John
- who is also a clearing member and that DCO must
- 13 facilitate that transfer.
- 14 COMMISSIONER SOMMERS: Thank you. My
- second question to clarify is with regard to the
- treatment of funds and the permitted investments,
- 17 to clarify that the funds a DCO holds that are not
- 18 4D funds are not subject to 1.25.
- MR. RADHAKRISHNAN: That is correct,
- 20 Commissioner. Rule 1.25 only goes to the
- investment of customer segregated funds, yes.
- 22 COMMISSIONER SOMMERS: Thank you.

1	CHAIRMAN GENSLER: Thank you,
2	Commissioner Sommers. Commissioner Chilton?
3	COMMISSIONER CHILTON: I'm curious if
4	we're expecting any resistance to the timeframes
5	for submitting swaps for clearing or for DCOs to
6	clear. And also if you think we will get any
7	resistance to a customer funds transfer proposal.
8	MR. RADHAKRISHNAN: We may get
9	resistance from the dealer community. For
10	example, there is a clearing organization that's
11	not regulated by this Commission that does
12	clearing on a weekly basis, on batch basis and so
13	people may resist because they're used a
14	particular way of doing business. Also I think
15	the dealer community may object to this transfer.
16	They say you don't have to close our your position
17	and reestablish your position just to move from
18	one clearing firm to another. That doesn't make
19	any sense at all. But perhaps the current
20	practice allows people to make more money so that
21	if we're potentially taking away a source of
22	revenue, people might resist.

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1 COMMISSIONER CHILTON: Thank you.
2 CHAIRMAN GENSLER: Thank you,
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- 3 Commissioner Chilton. Commissioner O'Malia?
- 4 COMMISSIONER O'MALIA: Thank you. Let
- 5 me follow- up on the comment questions. I don't
- 6 know if it was ever answered why we went with a
- 7 30-day or over a 60-day comment period for this
- 8 rule.
- 9 MS. DIETZ: The reason we were going
- 10 with a 30- day was because this rulemaking is
- 11 fairly limited and focused and we felt that that
- was an appropriate timeframe. It also with the
- overlap of the earlier proposed rulemaking would
- 14 enable us to proceed and go final with the entire
- 15 participant product eligibility rule and the
- entire treatment of funds rule at the same time.
- 17 CHAIRMAN GENSLER: May I help you on
- that one a little bit?
- 19 COMMISSIONER O'MALIA: Sure
- 20 CHAIRMAN GENSLER: But if we had a
- longer comment period, couldn't we possibly do a
- great deal of what we do in clearing in the spring

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or into the summer and this straight-through
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- 2 processing could possibly be done in a separate
- final rule? It is pretty targeted. Isn't that
- 4 possible as well?
- 5 MS. DIETZ: Yes, it certainly could be
- 6 done separately just as it is being done now. I
- 7 think that one thing to take into consideration
- 8 which I know has been discussed and there isn't a
- 9 final decision on it is how we consolidate and put
- 10 together all the different rulemakings. It's an
- 11 issue of mechanics more than anything else because
- once all the comment periods close, we will have
- the full breadth of the public comments. So it's
- just a matter of making sure that everything is
- sown together neatly and fits together. But this
- is as I think you will see free- standing so that
- if we went out with other rules and then did this
- 18 separately, it's certainly possible.
- 19 CHAIRMAN GENSLER: So I would say to
- 20 Commissioner O'Malia that this one might end up
- 21 being free-standing and I'd be open to making this
- 22 60 days as well.

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COMMISSIONER O'MALIA: I was going to
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       follow-up in my next part. I think we have shown
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       some flexibility and I think that the DOJ letter
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       that we received on our governance came in 38 days
       after the comment period and we accepted so that
       if 38 days is our new standard then I'm okay with
       that. I want to put that out there.
                 I have a question on Section 39.12. As
       the Chairman noted, the rule seeks to conform
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10
       swaps and futures markets. The rule now reads
       that "A derivative clearing organization shall
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       select contract units sizes and other terms and
12
       conditions that maximize liquidity, facilitate
13
14
       transparency in pricing, promote access and allow
15
       for effective risk-management." The preamble also
16
       explicitly states that the goal of the other terms
17
       and conditions language is to clarify that when a
18
       DCO is establish products and templates it must
19
       select termination or a maturity period,
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       settlement features and cash-flow conventions.
       The Chairman made a compelling argument for risk
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reduction, et cetera. On Tuesday we received a

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1 letter from Representative Barney Frank and in
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- 2 that letter he mentioned to the Commission that
- 3 swaps are very different products than those
- 4 currently traded in the "highly evolved equities
- 5 and futures market." I think we should listen to
- 6 that advice because these markets are different
- 7 and they have quite frankly not evolved in the
- 8 same way that Congressman Barney Frank has pointed
- 9 out. My question is to John and Phyllis, are you
- 10 absolutely certain that by forcing the
- 11 termination, settlement and cash-flow conventions
- on swaps that this is the current solution for the
- 13 swaps market?
- 14 MR. RADHAKRISHNAN: If you accept the
- proposition that swaps need to be cleared, I think
- 16 you got to give the clearinghouse the most
- 17 flexibility in determining how to clear a product.
- 18 Otherwise what you're going to get is, the worry
- 19 that you're going to have is, as between the
- 20 customer and its clearing firm you have one
- 21 contract, between the clearing firm and the
- 22 clearinghouse you're going to have another

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1 contract. That's not what happens in the futures
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- 2 industry. Everybody has the same contract so
- 3 that, one, it facilitates an E.D., an easy
- 4 movement of positions. Let's say if a firm is
- 5 having financial difficulty, it facilitates easy
- 6 movement and the reason we proposing contract size
- 7 constraints or that we propose this contract issue
- 8 is you want to make it easy for the clearinghouse
- 9 to determine how to clear a particular transaction
- 10 because once it's cleared it's not a bilateral
- 11 transaction anymore. It's a transaction between
- 12 the clearing member and the clearinghouse. So we
- 13 believe that smaller lot sizes will facilitate
- 14 liquidity thereby allowing these products to be
- listed on a DCM or a SEF, and also it will help in
- default management because it may be easier to
- 17 either liquidate or assign or move positions to
- 18 different clearing members. So far experience has
- 19 been in an instance of financial difficulty one
- 20 firm takes the whole book or buys the whole book,
- 21 but that may not be necessarily so. You may have
- 22 two firms agreeing to take a portion of a

1 particular book of a clearing and that's why we

- 2 proposed this.
- 3 COMMISSIONER O'MALIA: Can you think of
- 4 a scenario in which this rule might constrain the
- 5 swaps market?
- 6 MR. RADHAKRISHNAN: I cannot, but I
- 7 think that's why hopefully if there is something,
- 8 we'll get some public comment on it.
- 9 COMMISSIONER O'MALIA: In talking with
- 10 some of the buy-side asset managers, they raise
- 11 the issue of breaking up block trades and
- 12 allocating them to the clients prior to clearing.
- 13 They're trying to solve both operational risk and
- 14 counterparty risk. I'm trying to understand.
- This straight-through processing rule has this
- 16 immediate requirement. Would that undermine the
- 17 ability of an asset manager to reallocate all of
- 18 their trades to their clients before clearing
- 19 because they're not the clearing member, their
- 20 clients are dealing with this. Will that mess up
- 21 that process? Will it make it more expensive? Do
- we inject operational risk versus counterparty

- 1 risk? What do you think?
- MR. RADHAKRISHNAN: I don't think so,
- 3 but we've asked a question to that effect as to
- 4 whether there will be something detrimental. But
- 5 the way I look at it is very similar to how bunch
- 6 orders are treated in the futures world. The
- 7 issue of allocation is one that takes place after
- 8 execution and after clearing because what you want
- 9 to make sure is you allocate positions. Let's say
- 10 you're a money manager and you've got 10 clients.
- 11 You execute say a block of 1,000 contracts and
- you're going to give 100 to each of them. In my
- 13 view what has to happen first is clearing. After
- 14 clearing then you as the money manager can decide
- which of your clients get the trade. So I don't
- see how clearing will affect the allocation
- 17 process, but we have asked the question. Maybe
- we're missing something.
- 19 COMMISSIONER O'MALIA: But that's not
- the way it's done now though. Right? You've met
- 21 with these folks in the swaps world and they come
- in and they say we have this and we allocate it to

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1 our customer in a bilateral deal.
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- 2 MR. RADHAKRISHNAN: In the uncleared
- 3 world.
- 4 COMMISSIONER O'MALIA: It's uncleared.
- 5 MR. RADHAKRISHNAN: Right.
- 6 COMMISSIONER O'MALIA: But if they're
- 7 going to clearing, there is no reason why
- 8 standardization of terms and conditions in the
- 9 previous question, we're going standardize these
- 10 products and we're going to have a lot more
- 11 cleared products. How do they manage that
- 12 relationship that they currently have today in
- this new environment?
- MR. RADHAKRISHNAN: The difference
- between the uncleared world and the cleared world
- is this. In the uncleared world, let's say you're
- 17 a money manager.
- 18 COMMISSIONER O'MALIA: I understand the
- 19 relationship today. I'm saying what are the
- 20 consequences going forward and how will this
- 21 relationship change and have we thought of that?
- MR. RADHAKRISHNAN: The consequence

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1 going forward is that once it's cleared you have a
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- central counterparty, the clearinghouse. So as
- 3 between the customer, the customer will have a
- 4 relationship with the clearing firm and according
- 5 to Dodd-Frank unless the money manager is also an
- 6 FCM, the money manager must have a relationship
- with a clearing FCM so that in this case the money
- 8 manager will be functioning as a CTA. Probably
- 9 will have to be a CTA. The key difference is that
- 10 you've got a clearinghouse in between. You don't
- 11 have say 10 counterparties. You got one clearing
- member, one clearinghouse. We don't see, in fact
- 13 we think this will make it easier to do the
- 14 allocation process because let's say you do a
- 15 1,000 lot trade, I'm the money manager and I give
- it to Phyllis who is a clearing member so this
- 17 clears it with John. It's done. Clearing takes
- 18 place. Then Phyllis will tell me you're done and
- 19 now go ahead and allocate how you want to
- 20 allocate. Of course Phyllis needs to know because
- 21 the clients that I allocated to are also Phyllis's
- 22 clients because they're all customers. So I think

1 that this will make allocations much easier just

- 2 as it has done in the futures world.
- 3 COMMISSIONER O'MALIA: So in a default
- 4 situation with a clearinghouse and you've cleared.
- 5 MR. RADHAKRISHNAN: I'm the money
- 6 manager?
- 7 COMMISSIONER O'MALIA: You're the money
- 8 manager and you've cleared with the clearinghouse.
- 9 MR. RADHAKRISHNAN: I have a
- 10 relationship with the clearinghouse.
- 11 COMMISSIONER O'MALIA: But you just
- 12 cleared with the clearinghouse and then you just
- 13 unloaded it on your customer. Who does the
- 14 clearinghouse now have the relationship with?
- MR. RADHAKRISHNAN: The clearinghouses?
- If the position does not belong to me, I'm just
- 17 the manager?
- 18 COMMISSIONER O'MALIA: But you cleared
- 19 it. You and the clearinghouse have now done the
- 20 deal.
- 21 MR. RADHAKRISHNAN: Actually what
- 22 happens is I have to tell all my customers to open

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1 an account with the clearing FCM. Unless I am the
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- 2 clearing FCM, I cannot engage, I cannot clear, I
- 3 cannot act as a clearing member for customers with
- a clearinghouse unless I'm an FCM. So if I choose
- 5 just to be a money manager which happens right
- 6 now, I choose just to be money manager, I will
- 7 tell my clients whoever I manage the money for, to
- 8 open an account with an FCM, whichever FCM they
- 9 choose just like it happens in futures. So the
- 10 relationship is between the client and the FCM and
- 11 the FCM and the clearinghouse. I'm just the
- 12 adviser.
- 13 COMMISSIONER O'MALIA: So to my original
- 14 question how will this change, I think you've just
- identified that that's how it will change.
- MR. RADHAKRISHNAN: Yes, it will change.
- 17 In fact, I think it will make it much more
- 18 rational and it will introduce the clarity in the
- 19 futures world to the cleared swaps world.
- 20 COMMISSIONER O'MALIA: Thank you.
- 21 CHAIRMAN GENSLER: That change to which
- you just referred and it's part of why we're

1 reaching out to talk about implementation phasing

- because these changes for money managers, for
- 3 asset managers and ultimately financial end users,
- 4 not the nonfinancial, but for the financial end
- 5 users, over time Dodd-Frank says that if it's
- 6 cleared you have to clear through a futures
- 7 commission merchant. Am I right?
- 8 MR. RADHAKRISHNAN: Correct. Dodd-Frank
- 9 says that if a swap has to be cleared or in fact
- 10 if it's voluntarily cleared at a DCO, it must be
- 11 done through a registered FCM. As far as a
- 12 customer is concerned, only a registered FCM can
- 13 clear the transaction at a clearinghouse for a
- 14 customer.
- 15 CHAIRMAN GENSLER: This rule is not
- doing that. That's done by statute.
- 17 MR. RADHAKRISHNAN: That's right.
- 18 That's right.
- 19 CHAIRMAN GENSLER: So the change to
- 20 which you refer, there is a statutory
- 21 construction.
- MR. RADHAKRISHNAN: Right. I look upon

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1 it as a processing change because right now in the
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- 2 bilateral world there is no clearinghouse and
- 3 there is no clearing member, so the money manager
- 4 executes swaps with a counterparty, but he or she
- is doing it for the people who they manage money
- from and I would imagine that after the execution
- 7 is done, the money manager will then have to
- 8 identify to the counterparty who its counterparty
- 9 is because that's what the money manager does
- 10 unless the money manager is choosing to act as a
- 11 counterparty.
- 12 COMMISSIONER O'MALIA: Do you have a
- sense of what this would do the cost relationship?
- 14 The paradigm with having all these pension funds
- and worker's money in this and they go to an asset
- 16 manager and they manage this fund, and now you're
- 17 breaking up that relationship and changing that.
- 18 What impact will that have on the individual
- 19 pension fund?
- MR. LAWTON: I would make one point. I
- 21 think that currently the individual parties would
- have to have a relationship with whoever the

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1 counterparty is and going forward they would have
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- to have a relationship with an FCM. They wouldn't
- 3 have to have a direct relationship with the
- 4 counterparty anymore because it's going to
- 5 clearing.
- 6 CHAIRMAN GENSLER: In my meetings with
- 7 some large asset managers, regardless of this rule
- 8 they've said we know that we need to do this
- 9 documentation, we hope that we have enough months
- 10 and that you will work into the implementation
- 11 process because of their customers will have to go
- 12 from ISDA agreements to agreements with futures
- commission merchants and I think that that's
- 14 regardless of this why it's very helpful to hear
- from the public on these documentation issues
- 16 because I think it will affect our implementation
- schedules, and it certainly influences my thinking
- 18 on implementation.
- 19 COMMISSIONER O'MALIA: That is a great
- 20 point, Mister Chairman. The relationship is
- 21 changing and it is a huge documentation challenge
- 22 and I'm glad you recognize that and we're going to

- 1 accommodate that.
- 2 CHAIRMAN GENSLER: There is a cumulate
- 3 effect of all the rules and what Congress passed
- 4 was to help promote transparency and lower risk,
- 5 but it's got to be implemented over time, some
- 6 things sooner, some things later.
- 7 COMMISSIONER O'MALIA: Just keep in mind
- 8 that these are pension funds, people who are
- 9 trying to find the most cost-effective way to
- 10 manage their money and get the best return, and
- 11 for us to change that relationship or increase the
- 12 cost is going to hurt.
- 13 CHAIRMAN GENSLER: But I'm hearing from
- 14 Ananda, Phyllis and John that this particular rule
- here isn't what causes that, those documentation
- 16 issues.
- 17 COMMISSIONER O'MALIA: Agreed, but this
- is the opportunity I took to highlight the
- 19 paradigm shift.
- 20 CHAIRMAN GENSLER: I'm glad you did.
- 21 Did you feel you needed a change on the comment
- 22 period? No. If there are no further questions.

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1 MR. STAWICK: Commissioner O'Malia?
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- 2 COMMISSIONER O'MALIA: Aye.
- 3 MR. STAWICK: Commissioner O'Malia, aye.
- 4 Commissioner Chilton?
- 5 COMMISSIONER CHILTON: Aye.
- 6 MR. STAWICK: Commissioner Chilton, aye.
- 7 Commissioner Sommers?
- 8 COMMISSIONER SOMMERS: Aye.
- 9 MR. STAWICK: Commissioner Sommers, aye.
- 10 Commissioner Dunn?
- 11 COMMISSIONER DUNN: Aye.
- MR. STAWICK: Commissioner Dunn, aye.
- 13 Mister Chairman?
- 14 CHAIRMAN GENSLER: Aye.
- MR. STAWICK: Mister Chairman, aye.
- 16 Mister Chairman, on this question the ayes are
- five, the nays are zero.
- 18 CHAIRMAN GENSLER: The vote being
- unanimous, we'll be looking forward to sending it
- 20 to the Federal Register and look forward to
- 21 hearing public comment on this. Then we turn to,
- I can't remember of it's Part 3 or Part 4 first.

1 Part 4 of the Commission regulation's conforming

- 2 amendments.
- 3 Chris Cummings and Barbara Gold, it's
- 4 good to see you again. You've done excellent work
- 5 and have presented here before on registration and
- 6 other matters. Chris worked on the FX rules as
- 7 well. They are going to present the first of what
- 8 I suspect will be not just two considerations
- 9 today, but a number of considerations over the
- 10 next several months about conforming amendments,
- 11 looking through our whole Rule Book to ensure that
- it aligns with the financial reform bill passed
- last year, but this will be the first one I'll
- turn it over to Ananda, Chris Cummings and Barbara
- 15 Gold.
- MR. CUMMINGS: Thank you, Mister
- 17 Chairman, Commissioners, ladies and gentlemen. My
- 18 name is Chris Cummings and I'm an attorney with
- 19 the Division of Clearing and Intermediary
- 20 Oversight.
- 21 The rulemaking we are recommending to
- 22 you today proposes to make conforming and

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technical changes to Part 4 of the Commission's
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- 2 regulations. It has been nicknamed the Part 4
- 3 Cleanup and not without some reason. Part 4
- 4 governs the operations and activities of commodity
- 5 pool operators and commodity trading advisers.
- 6 The Dodd-Frank Act expressly included swaps in the
- 7 activities that bring persons within the CPO and
- 8 CTA definitions. Accordingly, the cleanup process
- 9 this proposed rulemaking involved reviewing the
- 10 existing regulatory text in Part 4 and making sure
- 11 that it accomplishes the intended customer
- 12 protection goals with respect to swap activity
- undertaken by CPOs and CTAs. To the extent we
- 14 found that changes were called for, we have
- developed proposed amendments for Commission
- 16 consideration.
- 17 For the most part, the proposed changes
- 18 are not substantive. They include inserting the
- 19 word swap or swap transaction or similar wording
- 20 where the existing regulation refers to
- 21 transactions or instruments as to which a CPO or
- 22 CTA must for example disclose information, make

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1 reports or keep records. They also including swap
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- dealer among the persons with respect to which a
- 3 CPO or CTA must provide information or disclose
- 4 conflicts of interest.
- 5 Three of the proposed changes could be
- 6 characterized as substantive but too are simply
- 7 necessary adjustments to accommodate the
- 8 provisions of the Dodd-Frank Act. The first of
- 9 these changes results from the fact that in Part 4
- 10 the term commodity interest is used as a shorthand
- 11 term for the instruments currently regulated under
- 12 the Commodity Exchange Act, namely futures
- 13 contracts, commodity options and off-exchange
- 14 retail foreign exchange contracts. In order to
- 15 ensure that swaps are considered in the various
- 16 places where the term commodity interest is used
- in relation to the activities of CPOs and CTAs, we
- 18 recommend that Part 4 be amended to contain a
- 19 definition of the term commodity interest that
- includes swaps.
- 21 The second of the substantive changes
- 22 concerns Regulation 4.30 which currently prohibits

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a CTA from accepting customer margin money in the
 1
       CTA's own name unless the CTA is registered as for
       example a futures commission merchant. Because
 3
       swap dealers generally will come within the
       statutory definition of commodity trading advisers
       and because a swap dealer engaged in uncleared
       swap transactions may be accepting funds or other
 8
       property from its counterparties as variation and
       initial margin payments, we are recommending that
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10
       the Commission amend Regulation 4.30 to exclude a
       registered swap dealer from the regulation's
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12
       prohibition in connection with a swap that is not
       cleared through a derivatives clearing
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14
       organization. In connection with this
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       recommendation and at the request of the General
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       Counsel, we have included the following text in
17
       the preamble, "The Commission intends to address
18
       the circumstances in which nonbank swap dealers
19
       may be required or permitted to accept margin
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       payments in uncleared swap transactions in a
21
       future proposed rulemaking. Accordingly, this
22
       proposed amendment to Regulation 4.30 should not
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1 be interpreted to impose or authorize any such

- 2 margin requirement."
- 3 The third and final substantive change
- 4 we are recommending is deletion of Regulation 4.32
- 5 which deals with trading by a registered CTA on or
- 6 subject to the rules of a derivatives transaction
- 7 execution facility or DTEF. Since the Dodd-Frank
- 8 Act does away with DTEF, this provision no longer
- 9 served a purpose.
- 10 That's about all there is to say about
- 11 this proposal. We would be happy to answer any
- 12 questions you have.
- 13 CHAIRMAN GENSLER: At this time I'll ask
- for a motion to accept the staff recommendation on
- 15 Part 4 on conforming amendments.
- 16 COMMISSIONER DUNN: So moved.
- 17 COMMISSIONER SOMMERS: Second.
- 18 CHAIRMAN GENSLER: I don't have any
- 19 particular question. For the public as Chris
- said, these are cleanup but they're on really
- 21 important rules, Part 4. It has been in place for
- 22 some time. Maybe I should ask for how long. Some

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of it probably predates our Commission. Is that
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- 2 right? When did this go into effect?
- MS. GOLD: Commodity pool operators and
- 4 commodity trading advisers were added to the
- 5 Commission's jurisdiction when the Commission
- 6 itself was established in 1974. Rules to regulate
- 7 CPOs and CTAs I believe first came out around 1977
- 8 and the regulatory scheme we're working with was
- 9 first adopted and issued by the Commission in
- 10 1979.
- 11 CHAIRMAN GENSLER: What I understand
- you've done is you've looked through all of Part 4
- and said given that the Dodd-Frank Act now
- includes in the definition of commodity pool
- operators and commodity trading advisers advising
- or pooling swaps, you've looked through it and as
- 17 you say you've done this conforming or cleanup.
- 18 Is that right, Chris?
- 19 MR. CUMMINGS: That is correct.
- 20 CHAIRMAN GENSLER: It would be helpful
- 21 also from the public's perspective if we hear any
- comments on Part 4, not just related to swaps.

1 These are 30-plus-year-old rules. Are there

- 2 comments?
- MS. GOLD: I would agree, but I would
- 4 note that they are 30-plus-year-old rules. From
- 5 time to time over the course of the past 30 years
- 6 they have been amended.
- 7 CHAIRMAN GENSLER: Of course. They
- 8 might be 30 years vintage, but they've been
- 9 refreshed. Thank you. Commissioner Dunn?
- 10 COMMISSIONER DUNN: Thank you, Mister
- 11 Chairman. I don't have any problems with this,
- but I'm going to ask on Part 4 and Part 3 as well,
- will these cleaned-up versions be put on our
- 14 website so that the public will have an
- opportunity to see what it looks like after
- 16 everything is put together at the end of the day?
- 17 Usually we wait until somebody prints one of those
- 18 books that gives us all our regulations and I'm
- 19 wondering how will the public be able to access
- this before such publication?
- 21 MS. GOLD: I will tell you. Perhaps 10
- 22 years ago the Code of Federal Regulations started

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1 publishing on its website an electronic version
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- and when you access the Commission's rules through
- 3 our website, that link is to the electronic Code
- 4 of Federal Regulations and the great thing about
- 5 that is it says right across the top "These
- 6 regulations are current as of " and typically the
- 7 regulations are current within two or 3 days of
- 8 the website's date.
- 9 COMMISSIONER DUNN: Thank you. Barbara,
- 10 you're just a great source of knowledge.
- 11 CHAIRMAN GENSLER: Commissioner Sommers?
- 12 COMMISSIONER SOMMERS: I don't have any
- 13 questions. Thank you.
- 14 CHAIRMAN GENSLER: Commissioner Chilton?
- 15 COMMISSIONER CHILTON: Just a quick one.
- I know this isn't an attention-grabbing headline
- thing, but these are important day-to-day
- 18 operations and I'm curious if you think there will
- 19 be any major pushback on anything from industry on
- these.
- 21 MR. CUMMINGS: We're not expecting any
- 22 kind of controversy at all on these. This is just

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1 simple reflex cleanup of things that are direct
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- 2 results of the enactment of the Dodd-Frank Act.
- 3 COMMISSIONER CHILTON: Thank you.
- 4 CHAIRMAN GENSLER: Thank you,
- 5 Commissioner Chilton. Commissioner O'Malia?
- 6 COMMISSIONER O'MALIA: I have one
- 7 question. I'm curious. In Rule 4.24, General
- 8 Disclosures, we require CPOs and CTAs to disclose
- 9 "any fees, costs or fees included in the spread
- 10 between bid and ask prices for retail Forex or swap
- 11 transactions." We've added swap transactions to
- this language that's already existing. How will
- that work? What costs are we thinking about?
- 14 Then for things that are transacted on a SEF, how
- is that going to work? I'm just trying to figure
- out what costs might be out there and how will
- 17 they be disclosed.
- 18 MR. CUMMINGS: This provision was
- introduced initially to cover the retail Forex market
- where it's the bid- ask spread or points or PIPs
- over or above and that sort of thing for
- 22 calculating what the customer pays and what the

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1 counterparty who is the dealer at the same time
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- 2 receives for income. The idea here is to try to
- 3 capture that the pool operator knows about that
- 4 amounts to a fee or cost to the customer that may
- 5 or may not be contained in a quoted bid-ask spread
- 6 or otherwise.
- 7 COMMISSIONER O'MALIA: Is the SEF and
- 8 the retail Forex relationship completely analogous?
- 9 MR. CUMMINGS: Certainly not because a
- 10 SEF would be an exchange and the retail Forex is
- 11 basically a counterparty-to-customer relationship.
- MR. RADHAKRISHNAN: But to the extent
- that you have bilateral transactions, I think
- 14 that's analogous because in an exchange
- 15 environment you have the bid-ask spread and then
- there will be a separate or commission or whatever
- it is and to the extent the CPO knows about it,
- 18 has to disclose it. But sometimes in bilateral
- 19 transactions there is the price plus something
- 20 else. So the extent the CPO knows about it, he or
- 21 she should disclose it.
- 22 MR. CUMMINGS: If it would help, we can

1 add to the language any costs or fees included if

- 2 known.
- 3 COMMISSIONER O'MALIA: That would be
- 4 helpful I think. Thank you.
- 5 CHAIRMAN GENSLER: I'd ask for unanimous
- 6 consent. Not hearing any objection, so moved.
- 7 COMMISSIONER O'MALIA: Thank you very
- 8 much. Maybe Mr. Stawick if you'd call the roll
- 9 and by the time we figure out Robert's Rules he'll
- 10 be back in.
- 11 MR. STAWICK: Commissioner O'Malia?
- 12 COMMISSIONER O'MALIA: Aye.
- MR. STAWICK: Commissioner O'Malia, aye.
- 14 Commissioner Chilton?
- 15 COMMISSIONER CHILTON: Aye.
- MR. STAWICK: Commissioner Chilton, aye.
- 17 Commissioner Sommers?
- 18 COMMISSIONER SOMMERS: Aye.
- 19 MR. STAWICK: Commissioner Sommers, aye.
- 20 Commissioner Dunn?
- 21 COMMISSIONER DUNN: Aye.
- 22 MR. STAWICK: Commissioner Dunn, aye.

- 1 Mister Chairman?
- 2 CHAIRMAN GENSLER: Aye.
- 3 MR. STAWICK: Mister Chairman, on this
- 4 question the ayes are five, the nays are zero.
- 5 CHAIRMAN GENSLER: It having passed, I
- 6 look forward to send this one to the Federal
- 7 Register as well. Ananda, we'll move to Part 3.
- 8 Thank you, Barbara, and thank you, Chris.
- 9 Excellent work.
- 10 MR. RADHAKRISHNAN: Mister Chairman and
- 11 Commissioners, Andrew Chapin, Associate Director
- in DCIO, and Claire Noakes, Special Counsel, will
- be presenting on registration of intermediaries.
- MR. CHAPIN: Thank you, Ananda. Good
- morning, Mister Chairman, good morning to the rest
- of the Commissioners. As an opening thought, I
- 17 will say that it's not my intent to simply recite
- 18 each of the provisions that are addressed in the
- 19 proposal. Many of these provisions are technical
- in nature or otherwise self-explanatory. Instead
- 21 I would like to more broadly discuss the intent
- and purpose behind this proposal.

1	As likely has been mentioned numerous
2	time, Title VII of the Dodd-Frank Act amended the
3	Commodity Exchange Act to establish a
4	comprehensive new regulatory framework to reduce
5	risk, increase transparency and promote market
6	integrity within the financial system by among
7	other things providing for the registration and
8	comprehensive regulation of swap dealers and major
9	swap participants. The Notice of Proposed
10	Rulemaking that we are here to discuss today sets
11	forth proposed regulations to further implement
12	these new statutory provisions consistent with
13	other Commission rulemakings and to make other
14	improvements to Part 3 of the regulations
15	regarding the registration of intermediaries.
16	The Commission's existing registration
17	process for futures, commotion options and retail
18	foreign-exchange intermediaries, their associated
19	persons, floor brokers and floor traders is set
20	forth in Part 3. Currently Part 3 does not
21	address the categories of swap dealers and major
22	swap participant. Nor does it reference swap

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1 execution facilities, a new market category for
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- 2 swap transactions created by Dodd-Frank.
- 3 The proposed revisions would provide
- 4 generally that the mechanics for registration
- 5 applicable to intermediaries engaged in certain
- 6 commodity interest transactions such as futures,
- 7 commodity options and retail foreign exchange
- 8 would similarly extend to the intermediaries
- 9 engaged in swap transactions. In other words,
- 10 this proposal would amend Part 3 to conform the
- 11 regulations regarding the mechanics of
- 12 registration by incorporating references to swap
- dealers, major swap participants and SEFs where
- 14 appropriate.
- 15 As a result, swap dealers and major swap
- 16 participants would for example be required to file
- 17 the same types of registration documents, be
- 18 required to maintain accurate identifying
- information and follow the same procedures for the
- 20 withdrawal of their registration as any other
- 21 derivatives registrant. It is worth noting that
- this regulation also would delete references to

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derivatives transaction execution facilities or
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- 2 DTEFs from Part 3. As was previously mentioned,
- 3 this term was abolished as a market category by
- 4 Dodd-Frank.
- 5 In addition to these conforming
- 6 amendments, the proposal today sets forth certain
- 7 modernizing and technical amendments. In
- 8 anticipation of an influx of new registrants
- 9 unfamiliar with the Part 3 requirements, the
- 10 proposal would improve Part 3 to make it more user
- 11 friendly. Among other improvements, the proposal
- will amend Part 3 to reflect current registration
- 13 practices of the National Futures Association and
- 14 clarify the standard under which a registrant may
- 15 simply amend its registration rather than
- 16 withdrawal and reregister due to changes to a
- 17 legal name or form of organization in conjunction
- 18 with a change in principles. It will consolidate
- 19 multiple references currently contained in various
- 20 provisions of Part 3 into a single appropriate
- 21 location. It would improve the consistency of
- terms across Part 3. Lastly, it will update

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1 cross-references to other regulations.
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- With that I will conclude my remarks and
- 3 we are prepared to answer any questions. Thank
- 4 you, Mister Chairman.
- 5 CHAIRMAN GENSLER: I'll entertain a
- 6 motion on accepting the staff recommendation on
- 7 conforming amendments on Part 3.
- 8 COMMISSIONER DUNN: So moved.
- 9 COMMISSIONER SOMMERS: Second.
- 10 CHAIRMAN GENSLER: I too will be
- 11 supporting this rule. As I understand it beyond
- the sort of the cleanup and technical, the main
- thing is to move the words swap dealer and major
- swap participant in where it's appropriate. Is
- 15 that the main thrust of this?
- MR. CHAPIN: That is correct.
- 17 CHAIRMAN GENSLER: Because this part,
- Part 3, is largely about intermediaries. How does
- 19 Part 3 work with the business conduct and other
- 20 rules that we've proposed and not yet moved to
- 21 final on?
- 22 MR. CHAPIN: Part 3 simply deals with

1 the mechanics of registration in how the firm must

- 2 identify itself to the Commission and to the
- 3 National Futures Association as it becomes a
- 4 registered entity.
- 5 CHAIRMAN GENSLER: So that Part 3 is not
- a set of affirmative obligations, it's more about
- 7 if I might call it process and procedure.
- 8 MR. RADHAKRISHNAN: Correct. And then
- 9 you go to Part 22 I guess.
- 10 CHAIRMAN GENSLER: Part what?
- MR. RADHAKRISHNAN: The new part that
- deals with business conduct. Once you are
- 13 registered as a swap dealer or an MSP, look at
- 14 this part and follow those rules.
- 15 CHAIRMAN GENSLER: Thank you.
- 16 Commissioner Dunn?
- 17 COMMISSIONER DUNN: I have no questions.
- 18 CHAIRMAN GENSLER: Commissioner Sommers?
- 19 COMMISSIONER SOMMERS: I don't have any
- questions.
- 21 CHAIRMAN GENSLER: Commissioner Chilton?
- 22 COMMISSIONER CHILTON: No questions.

1	CHAIRMAN	GENSLER:	Commissioner	O	'Maila <i>:</i>

- 2 COMMISSIONER O'MALIA: There is language
- 3 in the proposal that discusses exempting
- 4 individuals from registration as a swap dealer or
- 5 an MSP if they're employed by a swap dealer or
- 6 MSP. How many individuals have we potentially
- 7 identified who could become swap dealers or MSPs?
- 8 MS. NOAKES: I think that proposal is
- 9 intending to ensure that due to the broad nature
- of the definition of swap dealer and MSP, arguably
- if I as an employee, an associated person with a
- swap dealer, look at the definition, I might
- arguably fit into it. So this is just to
- 14 affirmatively state we are not intending those
- persons to fall into that category if they are in
- 16 fact associated persons of a swap dealer or major
- 17 swap participant.
- 18 COMMISSIONER O'MALIA: I certainly don't
- 19 disagree with your characterization of a broad
- definition.
- 21 CHAIRMAN GENSLER: Thank you. Mr.
- 22 Stawick?

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1 MR. STAWICK: Commissioner O'Malia?
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- 2 COMMISSIONER O'MALIA: Aye.
- MR. STAWICK: Commissioner O'Malia, aye.
- 4 Commissioner Chilton?
- 5 COMMISSIONER CHILTON: Aye.
- 6 MR. STAWICK: Commissioner Chilton, aye.
- 7 Commissioner Sommers?
- 8 COMMISSIONER SOMMERS: Aye.
- 9 MR. STAWICK: Commissioner Sommers, aye.
- 10 Commissioner Dunn?
- 11 COMMISSIONER DUNN: Aye.
- MR. STAWICK: Commissioner Dunn, aye.
- 13 Mister Chairman?
- 14 CHAIRMAN GENSLER: Aye.
- MR. STAWICK: Mister Chairman, aye.
- 16 Mister Chairman, on this question the yeas are
- 17 five and the nays are zero.
- 18 CHAIRMAN GENSLER: Thank you, Ananda,
- 19 Claire and Andrew. With the vote being unanimous,
- 20 we'll send this one to the Federal Register as
- 21 well. Ananda, I guess you get to step up and
- 22 we'll have the group with regard to interpretive

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1 guidance with Bob Pease. Who else is coming up?
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- 2 Vince is coming up? Is Steve also going to be
- 3 here?
- 4 MR. PEASE: Yes, Steve will be here.
- 5 CHAIRMAN GENSLER: Does he speak first?
- 6 MR. PEASE: No. I'm going to go first.
- 7 CHAIRMAN GENSLER: Then we're going to
- 8 keep moving.
- 9 MR. PEASE: Good morning, Mister
- 10 Chairman and Commissioners. Staff is recommending
- 11 that the Commission issue a proposed interpretive
- order providing guidance on the three disruptive
- trading practices in new Section 4(c)(A)(V) of the
- 14 Commodity Exchange Act.
- 15 CHAIRMAN GENSLER: Let me mention, Bob,
- 16 that you might move the mike closer because I
- don't know if it's going to be picked up.
- 18 MR. PEASE: The first prohibition of
- 19 Section 4(c)(A)(V) makes it unlawful to violate
- 20 bids or offers. Persons must transact at the best
- 21 available economic price. This prohibition on
- violating bids and offers applies in any trading

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1 environment where a person exercises some control
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- over the selection of bids or offers. This
- 3 prohibition applies to the specific trading
- 4 environment where the trading takes place. It
- 5 does not require market participants to search
- 6 multiple trading platforms for the best bid or
- offer. This section does not apply where a person
- 8 is unable to violate a bid or offer such as an
- 9 exchange automated matching engine. This
- 10 prohibition again does not apply to block trades,
- 11 bilateral noncleared swap transactions or exchange
- for physicals provided that the transaction
- complies with the rules of the DCM or SEF on which
- 14 it is traded.
- The second prohibition of Section
- 4(c)(A)(V) prohibits anyone from intentionally or
- 17 recklessly disregarding orderly execution of
- 18 transactions during the closing period. This
- 19 proposed order interprets the closing period to be
- 20 generally defined as the period in the contract or
- 21 trade when the daily settlement price is
- 22 determined under the rules of the trading

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1 facility. For example, with an IMEX natural
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- 2 contract the closing period is defined as the last
- 3 30 minutes of the last day of trading, while with
- 4 CBOT treasuries it is defined as the last 60
- 5 seconds.
- 6 While the proposal interprets the
- 7 prohibition in Section 4(c)(A)(V)(b) to accomplish
- 8 any trading, conduct or practices occurring inside
- 9 the closing period that affects the orderly
- 10 execution of transactions during the closing
- 11 period, potential disruptive conduct outside that
- 12 period may nevertheless form the basis for an
- investigation or potential violations under this
- 14 section. The proposed interpretive order reaches
- bids or offers as well as executed orders.
- The final provision of 4(c)(A)(V)
- 17 prohibits conduct that is or is of the character
- of spoofing. Under the Act, spoofing is defined
- 19 as bidding or offering with the intent to cancel
- 20 the bid or offer before execution. The proposed
- 21 order identifies the following examples of the
- 22 character of spoofing: submitting or cancelling

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1 bids or offers to overload the quotation system of
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- 2 a registered entity; submitting or cancelling bids
- or offers to delay another person's execution of
- trades; and submitting or cancelling multiple bids
- 5 or offers to create an appearance of false market
- 6 depth. This proposed interpretive order provides
- 7 that orders, modifications or cancellations will
- 8 not be classified as spoofing as they were
- 9 submitted as a legitimate, good-faith attempt to
- 10 consummate a trade. As an intent-based violation,
- 11 the Commission may look to patterns of trading
- 12 activity to examine whether the trading
- 13 constitutes spoofing. Spoofing does not cover
- 14 nonexecutable market communications. This
- proposed order provides for a 60-day comment
- 16 period on all aspects of the proposed order. An
- interpretive order once it becomes final agency
- 18 action would have the same force and effect as a
- 19 final rule.
- 20 Before concluding we would like to thank
- 21 the members of the antidisruptive trading teams,
- 22 Mark Higgins and Jerry Kuzamano from Enforcement,

- 1 Steve Seitz, Ralph Avery and Mary Connolly from
- the Office of General Counsel, Christian Sonenson
- 3 and Mike Penneck from OCE and Dave Cass and Jim
- 4 Goodwin from DMO. With that we'd be happy to
- 5 answer any questions you may have.
- 6 CHAIRMAN GENSLER: First I'd entertain a
- 7 motion on the staff recommendation on an
- 8 interpretive order on Section 747, Disruptive
- 9 Trading Practices.
- 10 COMMISSIONER DUNN: So moved.
- 11 COMMISSIONER SOMMERS: Second.
- 12 CHAIRMAN GENSLER: Thank you to the
- 13 team. I have a number of questions. My first
- 14 relates to scope. How does this relate to first
- 15 futures, and then my next question is swaps and my
- third if bilateral versus traded? I'm trying to
- 17 understand. I think I do understand it, but if
- 18 you can help the public understand what is the
- 19 scope of disruptive trading practices?
- MR. PEASE: The scope would apply to all
- of the above.
- 22 CHAIRMAN GENSLER: It applies to futures

- 1 and swap?
- 2 MR. PEASE: Yes.
- 3 CHAIRMAN GENSLER: Does it only apply to
- 4 on- exchange traded futures and on-exchange or SEF
- 5 traded swaps?
- 6 MR. PEASE: The statute would apply to
- 7 trading or any trading subject to the rules of the
- 8 registered entity if that's what you're asking.
- 9 CHAIRMAN GENSLER: A registered entity.
- 10 I guess my question is are bilaterals not covered
- 11 by 747?
- MR. PEASE: Bilaterals and noncleared as
- we said at the beginning would not be covered.
- 14 CHAIRMAN GENSLER: So the scope is
- 15 futures and the scope is swaps that are on a
- 16 registered entity, thus bilaterals are not
- 17 covered.
- MR. BERKOVITZ: That's correct.
- 19 CHAIRMAN GENSLER: That's the scope.
- I'm now going to ask a little bit about what you
- 21 just said about this has the same force and
- 22 effect. I want to follow-up on those words and

- 1 what you meant by that.
- 2 MR. PEASE: An interpretive order should
- 3 it become final has the same force and effect as a
- final rule. The order is given the same weight by
- 5 the courts as a preamble to a final rule. An
- 6 interpretive order is thus the same as any other
- 7 order issued by the Commission and is guidance
- 8 that the public can reply upon once that order
- 9 becomes final agency action.
- 10 CHAIRMAN GENSLER: Then if somebody is
- doing a bilateral swap, they're not covered by
- 12 747. That was my first question. This question
- is if you're trading on a swap execution facility
- or on a designated contract market, you can rely
- on this once we go final and based on public
- 16 comment, but you can rely on it and if you're
- doing the things in here that we say are okay,
- 18 you're fine.
- MR. PEASE: That's correct.
- MR. BERKOVITZ: I would agree that that
- 21 is correct.
- 22 CHAIRMAN GENSLER: Now my third question

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1 is that I think this has addressed many of the
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- comments, maybe not all of the comments, but many
- of the comments we heard in the roundtables and in
- the letters. I think was somewhere close to 30
- 5 comment letters that came in. Would it be fair to
- 6 say that this in effect narrows the number of
- 7 things that could be considered to be a violation
- 8 of the statute?
- 9 MR. PEASE: Yes. The statute would
- 10 become effective regardless of any action by the
- 11 Commission 1 year after the date of the enactment.
- 12 By putting parameters on it and providing this
- guidance, we are narrowing the scope of these
- 14 rules.
- 15 CHAIRMAN GENSLER: I think it's
- 16 appropriate and I support this because to use as
- 17 an example, I've heard from some commentors in
- 18 their letters and in the roundtable that if they
- 19 sent an order to an exchange and they planned to
- 20 by 100 contracts but they send a 200-contract
- order, they were concerned somehow somebody could
- 22 say that would be an intent to cancel, and we've

- 1 clarified that that's not going to be.
- 2 MR. PEASE: That's correct. You have to
- 3 have the intent to cancel bids or offers prior to
- 4 them being executed. If your intent was to get a
- 5 partial fill of a better offer, that would not be
- 6 covered.
- 7 CHAIRMAN GENSLER: Partial fills are not
- 8 a violation?
- 9 MR. PEASE: A partial fill with the
- intent to consummate a trade is not a violation.
- 11 CHAIRMAN GENSLER: One other area and I
- 12 know staff is still working on it which I think is
- very important is that we not only look here, but
- we review more broadly supervision and testing. I
- know that the Joint Advisory Committee last week
- 16 recommended that we take a close look at that.
- 17 Also, and I know Commissioner O'Malia has worked
- 18 closely with staff on this, that in the designated
- 19 contract market and the SEF, proposed rules that
- 20 there be a lot of responsibility there to make
- 21 sure the integrity of their markets if I can
- 22 paraphrase. I know Commissioner Chilton has

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1 raised this, I think all five of us are really
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- looking forward to hear staff's recommendations on
- 3 supervision and testing as it relates to these
- 4 practices but then more broadly with regard to
- 5 algorithmic trading in the modern world.
- 6 MR. PEASE: Those are your next steps,
- 7 Mister Chairman.
- 8 CHAIRMAN GENSLER: Thank you.
- 9 Commissioner Dunn?
- 10 COMMISSIONER DUNN: Thank you, Mister
- 11 Chairman. Let me refer to page 12 of the copy I
- 12 have. I'm working off of one I had last Friday so
- 13 I don't know if that's still relevant of not. It
- says, "In sum the Commission believes the market
- 15 participant should assess market conditions and
- 16 consider how their trading practices and conduct
- 17 affects the orderly execution of transactions
- during the closing period." I would like to know
- 19 how do they do that assessment, and in particular,
- 20 how do they do it if they're doing algorithmic
- 21 trading?
- MR. PEASE: What we're talking about

- 1 there is using the existing concepts of
- orderliness. We're not trying to create new
- 3 ground here. So they would look to the rational
- 4 relationship between consecutive prices, levels of
- 5 volatility, supply and demand, the relationship
- 6 between the price of a derivative and the
- 7 underlying physical commodity. We give some
- 8 examples of that in the proposed order.
- 9 COMMISSIONER DUNN: Are we assuming then
- 10 if someone is trading with an algorithm that
- 11 that's built into that algorithm?
- MR. PEASE: Yes.
- 13 COMMISSIONER DUNN: I really look
- 14 forward to see the comments on this. I want to
- thank the folks who commented on the advanced
- 16 notice of proposed interpretation that went out
- and the members of that roundtable because this is
- 18 something I'm having difficulty getting my arms
- 19 around and I really, really need the general
- 20 populace to help me with it.
- 21 CHAIRMAN GENSLER: Thank you,
- 22 Commissioner Dunn. I think I agree with that.

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1 I'm glad to see that we're putting something out
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- 2 that does narrow and addresses some of the
- 3 concerns that Commissioners have raised about
- 4 ambiguities with regard to the statute. I suspect
- 5 the public will tell us where they think there are
- 6 still additional ambiguities. Commissioner
- 7 Sommers?
- 8 COMMISSIONER SOMMERS: Thank you, Mister
- 9 Chairman. As I stated in my opening statement, I
- 10 have a lot of different concerns about this
- 11 proposal not really clarifying where the statute
- 12 was vague. Bob, with all due respect, I think
- that your answers to the Chairman's questions
- 14 created even more confusion for me. On the first
- subject when the Chairman asked with regard to the
- 16 scope of this proposal, you said that it didn't
- 17 apply to bilateral noncleared swaps, but does it
- say that anywhere in this proposal that the scope
- of this proposal does not apply to bilateral
- 20 noncleared swaps? In the section with regard to
- violating bids and offers it says that it will not
- 22 apply to bilateral swap transactions, but I took

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1 that to mean just A did not apply to bilateral
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- swap transactions. It doesn't say noncleared. Do
- 3 B and C also not apply to bilateral noncleared
- 4 swaps?
- 5 MR. MCGONAGLE: Commissioner, to follow
- on first on the section talking about where the
- 7 transactions are, continuing on into the footnote,
- 8 footnote number 36 to have the full context, the
- 9 proposed interp says that in addition to EFPs, the
- 10 Commission believes that the legitimate execution
- of exchanges for swaps, exchanges for options,
- 12 exchanges for risk and for any other transaction
- 13 that may be negotiated and executed bilaterally
- under the rules of a designated contract market or
- a SEF will not violate 4(c)(A)(V). With respect
- 16 to the first question, I think that we're clearly
- 17 saying that bilaterally negotiated swaps are not
- 18 part of the intent of the first part of the rule.
- 19 But the broader question as to whether they would
- get swept in under spoofing or the orderly
- 21 execution turns on on or subject to a registered
- 22 entity. So if the transaction is subject to the

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1 rules of a registered entity, then spoofing or
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- 2 orderly trading may be picked up, but absent any
- 3 further evaluation of that particular issue of how
- does a bilateral swap get to a registered entity,
- 5 I think the answer is no, that it's outside of the
- 6 provision of disruptive practices.
- 7 COMMISSIONER SOMMERS: Is it possible
- 8 for us to state that more clearly, that the scope
- 9 of this proposal does not apply to bilateral
- 10 noncleared swaps unless it's subject to the rules
- of a registered entity or whatever you just said?
- MR. MCGONAGLE: Yes. I think we can in
- the proposed iteration for a final interpretation
- spell out more clearly the preamble to A, B and C
- of the section to discuss what it means for
- 16 engaging in trading practice of conduct on or
- subject to the rules of a registered entity.
- 18 COMMISSIONER SOMMERS: I didn't know
- 19 that until you asked the question about scope so
- 20 that it brought that up.
- 21 CHAIRMAN GENSLER: I apologize. I
- 22 wanted to clarify. I thought that's what Congress

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1 did too. I always thought that disruptive trading
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- 2 practices meant something being on a trading
- 3 platform and that's why I asked the question and
- 4 they confirmed it.
- 5 COMMISSIONER SOMMERS: It just doesn't
- 6 say that. Your second question with regard to
- 7 partial fills, in the spoofing section of the
- 8 proposal it actually says that a partial fill does
- 9 not automatically exempt activity from being
- 10 classified as spoofing. What I understood the
- answer to the Chairman's question to be is that
- 12 partial fills without an intent element would not
- be a violation of C, but it doesn't say that here.
- 14 It says that partial fills aren't exempt.
- 15 MR. PEASE: If we're not clear there, we
- 16 can make it clear. The idea is there could be
- 17 circumstances where the intent is to engage in
- 18 spoofing, say for example, but because it is then
- 19 a bid and offer out there and before it's
- 20 cancelled it could possibly be hit and could
- 21 possibly have a partial fill. The idea here is
- that it must be intent based and the intent must

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1 be to engage in spoofing regardless of whether it
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- is partial fill or any other type of transaction.
- 3 COMMISSIONER SOMMERS: Thank you. I
- 4 certainly don't disagree with that. I am
- 5 suggesting that perhaps it's not as clear as what
- 6 your answer to the question was.
- 7 CHAIRMAN GENSLER: Let me ask. The
- 8 sentence, we could get out of the transcript your
- 9 answer to my question, but I'd ask for unanimous
- 10 consent that his sentence that answered the
- 11 question be put in here on that partial fill.
- 12 I'll for unanimous consent for that.
- 13 COMMISSIONER SOMMERS: I have no
- 14 objection to that.
- 15 CHAIRMAN GENSLER: You have no objection
- 16 to that?
- 17 COMMISSIONER SOMMERS: Thank you.
- 18 Moving on and going back to the questions I was
- 19 going to ask, the Chairman's questions just
- 20 brought up a couple of other questions for me. On
- 21 A, violating bids and offers, we had a lot of
- comment with regard to this area with regard to

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1 whether or not we needed to show intent in A. We
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- 2 have decided that we're not required to because
- 3 the Act doesn't require us to show that a person
- 4 violating a bid or an offer did so with the intent
- 5 to disrupt fair and equitable trading, but we
- 6 could have put that in. Do we have to show that a
- 7 person intended to violate a bid or an offer?
- 8 Should we show that a person even know of the
- 9 existence of a better bid or an offer? I'm trying
- 10 to understand without the intent element how we
- 11 move forward with this.
- MR. PEASE: We of course look forward to
- what commentors will have to say at this issue,
- 14 but when we looked at the three provisions
- together and the way Congress drafted the three
- 16 provisions together, Congress specifically put in
- an intent and a reckless requirement in the
- 18 closing period provision and put in intent and
- 19 specifically mentioned that in the spoofing
- 20 provision without putting in recklessness. So
- 21 what staff is recommending here is consistent with
- 22 the words that Congress gave us in this provision

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1 and since Congress did not give us an intent
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- 2 requirement here, we did not recommend that an
- 3 intent requirement applied to the violating bids
- 4 or offers.
- 5 MR. MCGONAGLE: Just a quick add-on,
- 6 with respect to the intent, differentiating the
- 7 intent, I think as you articulated the intent to
- 8 enter into a trade or put a bid or an offer that
- 9 you know is violating where the market currently
- 10 is versus an intent to put in a bid or an offer
- 11 with the intent to cause a disruption in the
- 12 market. Part of the interpretive guidance was
- addressing this latter issue that there isn't
- 14 specific intent required for subsection A to cause
- a disruptive effect to fair and equitable trading.
- 16 But as to the question as to whether what level of
- intent needs to be shown concerning the intent to
- 18 put a bid an offer that violates the market, I
- 19 think that's appropriate for comment and
- 20 consideration in the next round.
- 21 COMMISSIONER SOMMERS: That we could
- 22 potentially clarify more in this area after

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1 comment that a person would have to actually know
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- of the existence of better bids or offers.
- 3 MR. MCGONAGLE: I would expect that some
- 4 commentators would consider for example other
- 5 prohibited practices under 4(c), in particular
- 6 wash sales and what has the Commission articulated
- 7 with respect to the burden in wash sales and
- 8 whether or how that should relate to this new
- 9 disruptive practice.
- 10 COMMISSIONER SOMMERS: Moving on to B,
- 11 with regard to the orderly execution during the
- 12 closing period, it seems to me like we should have
- more of a focus in this area on protecting the
- 14 integrity of the settlement price so that I'm
- wondering because we mentioned settlement price
- but we don't expressly say that this intent should
- 17 have the impact on the settlement price and I'm
- wondering what your thoughts are on not expressly
- 19 having -- sorry, ultimate goal.
- MR. PEASE: When you get to discussing
- 21 an effect on price I think you're moving more away
- from an disruptive trading practice and into a

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1 manipulation matter and Congress separated out
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- these two provisions and did not lump disruptive
- 3 trading in with manipulation. The difference is
- 4 that in manipulation unlike disruptive trading you
- 5 don't require showing the person engaged in fraud
- or acted with the specific intent to create an
- 7 artificial price. I think the situation that
- 8 you're covering in terms of affecting the
- 9 settlement price may be better prosecuted under
- 10 manipulation.
- 11 COMMISSIONER SOMMERS: I guess I've
- 12 always assumed that if anyone is executing orders
- in a disruptive fashion in the closing period that
- 14 their intent to be to affect the settlement price
- 15 because that would benefit them. Why would
- someone act recklessly in the closing period for
- any other reason than to affect the settlement
- 18 price?
- MR. PEASE: That's a good question,
- 20 Commissioner, and that's where the two provisions,
- 21 manipulation and the disruptive trading during the
- 22 closing period overlap. I think it's just the

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1 level of proof that you would need in the way
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- 2 Congress set it out in these two provisions, what
- 3 proof you would need to establish a violation of
- 4 Section 747 or a violation of the manipulation
- 5 provisions.
- 6 COMMISSIONER SOMMERS: I'll move on to
- 7 spoofing. I think my overall concerns with
- 8 spoofing is that there is not a specific
- 9 definition of what spoofing is. When reviewing
- 10 some of the comment letters, I felt like at least
- in my view that some of the comment letters gave
- us some very good suggestions for how we could
- 13 potentially define spoofing, for having the
- 14 purpose of misleading market participants to
- benefit a person's own position and I think that
- 16 several different commentors commented in one way
- or another with those types of words. Why haven't
- we put some sort of proposal for defining
- 19 spoofing?
- 20 MR. PEASE: We think that the statute
- 21 defines spoofing and the statute defined it as the
- 22 intent to cancel the bid or offer before execution

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1 so that this is a specific-intent requirement
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- 2 here. Recklessness would not apply under the
- 3 proposed guidance that you have before you, so
- 4 that it would be a specific intent to enter into
- 5 these transactions and your intent at the time is
- 6 to send a false signal into the market and to not
- 7 engage in a completed transaction and that's what
- 8 we think the statute is providing for.
- 9 COMMISSIONER SOMMERS: I don't disagree
- 10 with that either. I was wondering if perhaps it
- 11 would be more beneficial to have more clarity
- 12 around legitimate versus illegitimate behavior.
- MR. MCGONAGLE: The proposed
- 14 interpretation does talk about outlining where
- 15 trading activity -- evaluate it so see whether
- there is an overload of the quotation system or
- delay another person's execution of trades or
- 18 creating the appearance of false market depth. We
- 19 are looking with the specific intent to nefarious
- 20 types of activity that's going to cause price
- 21 disruption so the extent that I think more
- 22 examples would be illustrative, I think that's

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1 something that we can consider again going through
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- 2 this next round. But the idea for spoofing is
- 3 this concept that you are engaging in activity
- that is the type that I see is a continuum where
- 5 it can have a price effect and we don't need to
- 6 show that it actually does have a price effect
- 7 which makes it a prohibitive transaction, and when
- 8 you look at false reporting where it's activity
- 9 that affects or tends to affect, and then finally
- 10 manipulation where you actually have to show that
- 11 there's an effect on price. So the design for
- 12 spoofing and prohibited practices is to get at
- 13 conduct which might otherwise disrupt -- the
- statute, orderly trading.
- 15 COMMISSIONER SOMMERS: Thank you. I
- 16 would suggest that if we could clarify further
- 17 that the type of behavior that is purposefully
- 18 misleading other market participants for the
- 19 benefit of your own position is what we're
- 20 specifically trying to get at.
- 21 My last question is with regard to
- 22 buying the board. In the ANPR we asked a question

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and we had a lot of comments back on that yet we

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didn't include it in this proposed guidance and
       I'm wondering if a market participant is buying
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       and selling at multiple levels at the same time if
       we're intending to include that in this proposal.
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                 MR. MCGONAGLE: I actually picked up on
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       that myself this morning unfortunately where I saw
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       one of the commentators had specifically addressed
       buying the board. As a general matter we would
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       not say that buying the board violates any
      provision of A, B and C. If you're looking at say
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       violating bids or offers, if you're engaging in
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       activity that otherwise complies with the rules or
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       regulations of the registered entity, we think
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you're going to be okay so that if you're buying

the board, in and of itself that's not going to

violate Provision A. If you're buying the board

in connection with some manipulative scheme then

we have a different conversation. So I think in

intended to be included for violation for bids and

offers, but it can be evidence of a manipulative

the first instance, buying the board is not

scheme and so may actually be evidence of another

- 2 violation of the Act.
- 3 COMMISSIONER SOMMERS: I would ask if
- 4 that was a mistake if we could add a sentence to
- 5 include that we did not intentionally leave out
- 6 buying the board in A.
- 7 CHAIRMAN GENSLER: I'm seeking unanimous
- 8 consent and I'm not hearing any objection.
- 9 COMMISSIONER SOMMERS: Thank you.
- 10 CHAIRMAN GENSLER: Commissioner Chilton?
- 11 Thank you, Commissioner Sommers.
- 12 COMMISSIONER CHILTON: Thanks, Mister
- 13 Chairman. I want to go back to the first thing
- 14 that Commissioner Sommers was asking about where
- 15 the Chairman had this discussion with Vince. With
- 16 regard to bilateral trades, unless the trades
- occur on a regulated entity, it does not apply.
- 18 Is that correct?
- MR. PEASE: Yes.
- 20 COMMISSIONER CHILTON: Thank you. When
- 21 I read this the first time, some of you probably
- remember that old commercial, that "Where's the

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beef" commercial that was a Wendy's commercial?
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- 2 Walter Mondale used it in a debate with Reagan to
- 3 absolutely no effect. But when I read this the
- first thing I thought is, wait, we're doing the
- 5 three things that the statute has called for but
- 6 we're not doing anything else. But as you read
- 7 through these comment letters and my colleagues
- 8 and I have read through a lot of them, they want
- 9 us to be cautious and careful and deliberate and I
- 10 think that's what we're doing with their concerns
- 11 and Commissioner Sommers was talking about some of
- them. But this is a proposal. You could propose
- these glasses. It's not a final rule and it
- 14 wouldn't be a very good proposal, but we could
- propose it. It's what we do in the final as we
- 16 talked about later with regard with the
- 17 cost-benefit analysis. We really need to know
- 18 what's going on then, so I commend you for the
- 19 work that you've done so far.
- 20 I did want to mention one thing and this
- 21 comes up again and again. As I was reviewing
- these letters last night, there was one. I'm not

- going to say who it is, but I shouldn't
- 2 characterize the entire letter of 13 pages. There
- 3 is one part here which is the type of thing which
- 4 isn't helpful actually. It says, the Commission
- 5 has not identified specific problem and this is
- 6 with regard to disruptive trading in 747; has not
- 7 identified specific problems or concerns where the
- 8 pre-Dodd-Frank enforcement authority is lacking.
- 9 Listen to this, because the language of 747 came
- 10 from the Commission itself. Congress passed the
- 11 law. We may provide some language to Congress,
- 12 but they passed the law and not us. It's their
- law and signed by the President. It's not our
- 14 law. We didn't write the law just because we give
- a suggestion. But it says, because the language
- came from the Commission itself, and they've made
- 17 another job, it is incumbent upon the Commission
- 18 to identify past ongoing problems that Section 747
- is targeted to address. First of all they said
- it's our language. We made it up. Second they
- 21 say and since you made it up, you've got to prove
- that there's a problem before you do anything.

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1 But that's not the language of the Act in general
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- and I've talked about this again and again on
- 3 other matters. It's to deter and prevent all
- 4 these things, fraud, abuse, manipulation, it's to
- 5 be proactive. We don't want to be crazy on this
- 6 stuff. I'm glad we ask all these important
- 7 questions. But to create new nonlegitimate
- 8 hurdles that the Commission does not to leap over
- 9 isn't helpful. The last thing in this letter
- says, absent identification of such problems, this
- 11 entity urges the Commission to seek repeal of this
- 12 provision, that we should repeal the law. If we
- 13 can't -- we repeal the law. First of all, we
- can't repeal the law. I guess we'd go to Congress
- 15 to repeal the law.
- 16 There are many helpful things in this
- 17 letter and we get these once in a while they're
- just trying to get out crap and that's not
- 19 happening on my watch. Thanks.
- 20 CHAIRMAN GENSLER: Thank you,
- 21 Commissioner Chilton. Commissioner O'Malia?
- 22 COMMISSIONER O'MALIA: Thank you. The

1 Chairman mentioned, Commissioner Sommers mentioned

- it and it's a process question. I want to walk
- 3 through this. Why did the Commission determine to
- 4 recommend interpretive guidance over proposed
- 5 rules?
- 6 MR. PEASE: Staff is not recommending
- 7 any additional regulatory text. As a result, we
- 8 thought the best vehicle which as I said earlier
- 9 if were an interpretive order would have the same
- 10 legal effect, we thought interpretive order would
- 11 be the best vehicle to use to provide guidance to
- 12 the marketplace.
- 13 COMMISSIONER O'MALIA: If it has the
- 14 same legal effect based on your cumulative legal
- scholarship, would it receive Chevron deference?
- MR. MCGONAGLE: That's my understanding.
- 17 CHAIRMAN GENSLER: May I interrupt?
- 18 General Counsel Berkovitz, do you have a view on
- 19 that?
- 20 MR. BERKOVITZ: That's correct. We
- 21 believe we would receive deference after the
- 22 Commission has promulgated the guidance through

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1 the notice and comment period.
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- 2 COMMISSIONER O'MALIA: Thank you. After
- 3 the 60-day comment period, if the comments
- indicate that the Commission has not provided the
- 5 appropriate guidance, what is our next step?
- 6 MR. PEASE: Out next step would be as in
- any other rulemaking, review the comments, decide
- 8 if we need to provide additional guidance or if we
- 9 need to correct anything that we have in here. It
- 10 would depend entirely on the comments that we
- 11 received and in conversations with you what the
- 12 next step should be.
- 13 MR. MCGONAGLE: I don't think the issue
- 14 has really changed, which is the determination at
- 15 the front end that the statute as drafted provides
- 16 notice to market participants about the violations
- 17 and whether the Commission determines to go
- 18 forward with interpretive guidance to give
- 19 context, the scope and parameters as Bob was
- 20 talking about with respect to how we would apply
- 21 Section 4(c)(A)(V).
- 22 COMMISSIONER O'MALIA: May I didn't ask

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1 this all that clearly. After the comment period
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- and we make whatever changes we want to make, we
- 3 would then go to essentially final guidance I
- 4 guess.
- 5 MR. PEASE: A final interpretive order.
- 6 COMMISSIONER O'MALIA: And that would be
- 7 implemented 60 days after publication?
- 8 MR. PEASE: I'll let Dan address this
- 9 too, I think it would become if it was done prior
- 10 to Dodd-Frank, the 60-day period occurred within
- 11 the period then that Dodd-Frank became effective,
- 12 I think it would become effective on the date of
- 13 Dodd-Frank. Otherwise it would be whatever we
- 14 provide for in the interpretive order when it
- 15 would become effective.
- MR. BERKOVITZ: Once the provision is
- 17 effective then this interpretive order indicates
- how we're going to apply it, so I'd have to look
- 19 technically as to whether it's effective
- 20 immediately or not, but in effect I think it's
- 21 basically effective immediately. We couldn't do a
- 22 contrary interpretation within any time period

- 1 after we've issued this.
- 2 MR. PEASE: I guess what I was trying to
- 3 say is Dodd-Frank provisions of 747 won't become
- 4 effective until a year after enactment. So
- 5 whether the interpretation is effective prior to
- 6 that doesn't really matter.
- 7 CHAIRMAN GENSLER: I think you should
- 8 assume that days from now with our very
- 9 legitimately full schedule in the spring we would
- 10 be doing a final order of this sometime in the
- 11 summer, but maybe we'll be able to do this before
- 12 July 15.
- 13 COMMISSIONER O'MALIA: Thank you. What
- 14 role do you anticipate the exchanges, and this is
- kind of subsumed by the other questions, that this
- 16 applies obviously to on- exchange transactions,
- 17 but what role will they have in enforcing this
- 18 guidance?
- 19 MR. PEASE: The exchanges will play an
- 20 important role and a coordinated role with the
- 21 Commission. As we say in the draft proposed
- order, the exchanges are very important. We

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1 recommend a multilayered approach with the
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- 2 exchanges. But Congress gave us the specific
- 3 authority also to enforce the provisions of
- 4 Section 747 and while the exchanges will play an
- 5 important role, we have a role to play here as
- 6 well.
- 7 MR. MCGONAGLE: The exchanges won't be
- 8 bringing an action for disruptive practices under
- 9 the Act. As part of our investigation process
- 10 with prosecutorial discretion as well, we'll be
- 11 making determinations as we do in any case whether
- 12 an exchange action for conduct occurring on the
- 13 exchange is sufficient or whether additional
- 14 separate action by the Commission make sense and
- that is not atypical from how the Commission has
- interacted with exchange actions over the years.
- 17 COMMISSIONER O'MALIA: You said they
- 18 cannot bring disruptive trading violations? They
- 19 have their own rules to ensure orderly execution.
- 20 MR. PEASE: Correct. I think they would
- 21 not bring an action for disruptive trading under
- 22 Section 747. They may bring an action under their

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1 own rules for disruptive trading.
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- 2 COMMISSIONER O'MALIA: As we could have
- 3 under ours.
- 4 MR. PEASE: Correct.
- 5 COMMISSIONER O'MALIA: How are we
- 6 proposing to define the term orderly execution and
- 7 is this definition altered by the trading venue in
- 8 which any trades occur?
- 9 MR. PEASE: I think we try to give some
- 10 guidance in the rule on how we're viewing that and
- 11 we give some examples of what you would look at
- 12 for existing concepts of orderliness. I don't
- think it varies -- in answer to your last
- 14 question, some of the things we would look at
- would be the rational relationship between
- 16 consecutive prices during the closing period, the
- 17 correlation between price changes and volumes,
- levels of volatility, the relationship between
- 19 price of the commodity and the other derivative
- 20 and the underlying physical commodity and similar
- 21 types of measures.
- MR. MCGONAGLE: By analogy,

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1 Commissioner, this is what I was thinking going
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- 2 through this proposed interpretation is Commission
- 3 case law in exacerbation. What are the market
- 4 participants' obligations as they evaluate trading
- 5 activity and how is that different? We're going
- 6 to be looking at the market circumstances. I know
- 7 there was one comment for example that says
- 8 volatility shouldn't be a guide here in terms of
- 9 determining that someone has engaged in a
- 10 violation and I think that that by itself is true,
- it's how you react in the known market conditions
- may however subject you to liability such in the
- 13 manipulation arena for exacerbation and I think
- this is just another way of looking at trading
- 15 activity that could impact the normal
- 16 price-discovery process. So it has to be
- open-ended.
- 18 COMMISSIONER O'MALIA: Let me you more
- 19 specifically in terms of May 6. In the view of
- staff, how would this guidance inform the
- 21 operators of the algorithm that ultimately set
- into motion the events of May 6? The trading was

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1 not in the closing period, so what would you say
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- 2 based on this guidance that the algorithm
- 3 recklessly interfered with the orderly execution
- 4 of a transaction?
- 5 MR. PEASE: Since it was outside of the
- 6 closing period, I don't think it would be covered
- 7 by the provisions that we're discussing today.
- 8 MR. MCGONAGLE: I actually think that
- 9 would be an evaluation that we'd have to do in
- 10 making the determination. If you're looking at
- 11 this section, you're looking at intentional or
- 12 reckless conduct so that we would have to
- 13 undertake that evaluation of investigation to
- 14 determine whether or what trading activity
- occurred during the timeframe and whether
- 16 algorithmic trading was responsible or cause for a
- market change, that that order entry was somehow
- done in a reckless or other inappropriate manner.
- 19 So by itself the activity that occurred during May
- 20 6 doesn't warrant division investigation. There
- 21 would have to be more just like in a manipulation
- 22 case when you're trying to divine what the

1 trader's intent is. Have they engaged in conduct

- 2 intending or with a reckless disregard for the
- 3 orderly execution?
- 4 COMMISSIONER O'MALIA: Based on how long
- 5 it took us to develop the Order Book and the
- 6 evaluation of May 6, put your enforcement on, how
- 7 would you based on the technology we have today go
- 8 about figuring this out and how long would it take
- 9 us under this new guidance?
- 10 MR. MCGONAGLE: Since we're dealing with
- 11 an intent standard, practically I don't see the
- investigation operation from the division any
- different than what we would do in a manipulation
- 14 case, and one of the first things we would focus
- on would be to get an understanding of the
- 16 communication between the traders at the time,
- 17 also then get an understanding concerning how they
- 18 engaged in the trading conduct or practice and
- 19 begin an evaluation of the recreation of the
- 20 trades as they were executed. I think that can be
- 21 a very complicated endeavor and certainly if there
- is information on the intent side on the front

end, that would help streamline the investigation

- 2 as it does in manipulation cases.
- 3 COMMISSIONER O'MALIA: This is probably
- 4 one of the toughest rulemakings. Based on what
- 5 Congress gave us or whether we gave it to Congress
- or Congress gave it to us, Congress did give it to
- 7 us so your challenge to define this and define
- 8 where good trading is separate from bad trading is
- 9 a very difficult challenge so I'm very sympathetic
- 10 to your efforts here. I do like the fact that
- 11 this is another comment period and nothing is in
- 12 effect and we're just asking the questions with
- more specifics than we did in the advanced -- I
- think we'll benefit from the comment period so I'm
- 15 willing to support it.
- 16 CHAIRMAN GENSLER: Thank you, and I'll
- 17 take a crack at one of your questions. I think it
- 18 also relates to more resources. I think the
- 19 Division of Enforcement and the Division of Market
- 20 Oversight and Surveillance, all of our divisions
- 21 have excellent staff, but without the resources to
- 22 have the technology to actually get the benefit of

what's going to be in the swap data repositories

- and have our folks be able to link up to that
- data, it's going to be a challenge to do the job
- 4 Congress has asked us to do.
- 5 COMMISSIONER O'MALIA: I'll give you an
- 6 amen. Put technology first.
- 7 CHAIRMAN GENSLER: Yes, and even an
- 8 Office of Data. I think I'm going to probably end
- 9 up letting Mr. Stawick call the vote.
- 10 MR. STAWICK: Commissioner O'Malia?
- 11 COMMISSIONER O'MALIA: Aye.
- MR. STAWICK: Commissioner O'Malia, aye.
- 13 Commissioner Chilton?
- 14 COMMISSIONER CHILTON: Aye.
- MR. STAWICK: Commissioner Chilton, aye.
- 16 Commissioner Sommers?
- 17 COMMISSIONER SOMMERS: No.
- MR. STAWICK: Commissioner Sommers, no.
- 19 Commissioner Dunn?
- 20 COMMISSIONER DUNN: Aye.
- 21 MR. STAWICK: Commissioner Dunn, aye.
- 22 Mister Chairman?

- 1 CHAIRMAN GENSLER: Aye.
- 2 MR. STAWICK: Mister Chairman, aye.
- 3 Mister Chairman, on this question the ayes are
- 4 four, the nays are one.
- 5 CHAIRMAN GENSLER: I thank you. With
- 6 that we will also be sending this on. I think at
- 7 this point I'd ask for unanimous consent to allow
- 8 staff to make technical corrections to the
- 9 documents voted on today prior to send them to the
- 10 Federal Register. There were three or four places
- 11 that we made some changes as well without
- 12 objection. The CFTC has identified 30 topic areas
- or rulemaking throughout the fall and winter
- including today. I think we've heard from the
- thirty-first team so that I think we have now
- 16 heard from 28 of our 31 teams. With the Volker
- 17 Rule, capital margin and product definitions being
- 18 the three we have yet to hear from.
- 19 Our next meeting will occur in March. I
- 20 believe it probably be toward the latter part of
- 21 March given we're still coordinate the date and
- we'll put that in the Federal Register when we

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1 have a date and we'll of course put the topics on
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- 2 the meeting site. Again we encourage the public
- 3 to comment. They're doing a terrific job
- 4 commenting. They're gracious with their comments,
- 5 but we need all of the input from the public on
- 6 the specific rules and on as you see the whole set
- of rules proposed, the interaction of those rules
- 8 and the ultimate phasing and implementation. It
- 9 would be enormously helpful to hear from the
- 10 public on the policies, the law of course, the
- 11 cost-benefit analysis and the phasing of these
- 12 rules.
- With that if there is not any other
- 14 Commission business, I'd ask for a motion to
- 15 adjourn the meeting.
- 16 COMMISSIONER DUNN: So moved.
- 17 COMMISSIONER SOMMERS: Second.
- 18 CHAIRMAN GENSLER: All in favor?
- (Chorus of ayes.)
- 20 CHAIRMAN GENSLER: The meeting is
- 21 adjourned. Thank you all.
- 22 (Whereupon, at 11:44 a.m. the

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1	CERTIFICATE OF NOTARY PUBLIC
2	DISTRICT OF COLUMBIA
3	I, Stephen K. Garland, notary public in
4	and for the District of Columbia, do hereby certify
5	that the forgoing PROCEEDING was duly recorded and
6	thereafter reduced to print under my direction;
7	that the witnesses were sworn to tell the truth
8	under penalty of perjury; that said transcript is a
9	true record of the testimony given by witnesses;
10	that I am neither counsel for, related to, nor
11	employed by any of the parties to the action in
12	which this proceeding was called; and, furthermore,
13	that I am not a relative or employee of any
14	attorney or counsel employed by the parties hereto,
15	nor financially or otherwise interested in the
16	outcome of this action.
17	
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20	Notary Public, in and for the District of Columbia
21	My Commission Expires: May 31, 2014
22	