THE COMMODITY FUTURES TRADING COMMISSION 2012 AGENDA

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

FEBRUARY 29, 2012

Serial No. 112–29

Printed for the use of the Committee on Agriculture
agriculture.house.gov

U.S. GOVERNMENT PRINTING OFFICE

74–137 PDF WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
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CONTENTS

WITNESS

THE COMMODITY FUTURES TRADING COMMISSION 2012 AGENDA

WEDNESDAY, FEBRUARY 29, 2012

HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The Committee met, pursuant to call, at 10:02 a.m., in Room 1300 of the Longworth House Office Building, Hon. Frank D. Lucas [Chairman of the Committee] presiding.

Members present: Representatives Lucas, King, Neugebauer, Conaway, Fortenberry, Schmidt, Thompson, Stutzman, Tipton, Crawford, Huelskamp, DesJarlais, Gibson, Hultgren, Schilling, Peterson, Holden, McIntyre, Boswell, Baca, David Scott of Georgia, Cuellar, Costa, Schrader, Kissell, Owens, Pingree, Courtney, Welch, Fudge, Sablan, Sewell, and McGovern.

Staff present: Tamara Hinton, Kevin Kramp, Josh Mathis, Ryan McKee, John Porter, Matt Schertz, Heather Vaughan, Suzanne Watson, Liz Friedlander, C. Clark Ogilvie, John Konya, Jamie Mitchell, and Caleb Crosswhite.

OPENING STATEMENT OF HON. FRANK D. LUCAS, A REPRESENTATIVE IN CONGRESS FROM OKLAHOMA

The CHAIRMAN. This hearing of the Committee on Agriculture to review the Commodity Futures Trading Commission 2012 agenda will come to order.

Good morning, and I would like to thank all of you for being here. Today's hearing will focus on the Commodity Futures Trading Commission, the CFTC agenda for the coming year. And I would like to thank Chairman Gensler for joining us to share his perspective.

This is a timely hearing as the CFTC is facing a number of issues of concern to our constituents. First and foremost, the CFTC's agenda for the coming year must be its investigation into the collapse of MF Global and its missing customer funds. Thousands of customers have yet to receive nearly 30 percent of the funds that MF Global should have held in segregated accounts.

While I commend the Trustee for working quickly to trace the thousands of complex transactions that occurred during MF Global's final days, the fact remains that many customers have yet to be made whole. Farmers and ranchers across the country continue to face hardships because of their missing funds and have lost confidence in the futures system. This raises several key questions about customer protections in place and the CFTC's role in futures markets. Although the CFTC has gained new authority over the swaps market under the Dodd-Frank Act, the MF Global collapse demonstrates the importance of CFTC's oversight responsibilities in futures market.

In addition to our concerns about MF Global customer funds, we also must address the Dodd-Frank rulemaking process. As the CFTC nears the halfway mark in completing the dozens of regulations required by Dodd-Frank, I remain concerned about the breadth of those proposals. Instead of focusing resources on the entities and activities that pose the most significant risk to our financial systems, the CFTC is casting a wide net that could needlessly catch end-users.

For example, for months we have been assured by Chairman Gensler that the *swap dealer* definition would not result in unnecessary registration of on end-users, which Congress never intended to fall within the swap dealer category. However, as the Commission neared completion of the rule last week, end-users were frantically seeking clarification that their hedging activities would not be classified as swap dealing. Now, this doesn't make sense because Congress never intended for hedging to be considered swap dealing.

Additionally, the CFTC has yet to propose a rule that would clarify the scope of its new regulations for activities that occur outside our borders, what we refer to as extraterritoriality. There is a longstanding precedent by both the CFTC and the Prudential Regulators to defer to foreign regulatory authorities in matters concerning foreign entities and transactions. Expanding the reach of the Dodd-Frank into activities outside our borders not only ignores the principles of international law, but it spreads our agencies and resources too thin. It also threatens the international cooperation required for global financial reforms as envisioned by the G20.

Additionally, the lack of clarification on the territorial scope of regulations has made it incredibly difficult for market participants to prepare for compliance. The confusion over the *swap dealer* definition and the foreign scope of those regulations are just two examples of many issues which the CFTC has failed to deliver concrete answers or policy solutions. Our constituents need more than empty reassurances.

Most of these concerns are rooted in an issue that we have discussed for more than a year now, the need for strong and robust economic analysis. The *Economist* magazine recently highlighted the Obama Administration's tendency to overstate the benefits of regulation while underestimating the cost. That has certainly been apparent in the Dodd-Frank rulemaking.

At a public meeting recently, CFTC staffers admitted they simply had not calculated the cost and benefits of a rule governing internal business conduct standards. They could not provide substantial substantive analysis for the conclusions they drew about how the rule would impact our economy and that is unacceptable.

Even if the CFTC was attempting to conduct economic analyses of Dodd-Frank regulations, it would be difficult given the lack of clarity about which organizations will be affected by each rule. Making policy without regard to the economic consequences is a luxury we cannot afford even in the strongest of economies, and we certainly cannot afford it right now.

I look forward to hearing Chairman Gensler's agenda for 2012. More than that, I look forward to a time when we can guarantee our constituents that they will not be overburdened by regulations that were not intended for them.

[The prepared statement of Mr. Lucas follows:]

PREPARED STATEMENT OF HON. FRANK D. LUCAS, A REPRESENTATIVE IN CONGRESS FROM OKLAHOMA

Good morning, and thank you all for being here. Today's hearing will focus on the Commodity Futures Trading Commission (CFTC) agenda for the upcoming year.

I'd like to thank Chairman Gensler for joining us to share his perspective.

This is a timely hearing, as the CFTC is facing a number of issues of concern to our constituents.

First and foremost on the CFTC's agenda for the coming year must be its investigation into the collapse of MF Global and its missing customer funds. Thousands of customers have yet to receive nearly 30 percent of the funds that MF Global should have held in segregated accounts.

While I commend the Trustee for working quickly to trace the thousands of complex transactions that occurred during MF Global's final days, the fact remains that many customers have not yet been made whole.

Farmers and ranchers across the country continue to face hardships because of their missing funds, and have lost confidence in the futures system.

This raises several key questions about customer protections in place, and the CFTC's role in futures markets.

Although the CFTC has gained new authorities over the swaps market under the Dodd-Frank Act, the MF Global collapse demonstrates the importance of CFTC's oversight responsibilities in futures markets.

In addition to our concerns about MF Global customer funds, we also must address the Dodd-Frank rulemaking process. As the CFTC nears the half-way mark in completing the dozens of regulations required by Dodd-Frank, I remain concerned about the breadth of the proposals. Instead of focusing resources on the entities and activities that pose the most significant risks to our financial system, the CFTC is casting a wide net that could needlessly catch end-users.

For example, for months we have been assured by Chairman Gensler that the swap dealer definition would not result in unnecessary registration of end-users, which Congress never intended to fall within the swap dealer category.

However, as the Commission neared consideration of the rule last week, end-users were frantically seeking clarification that their hedging activities would not be classified as swap dealing.

This doesn't make sense, because Congress never intended for hedging to be considered swap dealing.

Additionally, the CFTC has yet to propose a rule that will clarify the scope of its new regulations for activities that occur outside our borders—what we refer to as extra-territoriality.

There is a long-standing precedent by both the CFTC and the Prudential Regulators to defer to foreign regulatory authorities in matters concerning foreign entities and transactions.

Expanding the reach of Dodd-Frank into activities conducted outside our borders not only ignores principles of international law, but it spreads our agencies and resources too thin. It also threatens the international coordination required for global financial reform as envisioned by the G20.

Additionally, the lack of clarification on the territorial scope of regulations has made it incredibly difficult for market participants to prepare for compliance.

The confusion over the swap dealer definition and the foreign scope of regulations are just two examples of the many issues on which the CFTC has failed to deliver concrete answers or policy solutions. Our constituents need more than empty reassurances.

Most of these concerns are rooted in an issue that we have discussed for more than a year now—the need for strong and robust economic analysis.

The *Economist* recently highlighted the Obama Administration's tendency to overstate the benefits of regulation while underestimating the costs. That has certainly been apparent in the Dodd-Frank rulemaking.

At a public meeting recently, CFTC staffers admitted they simply had not calculated the costs and benefits of a rule governing internal business conduct standards. They could not provide substantive analysis for the conclusions they drew about how that rule would impact our economy. That's unacceptable.

Even if the CFTC **was** attempting to conduct economic analyses of Dodd-Frank regulations, it would be difficult given the lack of clarity about which organizations will be affected by each rule.

Making policy without regard for the economic consequences is a luxury we cannot afford even in the strongest economy. We certainly cannot afford it now.

I look forward to hearing Chairman Gensler's agenda for 2012, but more than that, I look forward to a time when we can guarantee our constituents that they will not be overburdened by regulations that were not intended for them.

The CHAIRMAN. And with that, I would like to recognize the Ranking Member for any opening comments he might have.

OPENING STATEMENT OF HON. COLLIN C. PETERSON, A REPRESENTATIVE IN CONGRESS FROM MINNESOTA

Mr. PETERSON. Thank you, Mr. Chairman, and welcome, Chairman Gensler, back to the Committee for today's hearing.

In addition to passing a farm bill, oversight of the CFTC has been a top priority of this Committee. It is important for Chairman Gensler to provide an update on the agenda of the CFTC for the year, along with the Commission's progress on implementing the financial reforms passed in 2010. Looking at the Dodd-Frank rules that have already been finalized by the CFTC, I believe it is safe to say that so far the CFTC has done a pretty good job. And in my conversations with Chairman Gensler, it seems to me that they are on the right track, going forward.

For example, during a legislative hearing last year, we heard concerns about business conduct standards and the potential impact that they could have on pension plans' ability to use swaps to hedge risk. In January, the Commission approved a bipartisan final rule establishing business conduct standards, and the general feeling I get from the pension plans is that the CFTC got the final rule right.

As the CFTC continues finalizing more rules, I suspect that they will continue to get it right and address the concerns that we have heard at various hearings. I know that some of you have expressed frustration with the CFTC's process for implementing these reforms. While it has not been a perfect process, we cannot lose sight of the importance of their taking the time so that they can, in the end, get the right outcome.

But the CFTC has more on its plate than just Dodd-Frank. It is still in the process of investigating what happened at MF Global and monitoring our futures market as we watch energy prices continue to climb. The Commission does these things and much more, all while being grossly under-funded.

Today's hearing will provide Members with an opportunity to ask about these and many other issues currently before the CFTC, so I look forward to hearing Chairman Gensler's testimony and I thank the chair for holding today's hearing.

[The prepared statement of Mr. Peterson follows:]

PREPARED STATEMENT OF HON. COLLIN C. PETERSON, A REPRESENTATIVE IN CONGRESS FROM MINNESOTA

Thank you, Chairman Lucas, and welcome Chairman Gensler to today's hearing.

In addition to passing a farm bill, oversight of the CFTC has been a top priority for this Committee and I think it's important for Chairman Gensler to provide an update on the CFTC agenda for the year along with the Commission's progress of implementing the financial reforms Congress passed in 2010.

Looking at the Dodd-Frank rules that have already been finalized by the CFTC, I believe it is safe to say that, so far, the CFTC has done a pretty good job. And, in my conversations with Chairman Gensler, it seems to me that they are on the right track.

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I know that some have expressed frustration with the CFTC's process for implementing these reforms. While it has not been a perfect process, we cannot lose sight of the importance of taking the time to do this right.

But the CFTC has more on its plate than just Dodd-Frank. It is still in the process of investigating what happened at MF Global and monitoring our futures markets as we watch energy prices continue to climb. The Commission does these things and much more, all while grossly under-funded. Today's hearing will provide Members with the opportunity to ask about these, and many other issues, currently before the CFTC.

I am looking forward to hearing Chairman Gensler's testimony and I thank the chair for holding today's hearing.

The CHAIRMAN. The chair appreciates the gentleman's opening comments. And the chair would request that other Members submit their opening statements for the record so the witness may begin his testimony and to ensure that there is ample time for questions.

[The prepared statements of Mr. Conaway and Mr. Baca follow:]

PREPARED STATEMENT OF HON. K. MICHAEL CONAWAY, A REPRESENTATIVE IN CONGRESS FROM TEXAS

Mr. Chairman, thank you for convening this hearing today. I look forward to the opportunity to hear from Chairman Gensler about the course the CFTC is charting over the coming year. In particular, I am interested in hearing more about the schedule for rolling out the final rules we are waiting on and the Commission's plans to bolster the cost-benefit analysis that it conducts on those rules still pending.

For the past year, I have pushed, cajoled, admonished, and begged the CFTC to do a better job in estimating the costs and benefits of the rules it proposes. For too long, the Commission has hidden behind the letter of the law which says the Commission must only "consider" the costs and benefits of a proposed rule. Often, it is left to the commenters to provide the relevant data and perform an analysis of the proposed rule. Unfortunately, this misses the point. The analysis is supposed to inform drafters of the proposal. The regulators ought to do their homework *before* they make proposed regulations, not after.

What is worse, this process is complicated by the continuing issue with the sequence of the rules. For many potential regulated entities, they simply do not know if a particular rule will apply to them or not, because we have not yet defined the very basic participants and components of the market.

I am certain the concerns I raise today are a surprise to no one. However, I continue to bring them up and I continue to push on them, because the work the CFTC is doing over this coming year holds the potential to make or break the financial markets that so many of my constituents depend on to manage their businesses and their financial affairs.

To that end, I was would like to highlight three statements by three of the CFTC Commissioners given at the most recent public meeting and enter them into the record. I believe together, these three statements ought to continue to guide the Commission as it completes its work over the coming year. They are the reasons why I demand the CFTC do its due diligence.

Commissioner Chilton noted correctly, that "we must, as we go forward, be extremely cognizant that all of these swaps rules are an interdependent set. It is a grave error to look at each rule as free-standing—they are not."

Although this idea should surprise no one, the Commission's failure to adequately consider the effects and scope of the rules proposed under Dodd-Frank have lead to contradictory mandates, duplicative filings, and sowed needless confusion among stakeholders in the derivatives and futures community. Unfortunately, this confusion is wholly self-induced. Better sequencing and a stronger commitment to analysis could have avoided much of the uncertainty that has plagued this process since the beginning.

Commissioner Sommers issued what I believe will be a prescient statement when she said, "I do not believe that these rules have a chance of withstanding the test of time, and instead believe that this Commission will be consumed over the next few years using our valuable resources to rewrite rules that we knew or should have known would not work when we issued them."

It is my fear that when we get to the end of the rulemaking process, we are going to find the new institutions and systems we have erected are not very good. Should that pass, blame will certainly rest with the drafters of the financial reform bill. But, our regulators will not have helped the process if they did not strive to understand every facet of every rule, before they were finalized.

Finally, Commissioner O'Malia's statement reached straight to the heart of the matter when he said: "Our inability to develop a quantitative analysis, or to develop a reasonable comparative analysis of legitimate options, hurts the credibility of this Commission and undermines the quality of our rules."

The Commission's failure to articulate economically defensible reasons behind its rules damage its reputation as a regulator and strain its relationships with the entities it oversees. Rules that are perceived to be arbitrary or pointlessly burdensome are rules that will be avoided or worse, actively circumvented. Bad regulation leads to loopholes, shortcuts, and will necessitate constant regulatory intervention to tweak and patch the rules for every new eventuality. If this happens, the rules laid down under Dodd-Frank will bring more risk and more uncertainty to the market.

Before I close, I want to commend Chairman Gensler on his openness and attentiveness, both with Members of Congress and market participants. He has engaged the Commission in an extraordinary campaign of meetings and public hearings as they have undertaken the staggering array of new rules required by Dodd-Frank.

However, he has consistently left idle the most important tool at his disposal—cost-benefit analysis. I fear that all his efforts in openness will not result in a better final product, because the Commission has not bothered with a sustained effort to quantify its proposals or any of their alternatives.

This analysis is not about making things easier for the bankers of Wall Street, it is about creating a regulatory framework in which *all* market actors can participate. I do not worry about the big banks or the big financial firms; they all have armies of lawyers prepared to help them sort through the end result of this process.

I do fear for the farmer whose local bank will not give him a loan, because he can no longer hedge his crop. I worry about the small manufacturer that wants to export products, but finds executing an interest rate swap is too expensive. And, I agonize over the jobs that will be lost because businesses are no longer able to effectively manage their risks.

Whether they know it or not, my constituents—the farmers, ranchers, manufactures, and small businesses spread across the 11th District—and all Americans are counting on the CFTC. Their ability to manage their financial lives will be impacted by the rules the Commission finalizes. To that end, I will continue to insist the CFTC utilizes every tool at its disposal to get them right.

PREPARED STATEMENT OF HON. JOE BACA, A REPRESENTATIVE IN CONGRESS FROM CALIFORNIA

Chairman Lucas and Ranking Member Peterson:

I am pleased to be here today to discuss the ongoing implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and discuss the 2012 agenda for the Commodity Futures Trading Commission.

I thank the Chairman and Ranking Member for convening this hearing. I also want to thank our witness, and recognize the Chairman of the Commodity Futures Trading Commission, Mr. Gary Gensler.

Chairman Gensler, thank you for your efforts—I know you have been working very hard to properly implement the regulatory requirements of Dodd-Frank.

Everyone in this room understands the important balance we need to reach as we look at establishing a regulatory framework for the complex area of derivatives and exotic futures trading.

We want to make sure our agricultural producers, business communities, and end-users have the flexibility to effectively trade commodities; BUT we also must protect the American public from predatory financial risks.

We all saw what happened the last time our regulators fell asleep at the wheel—financial institutions across the nation collapsed and our economy fell victim to a foreclosure crisis that is still paralyzing many segments of the country.

As the CFTC moves forward in finalizing the definitions of swaps and swap dealers—I hope it will keep in mind the predicament that many energy providers in my home State of California face.

Moving forward—I hope that any transaction an energy provider makes in order to comply with state regulations—is excluded from the process used to determine whether an entity is a swap dealer.

We all must remember the importance of the mission the Dodd-Frank Wall Street Reform Act laid out.

The American people must have OVERSIGHT and the ACCOUNTABILITY to ensure that all derivative trading occurs in light of day, and is above the board.

Again, I want to thank the Chairman and Ranking Member for their leadership on this critical issue.

I look forward to this opportunity to hear about the progress of the implementation of Title VII provisions of the Dodd-Frank bill; and to make sure the CFTC is properly following the legislation's Congressional intent.

Thank you.

The CHAIRMAN. With that, I would like to welcome to our witness to the table, Hon. Gary Gensler, Chairman of the Commodity Futures Trading Commission, Washington, D.C. Mr. Chairman, please begin whenever you are ready, sir.

STATEMENT OF HON. GARY GENSLER, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, D.C.; ACCOMPANIED BY HON. JILL E. SOMMERS, COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION

Mr. GENSLER. Good morning, Chairman Lucas, Ranking Member Peterson, and Members of the Committee. I am pleased to be here also with my fellow Commissioner Jill Sommers as well. Today, I am told it is my 39th time testifying before Congress in this job. Apparently, I have been in the job 109 days but I will tell you this is the first time I have testified on February 29.

After a full year in 2011, the CFTC has significant work in front of us for 2012. Derivatives markets are critical for farmers, ranchers, producers, and other end-users in the real economy. And as this Committee has noted to me, but I would give the statistic: the non-financial side of our economy provides 94 percent of private sector jobs. That is what the derivatives markets helps: futures and swaps, allow these companies to manage risk and focus on what they do best, that is, servicing customers, producing products, farming, milling, and investing in our economy.

My written testimony is more complete, but in short, our agenda includes completion of the swaps markets rules; clearing mandate determinations, which is a big piece of what Congress gave us; implementation of swaps reforms, working with members of the public on that; enhanced customer protections; and adapting oversight to changing market structure.

Last summer, we turned the corner from our proposal phase to starting finalizing rules. We have completed 28 rules to date and we have just over 20 to go. While the statute generally called for us to complete this within 1 year, it has taken us longer. And we are completing rules in a thoughtful, balanced way to get them right, not against the clock. And with 28,000 public comments and 1,300 meetings with the public to date, there is a lot to consider. We are close to finalizing rules with the SEC to further define the term *swap dealer*. I believe we will be responsive to comments from farm credit institutions that have been the subject of some of your discussions here in bills, agriculture cooperatives, and yes, the commercial end-users and the issue the Chairman raised about hedging. The product definition rules should follow later during the spring. But again, we are not trying to rush these. We are trying to get them right and listen to the commenters and this Committee.

We also are looking to soon finalize the Commercial End-User Exemption. Our proposal took Congress' intent to heart. Non-financial companies using swaps to hedge or mitigate commercial risk are out of the requirement for central clearing. The Commission's proposed rule on margin for swap dealers likewise provides that such non-financial companies will not be required by Commission rules to post margin for uncleared swaps.

I also want to mention that we are taking the legislative proposals of this Committee into consideration as we complete our rules. I view them as pretty serious comments in our comment file. The Commission, for example, has already provided for certain exceptions for inter-affiliate swaps from real-time reporting and the external business conduct rules that the Ranking Member mentioned. We also look forward to seeking public comment on inter-affiliate clearing for financial companies.

As we finalize reforms, we also have reached out broadly on how to best implement them, including last year's roundtables, public comment periods, and many meetings. And I thank you, Congressman Conaway, because we worked a lot with you, in thinking this through. In response to this public input, we have included phased implementation in many of our rules. We are also working internally to implement the swaps reforms. The Commission published a new strategic plan last year; we have restructured some divisions; in particular, standing up the new data and technology division. And given our increasing oversights needs, we are investing in updated market technology.

Before I close, I will mention resources. At about 700 people, we are only about ten percent greater than we were in the 1990s, and since then of course you have asked us to also cover the swaps market, which is nearly eight times the size of the futures market. The CFTC is not a price-setting agency. Nevertheless, rising prices for basic commodities—agriculture and energy—just remind us once again of the importance of having effective market oversight that ensures the integrity and transparency of these markets.

I will conclude just by saying that the derivatives reforms, once implemented, will benefit all Americans in the real economy. They will benefit the end-users of derivatives, which are responsible for most of the job creation in the economy. It will do this through the transparency and competition it brings to the marketplace. I think also it will benefit the public by lowering risk that Wall Street poses to the rest of us.

I thank you and I look forward to your questions.

[The prepared statement of Mr. Gensler follows:]

PREPARED STATEMENT OF HON. GARY GENSLER, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, D.C.

Good morning, Chairman Lucas, Ranking Member Peterson, and Members of the Committee. I thank you for inviting me to today's hearing on the Commodity Futures Trading Commission's (CFTC) 2012 agenda. I also thank my fellow Commissioners and CFTC staff for their hard work and commitment to protecting the public and promoting transparent and efficient markets. I'm pleased to be here with CFTC Commissioner Jill Sommers.

CFTC Mission

At its core, the CFTC's mission is to ensure the integrity and transparency of derivatives markets—both the futures and swaps markets. Each part of our economy relies on a well-functioning derivatives marketplace. These markets are critical for farmers, producers, ranchers and other end-users in the real economy—the non-financial side of the economy that provides 94 percent of private sector jobs. End-users can lock in a price or rate and manage their risk through these markets. The futures and swaps markets allow companies to focus on what they do best—servicing their customers, producing products, innovating, and investing in our economy. These markets are also critical for pension funds, mutual funds, community banks and insurance companies, and the Americans who rely upon these entities for their savings and financial needs.

The CFTC has historically been charged with overseeing the commodity futures markets. In 2010, Congress expanded the CFTC's mission to also oversee the previously unregulated swaps marketplace. At approximately $300 trillion, the domestic swaps market is nearly eight times the size of the futures market.

Combined these markets help their users hedge or transfer $22 of risk for every dollar of goods and services produced in the U.S. economy. Futures and swaps markets touch nearly every aspect of our economy from the food we eat, to the price at the pump, to our mortgages and credit cards, and to our retirement savings. Thus, it is essential that these markets are transparent and efficient and work for the benefit of the American public. And when markets are open and transparent, they are safer and sounder, and costs are lower for companies and their customers.

CFTC 2012 Agenda

After a very full year in 2011, the CFTC has a significant agenda this year to further enhance the futures and swaps markets to better protect the public. To start, I'll review what is ahead with regard to swaps a market reforms. I then will discuss further initiatives for enhancing customer protection and touch on some steps we are looking at to address changing market structure. I will close by discussing the CFTC's request for additional resources to best accomplish these goals.

Completion of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) Rules

The CFTC has made significant progress in completing the reforms that will bring transparency to the swaps market and lower its risk to the rest of the economy. But there is much work yet to be done.

During the rule-writing process, we have benefitted from significant public input. CFTC Commissioners and staff have met over 1,300 times with the public, and we have held 16 public roundtables on important issues, including a 2 day roundtable beginning today on further protections for customer money.

We substantially finished our proposal phase last spring, and then largely reopened the mosaic of rules for additional public comments. We have accepted further public comment after the formal comment periods closed. The agency received 3,000 comment letters before we proposed rules and 28,000 comment letters in response to proposals.

Last summer, we turned the corner and started finalizing rules. To date, we've completed 28 rules with just over 20 more to go. Attached to this testimony is a more complete list of rules we've finished, as well as proposed rules. It's my anticipation that we will finish most of the rule-writing work by this summer; however, it's possible that a handful won't be finished until later this year. While the statute generally called for completion of the rules in 1 year, for most of them, it has taken us longer. We are completing rules in a thoughtful, balanced way—not against a clock.

To promote transparent and competitive markets, we've been able to complete seven key reforms. Among these reforms, the Commission already has begun to receive position information for large traders in the swaps markets for agricultural, energy and metal products. Based on completed registration rules, three swap data repositories have already filed with the CFTC. In December, we finalized rules for the reporting of swaps transactions both to the public and to regulators, which will begin to take effect as early as July of this year. For the first time, the public and regulators will have specific information on the swaps markets, in aggregate and transaction-by-transaction. By contrast, none of this information was available leading up the 2008 crisis.

Looking forward, we hope to complete rules with regard to designated contract markets (DCMs), followed later this spring by rules for swap execution facilities (SEFs). These rules will be critical to bringing transparency and the benefits of competition to both buyers and sellers in the swaps market before they transact.

Last week, the Commission proposed a new block trading rule with a revised methodology for determining block sizes that benefitted from public input and a review of market data. As we have discussed in this Committee during previous hearings, the Commission is mindful that there are times when a reproposal of a rule is necessary to help ensure the Commission gets it right.

The CFTC also has made significant progress on rules to bring swaps into central clearing. We completed rules establishing robust risk management requirements for derivatives clearing organizations. We finished a rule on the process for clearinghouses to submit swaps that may be mandated for central clearing. In addition, the Commission adopted an important customer protection enhancement, the so-called "LSOC rule" (legal segregation with operational commingling) for swaps. It prevents clearing organizations from using the cleared swap collateral of non-defaulting, innocent customers to protect themselves and their clearing members.

To further facilitate broad access to these markets and promote competition, the Commission hopes in the near term to consider final rules on client clearing documentation, risk management, and so-called straight-through processing, or sending transactions immediately to the clearinghouse upon execution.

We also are looking to soon finalize the end-user exception. Consistent with Congressional intent, our proposal would ensure non-financial companies using swaps to hedge or mitigate commercial risk will not be required to bring swaps into central clearing. The Commission's proposed rule on margin for swap dealers likewise provides that such non-financial companies will not have to post margin for uncleared swaps.

The Commission has received substantial public input on the treatment of swaps among affiliates of the same business entity. The CFTC's final rules on real-time reporting and external business conduct standards include exceptions for such swaps. To address commenters' questions about a possible clearing requirement between affiliates of financial entities, I expect the Commission to consider a proposal and take public comments later this year.

The CFTC has begun to finalize rules to regulate swap dealers and lower their risk to the rest of the economy. First, we finished rules requiring registration of swap dealers with the National Futures Association (NFA). Second, we completed rules establishing and enforcing robust sales practices in the swaps markets. And third, a rule finalized this month requires swap dealers and major swap participants to establish policies to manage risk, as well as to put in place firewalls to prevent conflicts of interest between trading and research and trading and clearing units.

Later this year, we will consider final rules on capital and margin rules, which will have the benefit of close consultation with other regulators, both domestic and international. I also anticipate the Commission will explicitly seek public input on the extraterritorial application of Title VII of the Dodd-Frank Act.

The Dodd-Frank Act was clear on the meaning of swap and swap dealer, but the law called on the CFTC and the Securities and Exchange Commission (SEC) to act jointly in further defining these terms. We have benefitted from significant public input on the rule relating to entity definitions, and we are looking to finish it in the near term. We are taking into account all public comments, including those from farm credit institutions and agricultural cooperatives. The product definitions rule will follow in the spring.

Furthermore, the CFTC is working with participants in the electricity markets on possible exemptive orders for rural electric cooperatives, municipal public power providers and regional transmission organizations.

The Commission also is working with the banking regulators and the SEC on the Volcker rule. In adopting the Volcker rule, Congress prohibited banking entities from proprietary trading, an activity that may put taxpayers at risk. At the same time, Congress permitted banking entities to engage in market making, among other activities. One of the challenges in finalizing a rule is achieving these dual objectives. It will be critical to hear from the public on how to best achieve Congress' mandate. The CFTC's comment period closes April 16, and I very much look forward to the substantial public input I anticipate we will receive on this rule.

The global nature of the swaps markets makes it imperative that the United States actively consults and coordinates with foreign authorities. The Commission is working with our foreign counterparts to promote robust and consistent standards and avoid conflicting requirements in the global marketplace. CFTC staff is sharing many of our comment summaries and drafts of final rules with international regulators. We have ongoing dialogues with regulators in the European Union (EU), Japan, Hong Kong, Singapore and Canada. Last week, I met with EU Commissioner Michel Barnier during his visit to Washington. Next week, I will be in Basel to meet with the Financial Stability Board to discuss timely implementation of swaps reforms in each of the major market jurisdictions. I then travel to Brussels to meet with key European officials and industry leaders.

Clearing Mandate

Congress gave the CFTC an important role to play in determining which swaps must be mandatorily cleared. The clearing of standardized swaps will lower risk and make markets more competitive. Under the Congressionally mandated process, the Commission will have 90 days to review a clearinghouse's submission and determine whether the swap or group of swaps is required to be cleared. Last year, the CFTC finalized a rule on the process for review of swaps for mandatory clearing. Earlier this month, we asked each registered clearinghouse to submit for the agency's review all the swaps that it was clearing as of February 1, 2012, including all pre-enactment swaps. Staff is now reviewing these submissions and preparing recommendations for the Commission regarding which swaps or groups of swaps should be required to be cleared. During the Commission's review period, there will be a 30 day period for the public to provide comments. Though much of the timing depends on the clearinghouses, I anticipate that this comment period may begin this spring.

Implementation

As we move on from the rule-writing process, a critical part of our agenda is working with market participants on phased implementation of these reforms. We have reached out broadly on this topic to get public input. Last spring, we published a concepts document as a guide for commenters, held a 2 day, public roundtable with the SEC, and received nearly 300 comments. Last year, the Commission proposed two rules on implementation phasing relating to the swap clearing and trading mandates and the swap trading documentation and margin requirements for uncleared swaps. We have received very constructive public feedback and hope to finalize the proposed compliance schedules in the next few months.

In addition to these proposals, the Commission has included phased compliance schedules in many of our rules. For example, both the data and real-time reporting rules, which were finalized this past December, include phased compliance. The first required reporting is as early as July for interest rate and currency swaps. Other commodities have until October. Additional time delays for reporting were permitted depending upon asset class, contract participant and in the early phases of implementation.

The CFTC will continue looking at appropriate timing for compliance, which balances the desire to protect the public while providing adequate time for industry to comply with reforms. Furthermore, to ensure a smooth transition for market participants, we have given them exemptive relief from the effective dates of certain rules until July 16, 2012.

As swaps market reforms are implemented, market participants will continue to seek guidance, and in some cases petition for exemptions. The CFTC wants to be as responsive as possible to these inquiries, and this is an important part of our 2012 agenda. In the case of the large trader reporting requirements for the physical commodity swaps market, Commission staff worked with market participants and delayed requirements for 2 months to accommodate technical requirements. CFTC staff also engaged with market participants to ease the process of compliance. In addition to regular dialogue, our staff developed a guidebook of data standards, which can be found on our website. Just as we did with large trader reporting, staff is reaching out to market participants regarding the data rule we completed in December, and we will continue this type of engagement in other areas.

Another significant agenda item for this year will be the registration of new market participants. This process has already begun for SDRs and foreign boards of trade (FBOTs). Since the FBOT rule was finalized in December, three have requested to be registered. We expect other FBOTs that are currently operating under staff no-action letters to shortly request to be registered. We also are working with two new entities seeking to register with the CFTC as designated clearing organizations. In January, we finalized the registration rule for swap dealers and major swap participants, and we will be working, along with the National Futures Association, on these entities' registration and related questions. In addition, Commission staff estimates that 20–30 entities will seek to become SEFs, and I anticipate they would begin to register later this year.

The agency also has a lot of work to do internally this year to further prepare for the implementation of reforms. A year ago, the Commission published a new strategic plan for Fiscal Years 2011–2015 that incorporates the agency's expanded responsibilities to oversee both the futures and swaps markets. Importantly, the strategic plan also includes a new and tougher approach to agency performance measures to more accurately evaluate our progress. In addition, the CFTC's new responsibilities necessitated an agency restructuring to ensure the Commission uses its resources as efficiently as possible. The Commission created the Division of Swap Dealer and Intermediary Oversight and the Office of Data and Technology. The reorganization was put in place last October.

Our new Office of Data and Technology has a number of critical objectives to achieve in support of both swaps and futures oversight. The office will establish connections with SDRs so that the CFTC can collect and analyze swaps data for surveillance and enforcement purposes. It is taking on the challenge of how we aggregate data across SDRs, as well as how we aggregate it with futures market data. The office also will be working with the Treasury Department and international regulators on legal entity identifiers. Given our increasing oversight needs and the events of May 6, 2010, we will begin collecting daily order books from trading platforms for surveillance and market oversight purposes. The technology office also will continue to update and improve automated surveillance, including greater use of alerts.

Building on newly available data to the Commission, the CFTC plans to begin publishing aggregated swaps trader data. The public has benefited for years from the futures market data we have published in our Commitment of Traders reports. Our goal is to provide similar transparency to the public for the swaps market.

In October, the Commission adopted a final rule to establish position limits for physical commodity derivatives. The limits will come into effect once the joint rule further defining the term "swap" is completed and the Commission has received a year's worth of data on the relevant swap markets.

Customer Protection

Segregation of customer funds is a core foundation of customer protection in both the futures and swaps markets. The CFTC already has taken a number of steps in this area. The completed amendments to rule 1.25 regarding the investment of funds bring customers back to protections they had prior to exemptions the Commission granted between 2000 and 2005. Importantly, this prevents use of customer funds for in-house lending through repurchase agreements. In addition, clearinghouses will have to collect margin on a gross basis and futures commission merchants (FCMs) will no longer be able to offset one customer's collateral against another and then send only the net to the clearinghouse. And the LSOC rule for swaps ensures customer money must be protected individually all the way to the clearinghouse.

We will continue looking at options to further protect customers. Today and tomorrow Commission staff are hosting public roundtable sessions to examine additional enhancements. Also participating are other regulators, including the SEC and NFA. Panel topics include protections for the collateral of futures customers, consistent with the already-approved LSOC rule for cleared swaps. Additional discussion topics are alternative custodial arrangements for segregated funds, enhancing the controls over the disbursement of customer funds, and increasing transparency to customers and to the CFTC regarding the location and investment of customer funds. Also on the agenda are revisions to the bankruptcy rules for FCMs, protection of customer funds at FCMs to be traded on foreign futures markets, issues associated with entities dually registered with the CFTC as FCMs and the SEC as broker-dealers, and enhancing the self-regulatory structure. CFTC staff is actively seeking public input on these topics, and members of the public can submit comments through our website.

Changing Market Structure

This year, the Commission also will continue working to adapt our oversight to changing market structure, including emerging trends related to electronic trading. Instead of being traded in the pits, nearly 90 percent of futures and options on futures are traded electronically. While market participants used to be personally involved in each of their trades, they now often rely on algorithms to execute their trades. Humans are much more frequently depending on the judgment programmed into machines to execute their trading strategies. The makeup of the market also has changed. In contrast with the early days of the CFTC, swap dealers, managed money accounts and other non-commercial reportable traders make up a significant majority of many of the futures markets. Most of the trading volume in key futures markets—up to 80 percent in many markets—is day trading or trading in calendar spreads.

I expect the Commission will consider putting out for comment a concept release concerning the testing and supervision of automated market participants. These concepts will be designed to address potential market disruptions that high frequency traders and others who have automated market access can cause. Furthermore, the Commission's Technology Advisory Committee has established a subcommittee to specifically examine automated and high frequency trading.

In addition, the CFTC will continue working with the markets and the SEC on recommendations from the Joint-SEC–CFTC Advisory Committee on Emerging Regulatory Issues with regard to cross-market circuit breakers, pre-trade risk safeguards, effective testing of risk management controls and supervisory requirements regarding algorithmic trading.

The Commission staff also is developing proposed rules on the reporting of ownership and control information for trading accounts. These rules would enhance the Commission's surveillance abilities and increase market transparency.

Resources

The CFTC is a good investment for the American public. But the agency needs sufficient resources to do its job. The CFTC's budget request strikes a balance between important investments in technology and human capital, both of which are essential to carrying out the agency's mandate under the Commodity Exchange Act and the Dodd-Frank Act.

As we move into FY 2013, the CFTC will need additional resources consistent with the agency's expanded mission and scope. At our current size of about 700 people, we are but ten percent larger than our peak in the 1990s. Since then, though, the futures market has grown fivefold, and Congress added oversight of the swaps market, which is far more complex and nearly eight times the size of the futures market the agency currently oversees.

The budget request estimates the need for an appropriation of $308 million and 1,015 staff-years for the agency. This request is a significant increase over the $205 million FY 2012 enacted appropriations level, but it is much needed given the dramatic growth of the markets we oversee.

The CFTC will continue working hard to effectively oversee the futures market and implement reforms for the unregulated swaps market. Without sufficient funding, however, the nation cannot be assured that this agency can oversee the futures and swaps markets, that customers are protected, and that the public gets the benefit of transparent markets and lower risk.

Conclusion

The financial crisis brought our economy to a standstill. While there are signs of recovery, Americans continue to face a challenging economy and are seeing budgets squeezed because of increasing prices at the pump. Thus, it is essential that the futures and swaps markets are transparent, competitive and work for the benefit of the America public.

The financial crisis exposed that swaps helped concentrate risk in the financial system that spilled over into the real economy, affecting businesses and consumers across the country. The derivatives reforms in the Dodd-Frank Act, once implemented, will lead to significant benefits for the real economy and all the Americans who depend on pension funds, mutual funds, community banks and insurance companies. They will benefit from lowering the risk of the swaps market and increasing transparency.

Some have raised cost considerations about these reforms. But there are far greater costs—the eight million jobs lost, millions forced out of their homes, shuttered businesses and the uncertainty throughout the economy that came from risk, which spilled over from Wall Street.

Thank you for inviting me today, and I'd be happy to take questions.

ATTACHMENT

CFTC Dodd-Frank Update

Final Rules & Guidance

- Agricultural Commodity Definition
- Agricultural Swaps

- Anti-manipulation
- Business Affiliate Marketing and Disposal of Consumer Information
- Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations
- Derivatives Clearing Organization—General Provisions and Core Principles
- External Business Conduct Standards
- Foreign Boards of Trade—Registration
- Internal Business Conduct Standards (Duties, Recordkeeping, & CCOs)
- Investment Advisor Reporting on Form PF (Jt. with SEC)
- Investment of Customer Funds (Regulation 1.25)
- Large Trader Reporting for Physical Commodity Swaps
- Position Limits for Futures and Swaps
- Privacy of Consumer Financial Information
- Process for Review of Swaps for Mandatory Clearing
- Process for Rule Certifications for Registered Entities (Part 40)
- Real Time Reporting for Swaps
- Removal of References to or Reliance on Credit Ratings
- Reporting Certain Post-Enactment Swap Transactions (IFR)
- Reporting Pre-Enactment Swap Transactions (IFR)
- Retail Commodity Transactions—Interpretive Guidance on "Actual Delivery"
- Retail Foreign Exchange Intermediaries—Regulations & Registration
- Retail Foreign Exchange Transactions—Conforming Amendments
- Segregation for Cleared Swaps
- Swap Data Recordkeeping and Reporting Requirements
- Swap Data Repositories—Core Principles, Duties & Registration
- Swap Dealers and Major Swap Participants—Registration
- Whistleblowers

Proposed Rules & Guidance

- Block Rule
- Capital for Swap Dealers & Major Swap Participants
- Client Clearing Documentation, Straight Through Processing, Clearing Member Risk Management
- Commodity Options
- Conforming Rules
- Designated Contract Markets—Core Principles
- Disruptive Trade Practices
- End-User Exception
- Entity Definitions (Jt. with SEC)
- Governance and Conflict of Interest (DCM, DCO, & SEF)
- Harmonization of CPO/CTA Reporting
- Identify Theft (Jt. with SEC)
- Implementation Phasing for Clearing & Trading Mandates
- Internal Business Conduct (Documentation, Confirmation, & Portfolio Reconciliation)
- Margin for Uncleared Swaps
- Process for "Made Available to Trade" Determinations
- Product Definitions (Jt. with SEC)
- Reporting of Historical Swaps
- Segregation for Uncleared Swaps
- Swap Execution Facilities—Core Principles & Registration
- Volcker Rule

Final Orders

- Delegation to National Futures Association (NFA)—Certain exemptions for Commodity Pool Operators
- Delegation to NFA—Foreign Exchange Intermediary Registration function

- Delegation to NFA—Swap Dealer & MSP Registration function
- Exemptive orders—Effective Date for Swaps Regulation
- Treatment of Grandfather Relief Petitions—Exempt Boards of Trade & Exempt Commercial Markets
- Treatment of Grandfather Relief Petitions—Transactions done in Reliance on 2(h)

Studies

- Feasibility of Requiring Use of Standardized Algorithmic Descriptions for Financial Derivatives (Jt. with SEC)
- International Swap Regulation (Jt. with SEC)
- Study on Oversight of Carbon Markets (Jt. with various other Agencies)

The CHAIRMAN. Thank you, Mr. Chairman.

The chair would like to remind Members that they will be recognized for questioning in the order of seniority for Members who were here at the start of the hearing. After that, Members will be recognized in order of arrival. And I, as always, do appreciate the Members' understanding of that.

And I now recognize myself for 5 minutes.

Mr. Chairman, you have recused yourself from the investigation of MF Global, correct?

Mr. GENSLER. That is correct that I am not participating in that matter, sir.

The CHAIRMAN. And you have not been involved or privy to information regarding new developments in the investigation and relevant enforcement proceedings, correct?

Mr. GENSLER. That is correct, sir.

The CHAIRMAN. But Chairman, do you plan on being involved in any policy response that the Commission makes based on the lessons learned from MF Global. For example, the Customer Protection Roundtable scheduled for the next 2 days, you will be involved in those?

Mr. GENSLER. I have, for a long time, sir, focused along with my fellow Commissioners and customer protection was involved last summer and last fall when we tightened up the investment of customer funds protections in December when we, through the clearinghouse rules, ensured that margins should be posted on a gross basis. And as consensus develops to the extent consensus is developed I would anticipate being involved in some of these matters of general rules.

The CHAIRMAN. So as I understand it, it is your intention that the Commission moves forward on proposals potentially as early as this spring. So I guess my question would be, Chairman, how can you be in a position to lead the Commission in the policy response when it should clearly be supported by lessons learned during the investigation if you are not a part of the investigation?

Mr. GENSLER. Well, you are right, sir, that I am not part of that investigation, but as I mentioned, there are a number of things that the Commission laid out even before the matters of the fall, like tightening up the investment of customer funds. To the extent that a consensus forms through these 2 days of roundtables, through a lot of market input and market feedback, I would be involved in that as one of the five members of the Commission. And I do believe that there would be significant public input on anything in reaching any changes in the rules to really help the public and enhance what, as you said, is the core foundation of the futures and swaps market, that customer money is protected.

The CHAIRMAN. But you would acknowledge not being involved in the day-to-day investigation going on now that the lessons that hopefully will clearly come from that process will make it more challenging for you to be part of the solution?

Mr. GENSLER. Well, I think of this, if I might, somewhat as incremental. I think what we did in December was very critical to tighten up some of the loosening that we had frankly done in the early years to the investment of customer funds. I think what we have done in the clearinghouse rules are very critical as well. But again, as the consensus forms—and I don't know what will come out of these 2 days of public roundtables—but we have asked the public to weigh in. The public is also not participating in the investigation, nor am I.

The CHAIRMAN. Chairman Gensler, over the next several months, you have reassured this Committee that the definition of *swap dealer* will not result in end-users unnecessarily having to register as swap dealers, yet last week, it was your intention to propose the final rule related to swap dealers and the end-user community was frantically working to have an explicit exemption for hedging included in the rule. Chairman Gensler, it was of course never Congress' intent for the Commission to consider hedging activities to be swap dealing. In fact, Congress made every effort to ensure end-users were exempt from clearing and margin, which are only 2 of the many regulations associated with being a swap dealer. If you intended to make improvements to the rule as you have reassured Members of the Committee, and for that matter myself, then why were end-users forced to make last-minute appeals to Commissioners for help on something as fundamental as the classification that hedging is not swap dealing?

Mr. GENSLER. I think we have done a good job throughout these rulemakings to take into consideration public comment, but I will say that normally speaking, in the last 2 to 3 weeks before we vote on something, we hear from people reminding us of their comment letters, even sometimes when we have taken already and adjusted the base text of the rule because these documents are not put out again under the Administrative Procedures Act.

With regard to the actual rule itself, let me speak to the substance. One of the key things in the rule if I might say is market-making. There are three or four prongs that Congress laid out. If you are "regularly engaged in swap dealing" is one of them; but another one is if you are "market-making." And we received a lot of comments to narrow that, to address that, and I think that we will address that, particularly with regard to the word *hedging*.

The CHAIRMAN. I guess the question, Chairman Gensler, is based on your assurances in the past and the near panic that was set off over this definition issue, how can the Committee be assured that assurances given today won't lead to near panic on other rules as the process goes along?

Mr. GENSLER. Well, I think just as the Ranking Member mentioned on the pension fund concerns about external business conduct rule, I remember some pension funds being in our building 2 and 3 days before the Commission vote on our rule. I mean we are running a very open process and I welcome the commenters coming in. I am saying that there are a number of issues on the definition that you and I fully agree on and one is that the end-user community banks are not swap dealers. There are some parties that have chosen to deal, that make markets on a routine basis. In the energy swap area they actually list themselves as primary members of the International Swap and Derivatives Association, which says you can only be a primary member if you make markets, not for hedging. And that is really the approach. I think there is not a difference between you and I, sir, on this issue.

The CHAIRMAN. With the indulgence of my colleagues, one last question.

Chairman Gensler, would you say that you are coordinating with your international counterparts as required by Dodd-Frank in Section 754?

Mr. GENSLER. Yes, very much so. We share our draft documents with them before we consider proposals and finals, but more than that, we meet with them extensively, Commission Sommers and myself both. She was just recently in Japan. I will be over in Basel and Brussels next week.

The CHAIRMAN. Chairman Gensler, I understand that the European Commissioner for the EEU on this subject matter, Michel Barnier, just last week would have said in regards to the U.S. and its efforts of coordination, "it is not acceptable that U.S. rules have such a wide effect on other nations and foreign capital markets without any international coordination. A unilateral approach is a path to fragmentation and inefficiency. We need more international cooperation in all of these areas. This is the message I would bring to all of my U.S. counterparts. Think internationally."

How do you respond to that?

Mr. GENSLER. Michel Barnier and I had a very good meeting last week. His letter was I think specifically about the Volcker rule, which he and I had a lively discussion on that. It is a very difficult rule and challenging because Congress gave us two pieces—prohibit one thing, proprietary trading; permit another thing, market-making. But we have had an ongoing dialogue with Michel Barnier and his people, at one point weekly. We looked at gaps and overlaps. And as I say, I am going to meet with him again on Tuesday. So it has been a very constructive coordination, a partnership with——

The CHAIRMAN. But Chairman Gensler, my understanding of Commissioner Barnier's comments were not limited to the Volcker rule. In fact, they were much broader than that. And if leaders of one of our primary partners in the global regulatory reform, the EEU is concerned that we are taking a unilateral approach to reform, yet you are telling us you are working closely together. There is clearly a lack of coordination here and apparent inconsistencies with what you have told the Committee. International cooperation and coordination is a key to making global reform effective and to ensure that we are not unnecessarily building inconsistencies or duplications in the regime that will hamper competition growth. I just urge you to more carefully consider the feedback from our global partners.

And with that, Mr. Chairman, I thank you and I yield to the Ranking Member for 5 minutes.

Mr. PETERSON. Thank you, Mr. Chairman.

You know, I think everybody should understand that hundreds of millions of dollars have been spent over the last year or 2 by these folks trying to get around these rules. I think some of the concerns are legitimate and some of them aren't. But, from what I can tell kind of where you are heading with the Commission is that if you are actually hedging, you are an actual end-user, that is not going to trigger this swap dealer designation. But there are firms in the electricity area and in the energy gas and oil area that are actually dealers like you say. For myself, as one of the sponsors of this bill, those folks, the dealer part of their business should be regulated. So that is what I think. I guess you guys are sorting through that.

But, when it looks to me like some of the end-users are trying to convince Members that we are somehow or another trying to do something to them on their end-user status to get out of the other part of it where they are clearly dealers. I hope that we get more of this out into the public so people can understand what is going on. There has been a lot of noise made over all this stuff—and on the issue—it looks like a combination of this extraterritorial and Volcker rule that some of these folks are using the old saw that they are going to move their business overseas and so forth, we have heard that. That is part of why we didn't regulate people in the first place.

I just hope people understand that a lot of what is going on here is that people still don't want to be regulated. They still want to do whatever they want, which is what got us in trouble in the first place. I for one hope that you look carefully at this. From what I understand, the end-users that are actually hedging for commercial purposes are probably not going to be swept up in this, is that——

Mr. GENSLER. I agree with that and we can address that because Congress laid out one of the prongs to be a swap dealer is market-making. And so we can modify the final rule to clearly address—that it is really about routinely accommodating people knocking on your door to hedge their risk, not your risk——

Mr. PETERSON. Yes, they are——

Mr. GENSLER.—somebody else coming with you.

Mr. PETERSON.—actually competing in the same market as these big—Goldman Sachs and J.P. Morgan and so forth, right? I mean they are in the same market.

Mr. GENSLER. There is a small handful. For the tens of thousands——

Mr. PETERSON. Yes, I mean——

Mr. GENSLER.—of end-users are not going to be caught up in this——

Mr. PETERSON. Right.

Mr. GENSLER.—but there are some who have chosen actively to deal. The largest integrated oil companies, some of them have a dealing desk that they do because that is a business they choose to be in and provide liquidity to others. But it is set up as a regular business.

Mr. PETERSON. Yes.

Mr. GENSLER. And that was another prong that if they set it up as sort of a regular business to provide that liquidity and risk management again to others.

Mr. PETERSON. And it wouldn't be fair to the people that are being regulated to have their competitors not be regulated. I mean that just seems to be——

Mr. GENSLER. Well, I——

Mr. PETERSON.—they are actually in the business.

Mr. GENSLER. I think it is that or we could look back to 2012 and then we would call it the BP loophole instead of the Enron loophole. There are very real bylaws of the International Swap and Derivatives Association that say you can only be a primary member if you make markets and not for hedging.

Mr. PETERSON. Right.

Mr. GENSLER. There are six or eight companies that voluntarily choose to do that. Now, maybe they will stop choosing to do that. It is really to make sure, as you say, that the tens of thousands of end-users, I agree with the Chairman, are not swap dealers. If they are entering into a swap—foremost to hedge, if they are not routinely, making markets, or accommodating demands of somebody else, they are not a swap dealer. If they are entering into swap, really the purpose is to hedge the energy that they are producing or the oil they have in the refinery. That is not accommodating somebody else's business.

Mr. PETERSON. One other thing, Mr. Chairman, if I could.

We have heard various reports from folks that have met with you and other Commissioners. These rumors are circulating constantly. One of these rumors is that there is some interest in the Commission of exempting high-frequency traders from the definition of *swap dealer*. Until 3 years ago, very few people outside of Wall Street had even heard of high-frequency trading and there are some indications that it may have contributed to the flash crash of May 2010. So I would have concerns about such a blanket exemption. So is this under serious consideration at the Commission, and if it is, is it wise?

Mr. GENSLER. It is something that some high-frequency traders have come in to talk about. They actually sometimes tout that they make markets. They don't yet make markets in swaps, but if they were to develop to make markets over the next several years, I think it is consistent with Congressional intent that if you are making markets, actively accommodating demand in the markets, that you would register. So I think it would be unwise to somehow just leave them out.

Now, they wouldn't be necessarily coming under let's say the sales practice regimes or external business conduct rules because in January we made sure that those rules don't cover people anonymously trading on a market. But you are correct. Some of them have been making the rounds. One came in this week and said they look forward to registering. They are registered in other jurisdictions. So actually it is even amongst that community there is a split.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Iowa for 5 minutes, Mr. King.

Mr. KING. Thank you, Mr. Chairman.

Chairman Gensler, thank you for your testimony and repeated testimony here on the Hill. I understand that you have recused yourself from MF Global and I don't want to press anything on that. I just want to ask just a very standard question I think that could be reviewed from just reading the papers, but if they had not been switching between accounts to keep themselves liquid for the day, is it a safe conclusion that they would have gone bankrupt earlier, and if so, how much earlier would you guess?

Mr. GENSLER. I don't know. I think this might be when I turn to Commissioner Sommers.

Ms. SOMMERS. Congressman, I am not familiar with the press reports that you are referring to, but I guess I would say that our current investigation is doing just what you indicated. We are tracing those transactions out of the customer segregated accounts to find out where they would have gone.

Mr. KING. If I could just——

Ms. SOMMERS. I don't know at this point whether they would have gone bankrupt earlier. That——

Mr. KING. May I just say that from where I sit—and I will just make this comment then and you can decide whether you would like to answer or not—from where I sit, if they hadn't been using segregated accounts to meet their daily call, then my position would be that they would have collapsed earlier and gone into bankruptcy earlier. That is an observation from what happens when you run into a cash flow problem. I thought that was a simple, basic question. So that is my comment on it. If you choose to disagree, that is fine. But I don't want to put you on that spot.

I would like to instead move on a little bit and direct to the Chairman, I have information in front of me that says that of derivatives—well, first, maybe I better ask this broader question. Do we know the value of derivatives and the value of swaps, total notional value of each?

Mr. GENSLER. We have approximations. The size futures market runs in the U.S. between $35 and $40 trillion a year depending upon the month and the time of year. The total worldwide size of the swap market is reported that it is a little over $700 trillion and it is estimated a little less than ½ is in the U.S. So I usually use an estimate of $300 trillion. But it is just that, an estimate.

Mr. KING. Okay. Well, thank you. That gives us a sense of the scope of this. And I have data in front of me that shows that 96 percent of the value of the derivatives in this country are in the hands of the five largest banks or in control of the five largest banks, and then if you go to the top 25 banks, you are at 99.86 percent of the notional value of the derivatives. And we have a little over 1,000 small institutions that are trading there in that .14 percent. And I would just like to know is it your intent to regulate those small banks in the same method as the larger banks?

Mr. GENSLER. No.

Mr. KING. Are you concerned—good. What would be your intent?

Mr. GENSLER. Congress gave us a flexibility to set a *de minimis* in the *swap dealer* definition. And we put out to comment a *de minimis* that many commenters came in and said was too low. And so it is under consideration between the Securities and Exchange

Commission and us. But I think we have taken those comments to heart.

Worldwide there is between 35 and 40 large banking enterprises that are currently clearing at a London clearinghouse, the big interest rate clearinghouse. Most of those have indicated they will probably register. But then when you get beyond that group, depending again where we end up, we will add a couple of key definitions, the *de minimis* and also something I would like to be asked about, about swap dealing in connection with originating loans. I think that those thousands of small banks will not be touched at all.

Mr. KING. Would you have an estimate on how many banks would be of the—I went to 25. That number, it sounds to me like it will grow, but do you have an estimate on how many banks would be covered?

Mr. GENSLER. I don't sitting here, but the 35 to 40 international banks, some of which aren't in the U.S. that are registered with that clearinghouse are the types of banks that are likely to register.

Mr. KING. So the small institutions have breathed a sigh here I think. But I would like to go to——

Mr. GENSLER. That is our goal, sir.

Mr. KING. Yes. Then I would like to go to Dodd-Frank. And if this Congress did the sweeping thing and perhaps not this year, perhaps in the next Congress and repealed 100 percent of Dodd-Frank, what would be the impact from your perspective?

Mr. GENSLER. I think the public would lose the benefits of transparency and competition in this market, this $300 trillion or so notional market. I think end-users would—they may not feel it immediately—but the next time Wall Street spills out risk, they would look back and say that wasn't such a good thing to repeal, Title XII. I am just speaking about what this Committee came together to do. I really think the public would be more at risk. Let's not forget eight million jobs were lost largely because of the financial community's risk spilling out to the economy in 2008.

Mr. KING. If I could just conclude with this, Mr. Chairman, and that is that sometime back in 2007 or perhaps in the late fall of 2006 when we were first looking at these shifts that were taking place financially that brought about this downward spiral that we are reacting to now, I remember a conversation with an investment banker who said then what you do when you are in this business is pretty much what everyone else does. That way if they are making money, you are making money, and if things fall apart and there is a bailout, you will be bailed out with the rest of them. I make that statement because I wrote that down that day. I remember it clearly, and I think it was a precursor to what actually happened. I think our investors in this country, many of the large institutions were counting on a bailout. I think they knew they were running on the edge and taking those risks and the bailout came. That prediction came true.

So I just incorporate that into the process. There are two ways to do this. One is let the investors take the risk and evaluate the collateral. The other one is to do the regulatory and the expensive thing that has not been proven by the Obama Administration.

I appreciate your testimony and the response of the Commissioner as well. And I would yield back the balance of my time.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Pennsylvania for 5 minutes.

Mr. HOLDEN. Thank you, Mr. Chairman.

And Chairman Gensler, thank you for being here. I agree with the Ranking Member's opening statement that so far in the rulemaking process, the CFTC has been really attentive to concerns that have been raised. I just have one question about farm credit, though. Last month, this Committee passed in a very bipartisan manner H.R. 3336, Small Business Credit Availability Act. Among its provisions, this bill reaffirms Congress' original intent that farm credit institutions qualify for the statutory exemption we provided in Section 1(a) of Dodd-Frank, which states, "in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer." At a previous hearing, you raised a question as to the Commission's ability to ensure that farm credit institutions would be able to get this same exemption granted to insure depository institutions. Do you still have those doubts? And do you believe the Commission has the authority to grant farm credit banks this same exemption?

Mr. GENSLER. I do believe that we have the authority. The hearing was helpful. I don't remember how many months ago and there was a Member over here that asked it but I can't remember whom.

Mr. HOLDEN. Yes.

Mr. GENSLER. And we went back and researched it. I think we do have the authority. And though the American Bankers Association recently sent us a letter and pointed out they thought otherwise. So there are comments on both sides of this but——

Mr. HOLDEN. Okay. Thanks, Mr. Chairman. I yield back.

The CHAIRMAN. The gentleman yields back. The chair now recognizes the gentleman from Texas, Mr. Conaway, for 5 minutes.

Mr. CONAWAY. Thank you, Mr. Chairman.

And Mr. Gensler, welcome to the Committee. I am going to return to a topic that is near and dear to my heart and yours as well I suspect. I feel a lot like Sisyphus pushing this rock up a hill and it rolls back down, push it back up, and that is the cost-benefit analysis that the Commission in my view needs to do on each of its rules. As you know, we have passed a bill here that would strengthen Section 15a of the Commodity Exchange Act prospectively. We are going to have to go back and redo it for these. But recently, two of your Commissioners have been pretty critical of the cost-benefit analyses that have been done, particularly with respect to the business conduct rules, examples of 1 year retention on audio conversations that need to be taped whether the technology may or may not be available, a 15 year retention on documents with respect to swaps, a duplicative requirement on retention of documents that swap data repositories in accordance with your rules would be required to maintain as well, overlapping requirements. Can you talk to us about why that is cost-effective and/or necessary that these duplicative costs need to be put in place under the business conduct rules?

Mr. GENSLER. Congress said that records have to be kept, including voice recordings. That is statute. We received a lot of comments on that and we actually moderated it. We rolled back in the final and said the voice recordings no longer have to be digitized or put on an electronic file. And in fact with Commissioner O'Malia's help right there on the dais, we even rolled back a little bit more and we assured people all you have to do is keep it and make sure that if the enforcement folks request something that you can search it. And there is a lot of software to search it by keywords. And so I think we clarified that.

To the second question about keeping books and records. Books and records are important whether it is in the futures, securities, or now swaps area so that a company can manage its risk and even report to its public shareholders and to have a check actually on the clearinghouse or somebody else. So, we did come out that they have to keep internal books and records and don't, so to speak, outsource that to somebody else.

Mr. CONAWAY. So part of your analysis will be, then, to check records against records——

Mr. GENSLER. No, not that we——

Mr. CONAWAY.—against the internal documents? We are going to run into that?

Mr. GENSLER. It is just that they have to keep books and records on their transaction and trading so that they can manage their credit risk, manage their interest rate——

Mr. CONAWAY. I understand.

Mr. GENSLER. Okay.

Mr. CONAWAY. That is all done while the trade is active. I got that. They are going to do that anyway. Fifteen years when most other retaining requirements are 10? Why the 15 year retention in this area?

Mr. GENSLER. I would like to get back to you just on that if I might——

Mr. CONAWAY. Okay.

Mr. GENSLER.—because I don't remember the retention period.

Mr. CONAWAY. Let me ask you something else. And this came to our attention just within the last day or so. Single family offices where they are doing a lot of things for really wealthy families have enjoyed an exemption under the rule. SEC has recently given them an exemption from certain rules. Are you willing to work with that community to make sure that they are treated the way they have been previously with respect to Rule 413(a)(3) to make sure that they can do their business without unnecessary regulations and new layers of cost to these families?

Mr. GENSLER. Yes, but even further than that, I think there are four exemptive letters that we have given over the last 10 or 15 years, and we said affirmatively that those would apply, as a general matter. But there is always——

Mr. CONAWAY. Okay.

Mr. GENSLER.—things that are different. So yes——

Mr. CONAWAY. My concern, though, is under the Commodity Pool Operator rules that that exemption that previously was there was not included. It may be an oversight but you are willing to work with that community?

Mr. GENSLER. Oh, absolutely. The four letters—you see, they were actually letters; they weren't in our rule.

Mr. CONAWAY. Okay.

Mr. GENSLER. So those letters, then, can be relied on by other people in——

Mr. CONAWAY. Okay.

Mr. GENSLER.—similar circumstance. It is more a question whether it is a little bit different circumstance——

Mr. CONAWAY. All right.

Mr. GENSLER.—and that is where we would like to work with that community.

Mr. CONAWAY. All right. Well, Mr. Chairman, I continue to be concerned that the cost-benefit analysis that is either there or not there is not representative and there may be other ways to get at some of these regulations and get the industry reactions and their responses to these things, that the cost outweighs the benefits associated with what we are doing make sense. So with that, Mr. Chairman, I yield back.

The CHAIRMAN. The gentleman yields back.

The chair now recognizes the gentleman from Connecticut for 5 minutes.

Mr. COURTNEY. Thank you, Mr. Chairman. And thank you for holding these hearings and, Chairman Gensler, for your endurance. These are really important issues. And coming from Connecticut where my local gas station hit $4 a gallon last week, again, the importance of the work your Commission does is in people's faces every single day. I mean the data that we are seeing that is widely reported in the media, that supplies are higher than they were 3 years ago when gas was $1.90, that demand is down from where it was a year ago. Yet, we are seeing this spike happening in February of all times of the year at a moment when our recovery is finally getting some traction, again, to me just underlines the need for the Commission to move forward on what the Dodd-Frank bill mandated.

I have been reading the pleadings in the court challenge that somehow suggest that you exceeded your discretion by imposing these position limits last October. That is ludicrous. The law is crystal clear that this is something that the Commission was required to do. And not just to do it but to do it expeditiously.

I mean frankly there are a lot of folks in my state who are upset with the fact that it took so long for the Commission to extract the rule. And again I am not pointing the finger at you. I realized you had a juggling act in terms of trying to line up three votes on that Commission and you did it and I salute you for it. But obviously, we are 5 months out since that vote occurred and yet there are still no rules in place again with all of the negative trends that we are seeing reemerge again, the very issue which the Dodd-Frank legislation was intended to address. So, number one, I mean if you could give us an update because people are anxiously looking to you for relief here in terms of where we stand as far as the implementation of the October rule.

Mr. GENSLER. I think you refer to the position limit rule and that rule would go into effect after two important things. First, that we finalize jointly with the SEC the further definition of the term *swap*, the product definition rule. We have made good progress, but as you have seen on the *entity* definition, we have scheduled that once and rescheduled it a couple times so I would think the product definition rule is this spring to give you a realistic time frame. Second, that we collect 1 year of data. We started collecting that data last fall and I think the year runs through this August if I am not mistaken. It needed 1 year of data to collect and then apply the formulas. And then, of course, as you noted, there is this court challenge on the core question that, of course, I think you and I agree. I think if there is ever a clearer Congressional intent, this was— I mean people talk about intent on end-users and intent on the Farm Credit Bureau, but if there was ever an intent, I think the position limits this Committee had spoken of a number of times from 2008 on.

Mr. COURTNEY. Well, I know Commissioner Chilton issued a statement a couple of days ago again acknowledging the fact that you were able to muster the votes to get that measure through last October, but frankly, time is the enemy here in terms of trying to get a market that is transparent, that has some connection to supply and demand. I would urge you to—and I wrote to you a few days ago on this specific point—to get those position limits to follow the law, which is what the Congress enacted. You know, this Committee tried to trip up that law with H.R. 1573. Luckily, it has not moved forward, the 2 year stay on the Dodd-Frank legislation. But, the impact in terms of small businesses, individuals, consumers, the payroll tax cut extension which we just passed a few days ago, it is just going to go up in smoke literally at the gas pump. And it is just critical that we get these rules in place. I don't know if you wanted to——

Mr. GENSLER. I was just going to say I think some of what we have done has been very significant. We will have brought greater transparency to these markets by this summer when reporting has to begin in these markets, energy swap markets included. We have passed very strong rules unanimously, I recall, on anti-manipulation to give us new authorities to chase after folks that are manipulating markets. So I think we have done some very good and constructive final rules that are in effect, it will take some time to implement, but you are correct; the position limit rule takes a little longer.

Mr. COURTNEY. And last, the impact in terms of government spending as far as these price increases in terms of our military dwarf whatever your budget request is that came in. And again I hope that this Congress will recognize that you have hard work to do and that you need the staff to do it to protect our economy.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman yields back. The chair now recognizes the gentleman from Arkansas, Mr. Crawford, for 5 minutes.

Mr. CRAWFORD. Thank you, Mr. Chairman.

And thank you, Mr. Chairman, for your appearance today. I just want to ask you in your decision-making process, why have you chosen not to convene an Ag Advisory Committee since the grain, hog, and beef industries have been so severely impacted by the MF Global meltdown?

Mr. GENSLER. We consult with members of the Ag Advisory Committee pretty regularly. Some of them are even participating in this 2 day roundtable that was referred to. The actual formal meeting of the Committee, the last number of years, I think 6 years, has been once a year. We are only in February but we are certainly going to bring that together as a formal group and have a public meeting. We did have Commissioner Dunn, who had so successfully chaired it for years, retire, and so we also have to find a way to move forward but we are absolutely committed. And we use Members of the Committee as much as we can and seek their advice.

Mr. CRAWFORD. Do you have a timeline on that, when you might convene that just yet?

Mr. GENSLER. I don't because, it involves a little bit of working with the General Services Administration because charters have 2 year clocks and things like that. But we would be glad to work with your office and get you more details.

Mr. CRAWFORD. Okay. Thank you. Of course you know ag co-ops, for example, provide swaps to their members and then enter into another swap to offset that risk. This is critical to their ability to continue to provide hedging tools to members of their co-ops. In that scenario, would the offsetting swap make an entity eligible for the end-user clearing exemption?

Mr. GENSLER. Well, I think that—and I hope as we finalize this we have spent a lot of time with the agriculture cooperatives around the *dealer* definition again and if it is an agriculture cooperative that is Capper-Volstead and dealing with another co-op or one of its members. It is almost like an inter-affiliate transaction. I think we have worked through an approach subject to Commissioners of two Commissions voting on it that they are not going to get caught up in the *dealer* definition. To your question, then, if they are not a dealer, they are an end-user. I mean they are just then by definition an *end-user*.

Mr. CRAWFORD. Okay. Would the offsetting swap meet the definition of a *hedge of commercial risk?*

Mr. GENSLER. Well, I think they would be an end-user if they are not a dealer so any of their swaps, they would have a choice whether to come to a clearinghouse. And under our end-user exception that I think is what you are referring to, the proposal I believe would be a yes to that if that—I am trying to follow the question but I think what you are referencing is would they be exempt from clearing if they choose to be? And I think the answer is yes.

Mr. CRAWFORD. Right, okay. Let me switch gears to small banks real quick. Out in the country it is important for me, farmers, and ranchers that they be hedged against commodity price risk in order to qualify for loans from their local banks, the relationship between commodity hedging and borrowing. It is exactly what Congress intended to preserve in the swaps in connection with loans exemption from the *swap dealer* definition. Will community and mid-sized banks that provide commodity swaps to their loan customers be eligible for this exemption under the final swap dealer rule?

Mr. GENSLER. We have received comments; we are still looking at it. Again I think, as I mentioned to other Members, because of how we are addressing ourselves to the market-making definitions and *de minimis* definitions, those community banks to which you refer, I am not aware of any that will probably be above some of these numbers. But I am not suggesting there might not be one or two.

Mr. CRAWFORD. Okay. And finally, in the little time that I have left, if the commodities swaps that small and mid-sized banks provide to loan customers are not covered under the *swap dealers* definition in connection with loans exemption, continuing to provide those swaps will make them swap dealers and subsequently subject to Section 716 push-out provisions. So my question is has the CFTC examined the impact within the context of the swap dealer rule?

Mr. GENSLER. We are aware of it. It is part of our discussions. Again I think, you refer to community banks, particularly because there is an interplay between a *de minimis*, how high to make that, the definition of *market-making,* in essence how tight to make that. That, as I said earlier, I think the community banks—I mean if there is one that you specifically know of and your staff wants to share with us, it would be helpful to understand the issue better.

Mr. CRAWFORD. All right, thank you. I yield back.

The CHAIRMAN. The gentleman yields back. The chair now recognizes the gentleman from Vermont for 5 minutes, Mr. Welch.

Mr. WELCH. Thank you very much, Mr. Chairman.

Thank you, Chairman Gensler, for being here. I want to talk a little bit about gas prices in speculation premium. I have an article from *Forbes* that basically goes through a Goldman Sachs analysis that says that there is likely a $23.39 speculation premium in the price of a barrel of oil if oil is at $108 a barrel, which when this study was done it was at. What it talks about is that the positions on NYMEX for future contracts is the equivalent to 233 million barrels of oil, which is the equivalent of 1 year's crude supply from Iran to Western European nations like France, Belgium, Greece, Italy, and Spain. And it goes on to do an analysis in the careful Goldman way to state that if there is a $23 a barrel speculation premium, that translates into about 56¢ per gallon of gas. And obviously, that has a brutal impact on our consumers and it has a brutal impact on many of our manufacturers that depend on petroleum products.

Also, this is happening at a time when our production is high, our demand is relatively low, and the United States is actually exporting gasoline. Do you have the resources that you need to address the speculation premium that is now injected into the price of gasoline at the pump and that is doing so much harm to our economy and so much damage to the pocketbook of everyday consumers?

Mr. GENSLER. I will take a broader question. Do we have the resources we need? No, because Congress just gave us a large task. I hope that once we have finalized these rules, which I anticipate most will be done by this summer—there will be a handful that will take longer—that we can move on and work with this Committee, work with the appropriators and get the resources to move the agency close to a 1,000 person agency from 700 person agency. I do think that rising energy prices is a reminder as to why this is a good investment to the American public.

Mr. WELCH. The point of our legislation I think was to acknowledge that the futures market is absolutely essential for end-users, but that to the extent it is manipulated by Wall Street speculators, it is for their benefit at the expense of consumers in the productive economy. Is that a fair statement?

Mr. GENSLER. Absolutely. We are a good investment for the real economy. The real economy is 94 percent of the jobs in this country and I sometimes feel that people are trying to tip the scales back to Wall Street.

Mr. WELCH. Do you have any reason to dispute the analysis by Goldman Sachs as to how much of a price is being imposed through speculation as opposed to supply and demand?

Mr. GENSLER. I know it has been quoted by many. There are other analyses that say other things but I don't have things to either support it or deny it.

Mr. WELCH. All right.

Mr. GENSLER. To support or deny Goldman Sachs' analysis I just don't know.

Mr. WELCH. All right. Now, many of us who have supported legislation that would provide a steady and stable funding source for you—not you so much as your agency to do the work that needs to be done on behalf of consumers in the productive economy, much like the SEC, a small fee on transactions. Is this something that would be helpful to make certain that your agency had the resources that it needed to act on behalf of consumers and the productive economy?

Mr. GENSLER. The President referenced this in his recently sent budget to the Hill. I think prior Presidents of both parties have raised it. I would support whatever this Committee and Congress thought would help ensure that we have the adequate resources, whether it is out of the general Treasury or if these—I am supportive either way. And if this Committee would like to work on it, I would work with you on it.

Mr. WELCH. Well, I thank you, Mr. Gensler.

And Mr. Chairman, this seems like an area of common interest because all of us represent consumers who are getting hammered. We represent Democrats in Republican districts and we represent Republicans in Democratic districts and every one of us has been hearing from families where they are just wondering why, if the demand is going down, the price is going up and how in the world they are going to pay for this. And it is hurting our manufacturers as well. So if there is any way, Mr. Chairman, that we can find our way clear to help get the price down, I think we ought to do it.

I yield back.

The CHAIRMAN. The gentleman's point is appreciated. The gentleman yields back.

The chair now recognizes the gentleman from Illinois, Mr. Hultgren, for 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman.

And thank you, Chairman Gensler, for being here today. I apologize. I had another Committee so I just stepped out for a few minutes, so if any of this is repetitive, I apologize, but they are important questions for my constituents that I wanted just to ask and see if we could get some answers for.

One is I am just concerned about the continued delays in rule-making process that are creating regulatory uncertainty and affecting the ability of especially rural electric and farm co-ops to plan for the future, especially with regard to the pending definition of *swap dealer*. After several apparent delayed votes on that rule, I am wondering if you could give my constituents any idea of what to expect, when to expect it, specifically wondering on what your prediction is for the *de minimis* exception and where that will be set.

Mr. GENSLER. All right. I would like to not get out ahead of not just my Commission, but the SEC as well, so it is ten Commissioners' deliberation. You are right; we had hoped to vote on this and then there was more collaboration over at the SEC to go on. But in terms of the *de minimis*, higher than where we were without pinning myself down because it is ten Commissioners weighing in. And that with regard to the agricultural co-ops, as we have said, we have worked a lot with the community with this Capper-Volstead community offering risk management through swaps to their members. We are going to do our best to try to treat that like it is an affiliate situation.

And then on the rural electric cooperatives and municipal power authorities, we have been working on this, I think it is now for 6 or 8 months. We are hoping that they will come in and file a petition. We have been working actively with them. And then we will put it out to public comment and get what is called a 4(c) exemption, but we have to vote on it, put it out to public comment, and then finalize it. We are doing something similar with the regional transmission organizations. I hope we are close to them filing the actual petition but we are not there yet.

Mr. HULTGREN. So the delay is their filing or is the delay from your office?

Mr. GENSLER. Well, on the rural electric cooperatives I just want to say we have been working very cooperatively, but yes, I mean because that community is so diverse, in fairness to them to put this petition in front of us does take some coordination between a lot of actors in their community. But I can't speak for other Commissioners but I am personally supportive of it.

Mr. HULTGREN. What is your best guess? You know, is it 30 days? Is it 90 days? Is it 120 days for that specifically? And then also you had talked about dealing with the ten members, waiting for them to respond.

Mr. GENSLER. With regard to the finalizing the definitions, the entity definitions, it is my hope that it will be through this coming month, March. With regard to the cooperatives, the rural electric cooperatives, if we could get back to you but I was hopeful that we were going to have a petition in February but I don't want to speak for them. If the petition came in, then we would put it out to public comment. So I would say it is probably well into the spring by the time we start to get the public comment. And I that, I believe, takes 30 days as well.

Mr. HULTGREN. Well, okay. Again, I wasn't here for all of the debate on Dodd-Frank, but I am wondering just a little bit. You know, getting back to this *de minimis* exception, the $100 million level to start with, was that ever realistic? It just seems like such a low number and opens it up to so many questions out there, again, for my constituents and just wondering again if there is a recognition of what I see as just an unrealistic number and hopefully a realization that——

Mr. GENSLER. We have gotten a lot of comments—you are absolutely right on this—from whether it is community banks, end-users, and we are taking them very seriously.

Mr. HULTGREN. Okay. And maybe again you have already discussed this a little bit but we have been hearing a lot of questions about this as well. With commercial hedging, they are wondering if that will expressly be excluded from the activities that constitute swap dealing under the rule?

Mr. GENSLER. Congress laid out a number of important prongs. Market-making is one of them and regular business is another one if I might say. And so a lot of commenters came in and said, well, what is market-making? Can you be more specific about that? And in my mind—I am just speaking off the top of my mind. It is really about routinely making yourself available to others who need to hedge, not about your hedging. So it is not about some energy company that the purpose of what they are doing is hedging the oil in the refinery.

In terms of regular business we received a lot of comments about that. Can we be a little bit more specific and explicit about that? And again I don't want to speak for other Commissioners but in my mind I think there are things we can do there to help people out and of course address through the *de minimis*. Sometimes that is just an easy way to help folks.

Mr. HULTGREN. Well, hopefully it can be both, because I think both create that uncertainty and continue that. So my hope is that it can be well defined and what I am hearing from you is you are pretty much saying you don't have control of it. We would probably argue you have a little bit more control——

Mr. GENSLER. No, no, I——

Mr. HULTGREN.—than you are letting on, but, we want to make sure that we are getting that assurance that again there is going to be some express exclusion of commercial hedging. People who aren't in the business of that are in the business of trying to serve their customers, to run a business and knowing the uncertainties of agriculture and the commodities markets.

Mr. GENSLER. I think that we will sufficiently address the issue of hedging in the context of a producer or merchant. That is your point——

Mr. HULTGREN. Well, I look forward to seeing that. So thank you very much.

I yield back.

The CHAIRMAN. The gentleman's time has expired. The chair now recognizes the gentlelady from Ohio for 5 minutes, Ms. Fudge.

Ms. FUDGE. Thank you so much, Mr. Chairman.

And thank you, Chairman Gensler, for being here. I just have two brief questions.

You may well know that Congressman Steve Stivers and I introduced H.R. 2779, which is a bill that would exempt certain inter-affiliate transactions from swap dealers from meeting margin and clearing requirements. This would ensure that transactions are not classified as separate transactions. If these contracts are classified as separate transactions, there is a concern that it will increase the cost for customers of the products and it will impede the ability of businesses to manage their risk.

I have two questions. The first is that you talked about it, as well as in your testimony, you state that the final rules will include exceptions for inter-affiliate swaps. Is that going to be in that group that is coming in the summer or when is that?

Mr. GENSLER. Well, some of them have already been completed. For instance, in December we completed the reporting rule and I know in your bill I think you addressed reporting as well.

Ms. FUDGE. Right.

Mr. GENSLER. This is the public reporting or real-time reporting. So we addressed affiliate swaps there that are not really arm's length transactions and so forth. We addressed in January in the sales practice or external business conduct where again these affiliate transactions that aren't at arm's length. So we shouldn't have to protect the sales practices in that regard.

In most affiliate transactions, if one party is an end-user, there will not be any clearing requirement. But what we think we need to do is probably publish for notice and comment—and we believe we have the authority to do it—but publish for notice and comment between a financial company and its financial affiliate where both are financial companies. That is the one area. So for the end-user community, I truly don't believe that this is an issue but it is just within an insurance company between two of its affiliates, for instance.

Ms. FUDGE. What do you think that time frame is, I mean, to be——

Mr. GENSLER. I need to put out a proposal on this. Given our calendar it is going to be likely in the spring and then we have to put it out. Maybe we will decide only to put it out to 30 days comment instead of 60 because sometimes where there is more consensus we might go a little shorter. And in this whole area we have about 20 or so more rules. Adding an inter-affiliate, adding others maybe there will be 25. As I say, we will be working through the summer and fall possibly on some of these.

Ms. FUDGE. Okay. Thank you. And the second part of my question is I understand that the SEC has suggested that they will treat these transactions differently than you may. Can you discuss how you plan to address the concerns of market participants when they may have to comply with two different sets of rules on the same product?

Mr. GENSLER. We spent a lot of time with the SEC in trying to harmonize and sometimes advocate for our point of view. On the trades between affiliates I have not been brought—it is just not brought to my attention but if your office could help me, if there is something that you think the SEC is not doing that I should know about, I would like to help you on that.

Ms. FUDGE. We will certainly be in touch. Thank you.

I yield back.

The CHAIRMAN. The gentlelady yields back. The chair now recognizes the gentleman from Nebraska for 5 minutes.

Mr. FORTENBERRY. Thank you, Mr. Chairman, for holding this important hearing.

Chairman Gensler, welcome. What is causing the rise of the price of gasoline?

Mr. GENSLER. You know, I am spending so much time thinking about enhancing customer funds and working on these rules, but what we are, we are not a price-setting agency. It is not what Congress asked us to do. We are an agency that oversees the markets to ensure that they are transparent, competitive, and free of fraud and manipulation. And so that is what we can best do to ensure that these energy markets work and that whatever price, high or low, in the energy markets and the agriculture markets reflect buyers and sellers, both hedgers and speculators meeting in that market.

Mr. FORTENBERRY. Here is what is at issue: if you look at demand for gasoline, in fact you see lower demand currently. Supply disruptions, perhaps volatility in the Middle East are a factor but not significant enough to probably correlate directly to this spike that we are seeing currently. Back to Mr. Welch's question earlier, it has been suggested by your own Commissioner in a recent article, Bart Chilton, that there is a speculative premium built into the price of gasoline that may be as much as 56¢ per gallon. Do you agree with that assessment?

Mr. GENSLER. I agree that we need to make sure that our markets have a strong oversight, that we have a strong anti-manipulation regime, that we have transparency, and yes, that we complete position limits. That is where Commission Chilton and I are——

Mr. FORTENBERRY. Do you think these——

Mr. GENSLER.—aligned.

Mr. FORTENBERRY.—current speculative position limits would adequately address the problem?

Mr. GENSLER. I think that the whole regime—I must say I think that the limits are one part to ensure integrity of a market but I think that it is critical that we complete the other rules with regard to transparency. That we actually give the public the benefit of this whole work that this Congress did and that we are now about a year late on.

Mr. FORTENBERRY. What would you surmise the correlation to be between the Federal Reserve's loose monetary policy is driving down the value of our currency therefore increasing commodity prices, particularly oil, which tends to lead the other prices. What is the correlation there? In other words, our debt and the way in which we are printing money to solve it is lending itself to higher commodity prices, that is a major factor in this uptick of retail gasoline prices.

Mr. GENSLER. I have not seen a study on——

Mr. FORTENBERRY. I haven't either. That is why I am asking you but we are trying to examine all of factors here that are involved——

Mr. GENSLER. Right.

Mr. FORTENBERRY.—I mean something is doing it.

Mr. GENSLER. You are absolutely correct but if I might return. I think our role as a Commission, as an agency is not to set a price or even that a price is low or high. It is——

Mr. FORTENBERRY. No, I understand.

Mr. GENSLER.—really that the markets are transparent and work for the American public.

Mr. FORTENBERRY. I understand. You are just an expert in the dynamics of these markets so it would be helpful to hear your opinion as to all the factors that are driving up the price in this regard.

Mr. GENSLER. Though at any one time there are many factors, I am not aware of a study—and if there is one, I would certainly read it and so forth—but on the specific point that you mentioned about the monetary policy and so forth——

Mr. FORTENBERRY. It could be a factor?

Mr. GENSLER. Well, there are many factors that come into markets. These markets, to just give you a sense of the oil market today, the oil market today—and we publish these figures every Friday—has producers and merchants and that makes up between I think 13 to 15 percent of the open futures market. And then there are swap dealers that make up a big group. And then the managed money, that is the hedge funds, and then other financials. So somewhere between 80 and 85 percent of the futures market are swap dealers and what we call managed money or hedge funds and other financials and 13 or 15 percent of the futures markets—this is on NYMEX and so forth—are the producers and merchants.

Mr. FORTENBERRY. How has that ratio shifted through the years? It used to be inverted is my understanding.

Mr. GENSLER. We have only been breaking out this into four categories. We started doing that about 2 years ago and we have published I think 5 prior years. So over those 7 years it has shifted a little less than you said, but yes, it has shifted.

Mr. FORTENBERRY. Significantly?

Mr. GENSLER. A little bit more towards financial——

Mr. FORTENBERRY. I am about to run out of time. I am sorry to interrupt you. I think the broader point here is we are deeply concerned that a system originally designed to mitigate risk is actually creating risk now.

Mr. GENSLER. Well, I think that that is just a keen reminder as to why we have to continue to get our oversight right and also that we need to be a fully resourced and funded agency.

Mr. FORTENBERRY. Thank you.

I yield back.

The CHAIRMAN. The gentleman's time has expired. The chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. DAVID SCOTT of Georgia. Thank you, Mr. Chairman.

Welcome, Chairman Gensler. Chairman Gensler, let me ask you. The whole core of what we are trying to do rests on funding. We can write all kinds of laws; we can put out all kinds of regulations. Dodd-Frank is a tremendous, tremendous law, very complex and it puts a tremendous responsibility on your agency as the regulator. So I need to know and I think the Committee needs to know and the American people need to know your real serious thoughts on the funding of it. And I specifically want to ask you if you do not have sufficient funding, could we see delays in reviewing, for example, applications for new swap execution facilities, designated clearing organizations, and swap data repositories?

Mr. GENSLER. I thank you for that question. The answer is yes, we could see delays. We are about a 700 person agency, and with the help of this Committee and Congress, we have $205 million of funding. That is only about ten percent more staff than we had in the 1990s. And now, I deeply respect you all have a very hard job with the appropriators. We are asking, along with the President, for funding to move up to $308 million, a little over 1,000 people, 300 more people because we are taking on a market eight times the size. We do not right now have what I would consider a plan that is adequate to address all the registrations that will come in. We expect between 20 and 30 swap execution facilities, a handful of data repositories, two or three more clearinghouses. We are going to rely on the NFA to register dealers. We are probably going to borrow some of our enforcement staff and move some enforcement staff for 6 months or so to try to deal with some of these registrations. But that is a backup plan at best. It is the plan we have but it is not a plan that I think is the best for the American public.

Mr. DAVID SCOTT of Georgia. And this would also apply to delays in reviewing swaps to see if the clearing mandate should apply, requests for exemptions to the law's provisions as well.

Mr. GENSLER. Hopefully, the clearinghouses will start the review of mandatory clearing this spring but you are absolutely correct that when people knock on our doors for interpreter letters, no-action letters, exemption petitions, this is a human exercise and we do need more technology; but the computers can't just take an exemptive request and put it one end of the computer and it prints out at the other end.

Mr. DAVID SCOTT of Georgia. I think that is very important. And I think that we owe it to your agency if we are drafting these major pieces of legislation which are needed, certain tweaks certainly need to be made here and there. But there are forces at work that don't like Dodd-Frank. There are forces at work to find creative ways of trying to do away with Dodd-Frank and there is no more clearer way of accomplishing this than starving the very agencies and the regulatory people we assign to do the job. It is sort of like cutting the legs out from under somebody and then condemning them for being crippled.

Mr. GENSLER. Well, I would have to say to you, Congressman, I believe working with my fellow Commissioners and an excellent staff, we will get the rules finished and then the industry will want people there. But you are right; we will not have the people even to examine the clearinghouses on an annual basis, on a regular basis.

Mr. DAVID SCOTT of Georgia. Let me ask—and I have 1 minute to go—and our Ranking Member brought up an interesting subject of extraterritoriality. I hope I pronounced that long word right. And it is also an issue that you and I have discussed in my other committee, Financial Services. It is my understanding that the SEC Chairman Schapiro has announced that the SEC will issue a formal rulemaking related to the extraterritorial application of the Dodd-Frank law. Can we expect the CFTC to also issue a formal rulemaking on the extraterritorial scope of the Dodd-Frank as the SEC has announced?

Mr. GENSLER. Though our statutory situation is a little different, we will seek public comment on what is called 722(d) or it might be called 2(I) of the Commodity Exchange Act. They don't have that provision but that is basically the core to this question. In addition, I am hoping to get public comment through that release on swap dealer—where we defer to foreign regulators. We have a long history of deferring to foreign regulators. I am hoping that we can continue to do that but that will be also—and hopefully get public comment on it.

Mr. DAVID SCOTT of Georgia. All right. Thank you very much, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

For the benefit of the Members, it is worth noting we will next go with Mr. Schilling, followed by Mr. Boswell, followed by Mr. Huelskamp, followed by Mr. Thompson, and finally Mr. Tipton.

With that, Mr. Schilling is recognized for 5 minutes.

Mr. SCHILLING. Thank you, Mr. Chairman.

Good to see you again, Mr. Gensler. As you know, Congress provided an exemption for captive finance affiliates from both the definition of *major swap participant* as well as the definition of *financial entity* for the purpose of end-user clearing exception. The statutory language, however, leaves room for interpretation by the Commission and the operational realities of the financing provided by captive finance companies require additional clarification from the CFTC with regard to how they intend to interpret the calculation of the 90/90 rule. For example, take a tractor made by John Deere in Moline, Illinois. The tractor may have an implement that is not made by John Deere. Are they allowed to finance this transaction?

Mr. GENSLER. Though I am very familiar with the provision and we will carry out the intent of this Committee and Congress on the captive finance provision, I would like to sort of work with staff and get back to you on the specific question of the—I think if I follow the question is if John Deere sells a tractor but there is an implement that they sell with it——

Mr. SCHILLING. Right. Like let's say they sell a tractor and then they have an auger that goes with it——

Mr. GENSLER. Right. Right.

Mr. SCHILLING.—are they going to be able to do that basically?

Mr. GENSLER. Well, I know they will be able to sell it but your question about because the provision says that 90 percent of what they are financing has to be what they are manufacturing if I remember?

Mr. SCHILLING. Right.

Mr. GENSLER. And so it is a question of whether the auger, because it is not something they manufactured, would be counted against the 90 percent?

Mr. SCHILLING. Exactly.

Mr. GENSLER. I think that our proposal didn't speak negative or positive to it, but I know this question has come up and I don't know how we would address it other than in a facts and circumstances. But certainly if I can talk to staff afterwards and get back to you.

Mr. SCHILLING. Yes, that would be great because as I understand many of these companies are already hearing from the other folks that they do business with and they will demand assurances that these captives qualify for the exemption before they will trade with them. So it is just another piece of—certainly I think that the John Deeres to Caterpillars and other companies out there just really need to have some good solid clarification to where it is not going to be second-guessing by you guys, so, very good.

With that I yield back my time. Thank you, sir.

The CHAIRMAN. The gentleman yields back.

The chair now recognizes the gentleman from Iowa, Mr. Boswell, for 5 minutes.

Mr. BOSWELL. Well, thank you, Mr. Chairman.

And thank you, Chairman Gensler, for your work. It seems to me like if we just give you the tools and get out of your way you will get on with it, you have lots to do and it is just kind of holding you up.

But we keep discussing it and this is not a criticism, Mr. Chairman. This is just a discussion. It seems like half of our hearings have been about this subject, full Committee and probably as much on the Subcommittee. And I am sure you will have something to say. But I will yield to you momentarily.

I understand and I support the need for Congressional oversight but I believe we must get to other business, too, and I am concerned about the farm bill. Many of us have experienced the hands-on, you and me, and we know the plan. We have to have a little information to plan ahead. And you probably know things I don't know about this farm bill so I just hope we get to it. I think it is important and I know you do, too. So you might comment on that.

Another issue, Mr. Welch touched on it, and this *Forbes* report about speculation in the cost per barrel. Now, I have spent a lot of my life in Texas and a lot of my life in Oklahoma and I know what those arms going up and down mean. I see them all over the place, even I believe where the State Capitol grounds, in Oklahoma, used to be. So I understand that. I am not quarreling about that. But I just feel like that this gasoline price impact on our producers, economy, everything about it, we owe it to our people that we support that they have other options as well as they go about planning their business and not relying on OPEC and Wall Street. So could you comment on some of that for my ratification and my clarification or whatever?

The CHAIRMAN. And the gentleman yields and I appreciate that yield. To the fine gentleman from Iowa I would note as far as the farm bill goes, this is one of those issues where as the pieces come together we will move as aggressively together as we possibly can. Whether it was last fall in the hurry-up effort for the Super Committee where the chair and the Ranking Member worked very diligently with the chair and Ranking Member of the other body to try in a time frame that was very tight to craft policy. Unfortunately, the rest of Congress and the Super Committee didn't match the efforts of the House and Senate Agriculture Committees. Whether it was that scenario or the situation we are in this summer, we are going to do everything within our power working with every Member of this Committee in regular order to craft that good farm policy and move us forward.

As far as the number of hearings that this Committee has dealt with that relate to Dodd-Frank and the Commodity Futures Trading Commission, I just simply observe that the very aggressive rulemakings process that the Commission has gone on mandated by Dodd-Frank has the potential for tremendous effect on the economy, not just agriculture but the entire national and international economies. And doing our responsibilities of oversight, looking over the Chairman's shoulder on a regular basis, asking the Chairman lots of pointed questions on a regular basis is a part of our responsibility and I believe that helps him and his fellow Commissioners do a better job in their important role. And we will continue to work that.

I won't deny to you for a moment that when all of this is done and all the rules are in place and hopefully everyone agrees on the same interpretation, if we never have another CFTC hearing as long as I live, it will be too soon. But that said, until we reach that magic point, we are going to do our job. And I would also note to my good colleague from Iowa that very soon we will announce a series of hearings in the field addressing farm bill issues. I suspect after that there will be a few more hearings here in this very Committee chamber addressing farm bill issues and we are going to load our quiver, we are going to sharpen our blades, and we are going to get after that farm bill, sir.

Mr. BOSWELL. All right.

The CHAIRMAN. Thank you for those questions.

Mr. BOSWELL. Well, thank you for the reassurance.

And thank you, Mr. Gensler, for your work. I know we gave you a lot of responsibility and a whole volume of rules to come up with and so on but I appreciate your work and the time that you have had to spend answering questions from me and so on, thank you for that. And I wish you continued success.

And Mr. Chairman, thanks for your remarks, but speculation is going on. I don't know to what degree out there but I think we probably do and I do think we do agree that we have responsibility to do everything we can. I know we agree to do everything we can to let our producers out there know what they have to deal with.

Thank you for your efforts, I appreciate it. I yield back.

The CHAIRMAN. And the only comment I would add is just let it rain in Oklahoma. With that I thank the gentleman and he yields back.

And I now turn to the gentleman from Kansas, Mr. Huelskamp, for 5 minutes.

Mr. HEULSKAMP. Thank you, Mr. Chairman.

And I appreciate the opportunity to visit with you, Mr. Chairman, as well. And I know in one of your previous answers you said that your main priority, a top priority was enhancing customer funds and I wanted to follow up with a few more questions. I know you were unable to make our hearing in November on MF Global and I understand. And these questions will be directed—before you recused yourself from the investigation, I would like your comments that given that 99 percent of MF Global's accounts were commodity accounts regulated by the Commission, do you think it was appropriate the bankruptcy was structured as a SIPA bankruptcy, thereby stripping customers of their priority status?

Mr. GENSLER. If I might just try to answer it in a general question about when futures commission merchants under our jurisdiction and regulation are also broker-dealers under the Securities and Exchange, there is the bankruptcy protection of SIPA, the Securities Investor Protection Act, and there is the bankruptcy protection which is in the Bankruptcy Code and so forth and they interact. But as I understand it from my knowledge of this from staff is that once it is a joint broker-dealer futures commission merchant and there are securities customers at risk the way the law interacts is that the Securities Commission and SIPA can put it into a SIPA Trustee. The good news though from what I understand is everything that is in the Bankruptcy Code to protect the futures customers, Subpart 4 I think it is called, or our code rules 190, they have to use those same provisions.

Mr. HEULSKAMP. Customers with segregated funds that were lost, they did lose their priority status, is that correct, with this approach in bankruptcy?

Mr. GENSLER. I might have to turn to Commissioner Sommers because it is about this specific matter, but I don't know. I mean I am able to sort of——

Mr. HEULSKAMP. I have a couple other questions as well. And Ms. Sommers, if you would answer that question, I would appreciate that.

Ms. SOMMERS. Of course. Thank you, Congressman. In the SIPC proceeding for MF Global, commodity customers have an exclusive right to the customer property that were in the segregated accounts. They did not lose their priority status in that particular bankruptcy case.

Mr. HEULSKAMP. Okay. Thank you. Second question would be, Mr. Chairman, I guess given it was obvious on October 31—and I know you weren't able to make our November hearing I guess on this issue—it was obvious by then from the details that we have seen that customer funds were missing and likely commingled. Why didn't the Commission move immediately to freeze the assets of MFGI and MFGH with that knowledge in hand on October 31?

Mr. GENSLER. I will try to answer just that what I know about from that weekend. I think that is before I recused myself. But just from what I know about that weekend, MF Global had filed that they were in compliance each day and that weekend, most of that Sunday the company, not us, were working to move the customer positions to another company, Interactive Brokers. And so there were a series of conference calls on that Sunday to help facilitate the movement of the positions. And as it has been widely reported, somewhere around 2:30 in the morning that I was woken up and told, no, that is not the case. And then a few hours later this SIPA—I mean the protections of SIPA and the bankruptcy court were put in place.

Mr. HEULSKAMP. Put in place on what day?

Mr. GENSLER. The same——

Mr. HEULSKAMP. At 2:30 in the morning? The same day?

Mr. GENSLER. Well, no, they weren't put in place until whatever—I don't know if it was 6 or 8 hours later.

Mr. HEULSKAMP. Okay. So you had no knowledge or no one at the Commission had knowledge before that that there was a commingling of funds occurring?

Mr. GENSLER. I can only speak to what I know of.

Mr. HEULSKAMP. Well, yes. That is why I am asking you the questions. I don't want to ask anybody else because you are the head of the Commission. This is 10 days before you recused——

Mr. GENSLER. I was woken up around 2:30 in the a.m. on the 31st of October.

Mr. HEULSKAMP. And did they tell you funds were commingled at that time?

Mr. GENSLER. To be more precise I was told that there was—that the account was—I don't actually remember the words but the word that you used was not used. It was just that the——

Mr. HEULSKAMP. Well, tell me what word they used, please, if you would if you can remember. What, we are talking about billions of dollars. I know we are talking about 2:30 in the morning for you but these are billions of dollars for farmers and ranchers that have just been lost——

Mr. GENSLER. Absolutely. I recall being woken up and saying—being informed with a lot of people on a phone call—international regulators, the SEC and so forth—that the customer funds account was not—that the deal with Interactive was off and the customer funds account was not whole.

Mr. HEULSKAMP. So there were customer funds missing. That is what you were told?

Mr. GENSLER. I don't recall the exact words, sir.

Mr. HEULSKAMP. Okay. And, Mr. Chairman, if I might just for 30 seconds, if I can just figure out—then could you provide for the Committee what you were told at that time at a later moment? And again this is 10 days before your recusal or whatever you are, a nonparticipant——

Mr. GENSLER. I want to work with this Committee but also not prejudice an ongoing investigation of the career staff and so forth. So——

Mr. HEULSKAMP. So you won't tell us what you were told then, Mr. Commissioner?

Mr. GENSLER. No, I want to work with this Committee and—but it is also what was told to any representative of the CFTC over that——

Mr. HEULSKAMP. Okay.

Mr. GENSLER.—weekend, and I was a representative of the CFTC is also a matter of an investigation as well so——

Mr. HEULSKAMP. So are you personally being investigated?

Mr. GENSLER. No.

Mr. HEULSKAMP. Is that why——

Mr. GENSLER. No, it just is a fact——

Mr. HEULSKAMP. So I want to ask you as a Member of the Committee that you will tell us in writing if necessary what exactly you were told at that time of the night.

Mr. GENSLER. And we are just working with the Committee and the Division of Enforcement.

Mr. HEULSKAMP. Well, I don't care about the Division of Enforcement. This is a request from myself as a Member of this Committee and I am not asking about the division and I would just like to know what you and apparently dozens of other folks were told.

So thank you, Mr. Chairman.

The CHAIRMAN. The gentleman yields back.

The chair now recognizes the gentleman from California for 5 minutes.

Mr. COSTA. Thank you very much, Mr. Chairman. Good hearing this morning and I have several questions.

One, and California is specifically related. Last hearing on the markup of H.R. 3527 you may or your staff may have informed you that there was a California-specific issue that Congressman Baca and I raised at the time to the chair and the Ranking Member on California's ability for our energy providers to comply with our unique regulatory system. That under the changes it might designate California's energy companies as swap dealers. The utility companies have submitted comments to the CFTC. There has been extensive discussions with your staff. We have seen no positive—at least I have been told that there has been no positive movement on the issue. Later today, I am going to be sending you a letter to more thoroughly outline my concerns and hoping you might be able to speak to whether or not you believe actions that have been undertaken to comply with state or local laws or regulations should be specifically included in terms of what is determined as to whether or not an entity is a swap dealer or not.

Mr. GENSLER. I am trying to recall the hearing to which you are referring. Is this related to the municipal power authorities in Los Angeles and elsewhere?

Mr. COSTA. It is related to the major utility companies in California, PG&E, Southern California Edison, San Diego Gas & Electric. We have a deregulated environment under which they purchase and under the H.R. 3527 they may be viewed as a swap dealer and they don't believe they are swap dealers. But obviously this issue has not come to your attention.

Mr. GENSLER. Well, there were two California issues because the Municipal Power Authority of Los Angeles——

Mr. COSTA. This is not Municipal Power Authority's——

Mr. GENSLER. I just wanted to——

Mr. COSTA. It is needed to ensure that these companies and ultimately California ratepayers are not charged the additional fee on this issue.

Mr. GENSLER. So I believe that we will successfully address through the entity definition rule that, as Congress said, if somebody is making markets, it is only if they are accommodating others on a routine basis and I am not familiar enough with PG&E's——

Mr. COSTA. Well, please——

Mr. GENSLER.—business——

Mr. COSTA.—get familiar with it and get back to us. I was going to send you the letter this afternoon. We don't want—because these California companies are complying with state law—to be penalized by the Federal regulators that ultimately could impact the ratepayers in California.

Mr. GENSLER. I think they will benefit by this law because it will bring transparency and I believe it will——

Mr. COSTA. No, that is——

Mr. GENSLER.—address your——

Mr. COSTA.—the largest issue but there is a problem. Get this? There is a problem with complying with state law, Federal law and we need to work through that problem.

Mr. GENSLER. I look forward to reading your letter.

Mr. COSTA. Okay. Thank you very much.

On the broader set of issues and it has been talked about before in terms of the impacts on gas prices and the volatility and the potential speculation, while they are talking about the potential to reach $4 a gallon, they have exceeded $4 a gallon in California. I was at the pump on Saturday and it was in excess of $4.18 a gallon as I saw my fill-up reach almost $70. So we are aware of the BP fire in Washington State at the refinery, but other places in the West are being similarly impacted. We know from the data at the Energy Information Administration that the supply, as has been already stated here this morning, of oil and gas is higher today than it was 3 years ago when the national gasoline was below $2 a gallon.

We know it is a worldwide market, of course, but right now the demand for oil in the U.S. is the lowest since 1997. I am not satisfied with the response you have made earlier this morning as to whether or not you agree that something else more basic than supply and demand is driving these prices.

Mr. GENSLER. These markets are made up of hedgers and speculators and at any given time both are part of a market. As I mentioned earlier, in fact, the futures market, over 80 percent of the market is swap dealers, hedge funds, managed money, other financial——

Mr. COSTA. So you would say essentially——

Mr. GENSLER.—is less than 20 percent——

Mr. COSTA.—speculation as having some impact; you just can't quantify it?

Mr. GENSLER. On any given day financial actors, as you are referring to them as speculators, are part of the pricing of energy and agricultural products. Our role is to make sure and ensure that that market is free of manipulation, it is transparent, and it reflects supply and demand.

Mr. COSTA. Well, my time has expired but, Chairman Gensler, the fact is is that for American farmers and all of the benefit from the products that we produce, the CFTC is undertaking with other authorities to address the extensive energy speculation that is destroying—I don't know if you care to comment any further as to what specific efforts you are taking under the new Dodd-Frank rule.

Mr. GENSLER. Well, just that there are broad rules, it is new anti-manipulation authority, it is transparency authorities, it is trying to complete once the data is in, position limits authority, so I think it is really the collection that this Committee asked us to address the markets with.

Mr. COSTA. Mr. Chairman, I wasn't here earlier but is it the desire of the Committee to have the Commissioner to come back and report when they have made their findings or to provide it in some informative fashion?

The CHAIRMAN. I believe that is certainly possible and that can be addressed as one of the questions submitted to him, and a response to that would be the report.

I thank the gentleman from California. His time has expired.

Mr. COSTA. Thank you.

The CHAIRMAN. I now recognize the gentleman from Pennsylvania for 5 minutes, Mr. Thompson.

Mr. THOMPSON. Chairman Lucas, thank you.

Chairman Gensler, thanks for coming once again. You had mentioned in your testimony the time constraints for completion of the rules and that the CFTC is "completing rules in a thoughtful, balanced way, not against the clock." Well, how specifically is CFTC allowing for flexibility with rulemaking?

Mr. GENSLER. Well, foremost, Congress gave us 1 year to complete which was last July, and of course, here we are 8 or 10 months later. We put out exemptive order last July to say the whole market could rest at ease until December and then again we came back in October and November and said rest at ease again until this coming July. In addition, in each of the rules we have phased in implementation and in some cases it goes out years; some cases it is just months. It depends on what comments we have heard from the markets. I would be hopeful that we would complete most of our rules by this summer, but as I have said in my written testimony, some might take longer. We want to get these things right.

Mr. THOMPSON. One of the things I see just burdening our economy is on certainty from many different aspects, and so what is your agency doing to help relieve some of the uncertainty that many of our banks and financial institutions are experiencing as these rulemaking processes continue?

Mr. GENSLER. You raise a good point because it is balancing lowering that regulatory uncertainty with not trying to rush things. And I think this Committee wants us to do both but I have taken the Chairman to heart not to rush things. But as we complete each rule, I think we do help lower that uncertainty. Beyond that what we have tried to do is really reach out and have a lot of work with market participants before and after a rule is done through roundtables and then, as we have done in some of these data rules, to actually have weekly calls with market participants to sort through some of their questions. In one case, we put out an over 100 page topic area on large trader reporting to help describe how to get the data in.

Mr. THOMPSON. You mentioned in your testimony that a motive for the current expansion of regulations that you believe failure to regulate swaps and future markets led to the 2008 financial crisis. Could you please describe a specific regulation that you have added since the 2008 financial crisis that significantly reduces the risk of future financial crises?

Mr. GENSLER. I think in a number of places. I do think swaps were not the only cause of the crisis but it was part of it. I think the overall regime of clearing and central clearing lowers the interconnectedness and I think we will get this right. This Committee and Congress want end-users out but the other part of the markets to be in clearing. I think transparency, even what we completed in

December. Starting this summer in July of this year, regulators and market participants for the first time will actually see the pricing of these transactions. It will be delayed to protect the anonymity, to protect the market, but people for the first time will start to see what the pricing of these transactions are.

Mr. THOMPSON. One of the critical pieces of the mosaic of regulations that you describe in your testimony is the definition of a *swap*. Could you please share with us your preliminary definition and indicate areas in which you think changes are likely?

Mr. GENSLER. In the definition, did you say swap or——

Mr. THOMPSON. Swap, please.

Mr. GENSLER. We have gotten a lot of questions and comments, which I think were very helpful just drilling in on where forwards would not be considered to be swaps. And I think it was the intent of this Committee—I know there was an important colloquy with then-Chairman Peterson on this matter that forwards aren't treated as futures and they are not treated as swaps. My hope would be we give greater clarity on that whole topic. There are similar topics that people have raised, concerns about when insurance is not a swap, when regular commercial transactions are not a swap. So I think the final rule will benefit from those comments and clarity.

Mr. THOMPSON. Okay, thank you.

Mr. Chairman, I yield back.

The CHAIRMAN. The gentleman yields back.

The chair now turns to the gentleman from Colorado, Mr. Tipton, for 5 minutes.

Mr. TIPTON. Thank you, Chairman Lucas. And thank you, Chairman Gensler for being here.

Chairman, we are very aware of the importance for agricultural producers to be able to gain access to credit, and quite often an important component of their ability to gain that access to credit is to ensure that they are hedged against the risks they face, commodity prices, be it interest rates or currency rates. In recognition of this, Dodd-Frank provided an exemption for banks to provide swaps in connection with loans from designation of swap dealers to ensure the important relationship between risk management and flow of credit that it can continue between small- and mid-sized banks and businesses. This link I believe is well described in a letter by one of the banking regulators from the OCC that they sent to you last year expressing their concerns. With a narrow approach to the swaps in connection with loans, the exemption is proposed by the CFTC and the impact that this may actually have on our banks.

The OCC—and I will read this—stated specifically in their letter, "the statutory language does not limit the loan exclusion with swaps that are connected to the financial terms of a loan, nor does it require that the swap be entered into contemporaneously with a loan origination. CFTC's proposed implementation of the loan exclusion effectively prevents community and mid-sized banks from offering commodity-based swaps to loan customers. We are concerned that this interferes with the bank's risk management and believe that it was precisely this type of risk management that Congress intended to preserve through the loan exclusion. Loan underwriting criteria for the community and mid-sized banks that offer loans to commercial customers engaged in commodity-driven business may require as a condition of the loan that the borrower be hedged against commodity price risk incidental to its business. This hedging activity reduces the bank's credit risk on the loan since the borrower is situated to withstand potentially volatile commodity price fluctuations."

It did continue on in regards to the restrictions on the timing of the swaps relative to the origination of the loan. In their letter they stated, "the loan exclusion should also be implemented in a manner that recognizes practical reality of bank and end-user risk management practices." To that end, the loan exclusion should be tailored to allow for ongoing hedging throughout the life of a loan, providing such hedging is connected to the origination of a loan, as discussed above. Eliminating the exclusion to swaps that are contemporaneous to loan origination or close thereto, as is contemplated in the proposed rule, would preclude ongoing risk management connected to bank lending and increased credit risk for bonds."

So I am familiar with that. And Mr. Gensler, in light of the fact that one of our primary banking regulators expressed concern that precluding commodity swaps from the exemption or by placing arbitrary timing restrictions on swaps in connection with loans will actually raise credit risk at our banks. Can we expect these restrictions to be omitted from the final rule?

Mr. GENSLER. I am familiar with the comment letter and other comment letters about lending in connection with originating a loan. We are taking them all into consideration. We actually asked questions of the public on a number of these issues. Let me just focus on one. The second that you raised is to what does it mean, in connection? Is it contemporaneous? Is it a week before? Is it a month before? *Et cetera.* Is it throughout the life of the loan? We received a lot of different—there was a range of feedback on that and we will be addressing all of the issues I think in that Comptroller's letter. Some of them would add clarity but again subject to other Commissioners and to Commissions.

I would say the other piece of this is——

Mr. TIPTON. I am not sure—not to interrupt but I am going to run out of time. I am not sure I am hearing an answer to the question. Can we expect that to be omitted from the final rule because the primary purpose of Dodd-Frank was to be able to lower that risk.

Mr. GENSLER. I am answering as best I can that in a pack of rulemaking that we will take into consideration and I am very familiar with the Comptroller's letter and his other letters on other topics. John and I sometimes talk about these letters as well, and I believe the community banks also will ultimately understand that as we address ourselves to the *de minimis* standard as well. But I am not able at this stage to say that we are accepting the Comptroller's letter completely.

Mr. TIPTON. Okay. You aren't willing to accept that but you said you were reaching out to the market participants and they are directly saying with the backup of the OCC that this is going to raise that risk?

Mr. GENSLER. Again, sir, it is the banks who offer swaps in connection with originating loans have raised questions about when can they give that. We are going to address that as best we can, those comments and the comments of the Comptroller and address the comments separate from that letter about the *de minimis*.

Mr. TIPTON. Mr. Chairman, if I can just have about 30 more seconds here?

The CHAIRMAN. Thirty more seconds.

Mr. TIPTON. I appreciate that. I would really applaud and stand behind Mr. Costa in terms of his regard to be able to bring these back to Committee because I think the legislative intent is incredibly important. As you are developing these rules and I would join myself and associate myself with Mr. Huelskamp's remarks as well in regards to actually having a response back to his request. So thank you.

The CHAIRMAN. The gentleman's time has expired.

The chair will now turn to the gentleman for final questions from the Republic of Texas for 5 minutes, Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Chairman Gensler, good to have you here today.

Mr. GENSLER. Good to be with you, sir.

Mr. NEUGEBAUER. You had mentioned that Commissioner O'Malia last week strongly criticized the final swap dealer business conduct rule saying that he felt like the Commission had failed to really do a comprehensive cost-benefit analysis of that rule. I think in fact in some of the discussions with some of the CFTC lawyers, they really couldn't produce any substantial numbers to indicate that really any kind of cost-benefit analysis had been done. And I believe Mr. O'Malia asked the OMB for independent review of that process and to see whether those rules comply with the Obama Administration's Executive Order. In fact I think he used the word that you all had committed regulatory malpractice. That is a pretty strong statement from one of your Commission members.

And I think one of the things that many of us are concerned about is we have been tracking the compliance side of Dodd-Frank. So it has about 400 different rulemaking requirements. I think we reached a milestone the other day—I think we are at 140. I think you said you had done about 25 or 26; you had 20 more. So that means we are ⅓ of the way through this process and the current number is that it takes about 21 million man hours to comply with the first 140 rules. Now, I want to put that in perspective for you. It means that it only took 20 million man hours to do the Panama Canal. And so basically what somebody said earlier this week is for 21 million man hours what we have done rather than connecting two oceans and creating a huge economic engine, the only thing we have united here is lawyers and billable hours.

And so I think the importance of these cost-benefit analyses can't be overemphasized. And you must comply with the law because we are giving the American people a lot of regulations and we are not, one, sure it is going to fix all of the issues that many thought that were a part of the crisis in 2008. But the other issue is the huge burden that it is going to put on the economy and the financial systems in total.

And so what is your response to "that you committed regulatory malpractice?"

Mr. GENSLER. I am very proud of the agency's work, the Commission's work and I think that we have fully complied with the Commodities and Exchange Act and the Administrative Procedures Act on cost-benefit considerations. We take them into consideration on each of our rules. The Chief Economist's Office has to sign off on any rule that comes before us, and in many of our internal deliberations it is really very helpful what commenters have come in and said to us about this.

Mr. NEUGEBAUER. What is your response though that your own lawyers admitted they had not crunched the numbers when analyzing the impact or any of the alternatives to that——

Mr. GENSLER. I was at the same hearing and that, with all respect, what they said was to a very specific question about, as I recall, specific numbers on the ability to search voice records, one question. Congress mandated that voice records be kept and in our proposal we said that it had to be put in electronic form. A lot of people didn't like that so we then said, okay, you do not have to put it in electronic form. We rolled back. We dialed back because of the cost of that but we said you still just need to be able to search it to find a key term. You know, if there is an enforcement case later, then somebody has got to be able to search it. And there are readily available search tools to just to be able to search and find a key term.

Mr. NEUGEBAUER. So you have a definitive document that says cost-benefit analysis for this rule and it has quantitative data in it?

Mr. GENSLER. Well, it is actually called cost-benefit considerations because that is what the statute——

Mr. NEUGEBAUER. So there is——

Mr. GENSLER. Yes. Oh, yes. That is in each of our rules, absolutely.

Mr. NEUGEBAUER. Can you furnish me with a copy of that?

Mr. GENSLER. We will do that.

Mr. NEUGEBAUER. Do you understand the importance of why this cost-benefit analysis is important? Because it is not just what you are doing at this Commission but it is what is going on across the whole spectrum. And what we are already hearing is in many cases there is duplication, there are conflicts of what rules that are being put out by you and other regulators. And so it doesn't appear we are moving in a direction that is necessarily positive.

Mr. GENSLER. I not only understand it; I have found it very, very helpful, not just commenters' views on costs and benefits but our own deliberations when somebody in our Chief Economist's Office says, well, how do you justify this? Now, it is only within the discretion we have, but like this example of voice recordings that we said, no, do not put them in electronic form——

Mr. NEUGEBAUER. And is the cost-benefit analysis that you do, is that done prior to releasing the rule or before the rule is final?

Mr. GENSLER. There is a cost-benefit consideration section that is in a proposal. We ask commenters to comment. We particularly ask them if they can send us quantifications. A lot of times we don't get quantities and numbers. And so it may not be as much quantification as any of us would think about in keeping our own bank account or something. But, yes, we get comments through our roundtables, through our meetings, and then we include that in the final rule as well.

Mr. NEUGEBAUER. The feedback I get is that basically the quantification comes from the people commenting that your documents, the rules themselves don't really have very much of a concrete quantification or justification of the cost-benefit analysis and that you ask for additional information on that aspect. The problem with that is then that you take that into consideration; then you go out and put out the rule. I would submit to you that if you don't have the data, you are asking for the data, that when you get that information back, that you should resubmit the rule with an updated version of the cost-benefit analysis so that then there could be comment on that. But if you are mining a lot of data from the people on comment, not everybody has the eyes to get to see that prior to when you finally—or if you don't resubmit the rule, then it comes in after the fact.

Mr. GENSLER. The good piece of the process of every agency, and ours as well, is everybody gets to see everybody else's comments. So we actually get comments on comments, and we have used our discretion to allow people to put in late comments. And often it is on cost and benefits and they have been very helpful.

The CHAIRMAN. The gentleman's time has expired. All time has expired. Any closing comments from the Ranking Member?

Seeing none, the chair simply notes once again we appreciate the opportunity to look over Chairman Gensler's shoulder. We will continue to do that as we work together to make sure the good policy is corrected in this process.

Mr. GENSLER. Could I say, Mr. Chairman, I would hope that even when we do finish the rules that we would keep coming in front of this Committee, but if you were trying to give us the motivation to slow it down more so that it can always have a reason to come in front of you——

The CHAIRMAN. Chairman Gensler, you are almost like a member of my family we have spent so much time together. And like all family members, you will always be welcome——

Mr. GENSLER. Thank you. Thank you.

The CHAIRMAN.—to finish this process.

Mr. GENSLER. All right.

The CHAIRMAN. With that, under the rules of the Committee, the record for today's hearing will remain open for 10 calendar days to receive additional material and supplemental written responses from the witnesses to any question posed by a Member.

This hearing of the Committee on Agriculture is adjourned.

[Whereupon, at 12:00 p.m., the Committee was adjourned.]

[Material submitted for inclusion in the record follows:]

SUBMITTED LETTER BY HON. PETER WELCH, A REPRESENTATIVE IN CONGRESS FROM VERMONT

Commodity Markets Oversight Coalition—An Alliance of Commodity Derivatives End-Users and Consumers

February 29, 2012

Hon. HAROLD ROGERS, *Chairman,* House Committee on Appropriations, Washington, D.C.;	Hon. NORMAN D. DICKS, *Ranking Minority Member,* House Committee on Appropriations, Washington, D.C.;
Hon. DANIEL K. INOUYE, *Chairman,* Senate Committee on Appropriations, Washington, D.C.;	Hon. THAD COCHRAN, *Ranking Minority Member,* Senate Committee on Appropriations, Washington, D.C.

Dear Chairmen Rogers and Inouye, and Ranking Members Dicks and Cochran:

The undersigned members of the Commodity Markets Oversight Coalition write to endorse the Administration's Fiscal Year 2013 budget request of $308 million for the Commodity Futures Trading Commission. We believe this funding level is necessary to ensure the oversight, transparency and stability necessary for the proper functioning of our nation's commodity markets and to ensure adequate protections for commodity hedgers and commercial end-users.

The CMOC is an independent, non-partisan and nonprofit alliance of organizations that represents commodity-dependent industries, businesses and end-users that rely on functional, transparent and competitive commodity derivatives markets as a hedging and price discovery tool. The coalition advocates in favor of government policies that promote stability and confidence in the commodities markets, that seek to prevent fraud, manipulation and excessive speculation, and that preserve the interests of *bona fide* hedgers and consumers.

While we acknowledge the deficit crisis our country faces and commend Congressional leaders for their calls to rein in Federal spending, the Commission must be funded sufficiently to exercise its statutory responsibilities. For more than a decade, the CFTC has been under-funded, understaffed, and under-resourced. All the while it has faced complex new market trends and technologies, a vast expansion of authority over unregulated over-the-counter swaps markets, and challenges to market stability and security, including the recent bankruptcy of commodity brokerage firm MF Global. The collapse of MF Global illustrates the importance of rigorous market surveillance, accountability and consumer protections.

By CFTC Chairman Gary Gensler's own admission, the current funding level of $205 million is wholly insufficient to meet these challenges. Furthermore, failing to provide this important financial regulator with needed funds could further jeopardize security, stability and confidence in the commodity markets and adequate consumer protections.

As businesses that depend on competitive, transparent and functional commodity derivatives markets, we urge Congressional appropriators to provide the Commission with the amount of $308 million as requested by the Administration for Fiscal Year 2013.

Thank you in advance for your thoughtful consideration.

Sincerely,

Airlines for America;
American Feed Industry Association;
American Public Gas Association;
American Trucking Associations;
Colorado Petroleum Marketers Association;
Consumer Federation of America;
Florida Petroleum Marketers Association;
Fuel Merchants Association of New Jersey;
Gasoline & Automotive Service Dealers of America;
Independent Connecticut Petroleum Association;
Institute for Agriculture and Trade Policy;
Louisiana Oil Marketers & Convenience Store Association;
Maine Energy Marketers Association;
Massachusetts Oilheat Council;
Montana Petroleum Marketers & Convenience Store Association;

National Association of Oil & Energy Service Professionals;
National Association of Truck Stop Operators;
National Family Farm Coalition;
National Farmers Union;
New England Fuel Institute;
New Jersey Citizen Action Oil Group;
New Mexico Petroleum Marketers Association;
New York Oil Heating Association;
Oil Heat Council of New Hampshire;
Oil Heat Institute of Long Island;
Oil Heat Institute of Rhode Island;
Organization for Competitive Markets;
Petroleum Marketers & Convenience Store Association of Kansas;
Petroleum Marketers & Convenience Stores of Iowa;
Petroleum Marketers Association of America;
Public Citizen;
Ranchers-Cattlemen Action Legal Fund (R–CALF) USA;
Society of Independent Gasoline Marketers of America;
Vermont Fuel Dealers Association;
West Virginia Oil Marketers and Grocers Association;
Wyoming Petroleum Marketers Association.

CC:

Chairman Gary Gensler, Commodity Futures Trading Commission;
Commissioner Jill Sommers, Commodity Futures Trading Commission;
Commissioner Bart Chilton, Commodity Futures Trading Commission;
Commissioner Scott O'Malia, Commodity Futures Trading Commission;
Commissioner Bart Chilton, Commodity Futures Trading Commission;
Rep. Jack Kingston, Chairman, House Appropriations Subcommittee on Agriculture;
Rep. Sam Farr, Ranking Member, House Appropriations Subcommittee on Agriculture;
Rep. Frank D. Lucas, Chairman, House Committee on Agriculture;
Rep. Collin C. Peterson, Ranking Member, House Committee on Agriculture;
Rep. Fred Upton, Chairman, House Committee on Energy & Commerce;
Rep. Henry A. Waxman, Ranking Member, Committee on Energy & Commerce;
Sen. Richard Durbin, Chairman, Senate Appropriations Subcommittee on Financial Services and General Government;
Sen. Jerry Moran, Ranking Member, Senate Appropriations Subcommittee on Financial Services and General Government;
Sen. Debbie Stabenow, Chairwoman, Senate Committee on Agriculture, Nutrition & Forestry;
Sen. Pat Roberts, Ranking Member, Senate Committee on Agriculture, Nutrition & Forestry;
Sen. Jeff Bingaman, Chairman, Senate Committee on Energy & Natural Resources;
Sen. Lisa Murkowski, Ranking Member, Senate Committee on Energy & Natural Resources.

SUBMITTED QUESTIONS

Response from Commodity Futures Trading Commission

Questions Submitted by Hon. Frank D. Lucas, a Representative in Congress from Oklahoma

MF Global

Question 1. Please tell us why and what led to your decision as Chairman of the CFTC to recuse yourself from the largest failure of a CFTC registrant and arguably the largest investigation the Commission has ever had. What are the parameters of your recusal? Do you participate in any Commission deliberations or review any reports of the investigation?

Question 2. Why does your "Statement of Non-Participation" regarding matters involving MF Global extend to J.C. Flowers & Co.?

Question 3. Please describe the nature of your relationship with J.C. Flowers and any and all communications you have had with him while serving as Chairman of the CFTC.

Answer 1–3. For the convenience of the Committee, I include two documents which address *Questions 1, 2,* and *3.* The first is the text of my statement of non-participation. The second is a Memorandum which includes information detailing my activities prior to my withdrawal from participation in the matter. (*See* ATTACHMENTS 1–2).

Question 4. You directed the agency's Division of Swap Dealer and intermediary Oversight to find ways to bolster agency regulations for how it oversees and what it requires from self-regulatory organizations and futures commission merchants in direct response to MF Global. What recommendations did you receive?

Answer. Commission staff members are reviewing the customer funds protection provisions of the Commodity Exchange Act and Commission regulations to identify enhancements to the protection of customer funds. As part of this process, Commission staff held a 2 day public Roundtable on February 29 and March 1, 2012 to solicit input and to identify enhancements to FCM internal controls surrounding the handling of customer funds. Panelist at the Roundtable represented a cross-section of the futures industry including academics, consumer groups, agricultural and energy interests, managed funds and pension plans, FCMs, derivatives clearing organizations, self-regulatory organizations, securities regulators and securities self-regulatory organizations, and industry trade associations.

The Roundtable provided a forum for Commission staff to obtain information and views on a range of customer protection issues. Day one of the Roundtable focused on customer funds segregation models; FCM controls over the disbursement of customer funds deposited for trading on U.S. futures markets; increasing transparency surrounding an FCM's holding and investment of customer funds; and lessons learned from commodity brokerage bankruptcy proceedings. Day two of the Roundtable focused primarily on the protection of customer funds deposited with FCMs for trading on foreign futures markets; particular issues associated with entities dually registered with the CFTC as FCMs and the U.S. Securities and Exchange Commission as broker-dealers; and enhancing the self-regulatory structure.

Commission staff also has held discussions with representatives of the Futures Industry Association ("FIA") and the two primary futures markets self-regulatory organizations, the National Futures Association ("NFA") and the Chicago Mercantile Exchange ("CME"), regarding enhancing customer protections. Staff is taking into consideration the recommendations that FIA issued in its document titled, *Initial Recommendations for Customer Funds Protection,* and in its publication of frequently asked questions regarding the protection of customer funds.

The Commission recently approved an NFA proposal that stemmed from a coordinated effort by the CFTC, the SROs, and market participants

The three key areas of reform included in the NFA rules are:

- First, FCMs must hold sufficient funds in Part 30 secured accounts (funds held for foreign futures and options customers trading on foreign contract markets) to meet their total obligations to customers trading on foreign markets computed under the net liquidating equity method. FCMs will no longer be allowed to use the alternative method, which had allowed them to hold a lower amount of funds representing the margin on their foreign futures;
- Second, FCMs must maintain written policies and procedures governing the maintenance of excess funds in customer segregated and Part 30 secured accounts. Withdrawals of 25 percent or more of excess funds in these accounts (that are not for the benefit of customers) must be pre-approved in writing by senior management and reported to the NFA; and
- Third, FCMs must make additional reports available to the NFA, including daily computations of segregated and Part 30 secured amounts, as well as twice monthly detailed information regarding the cash deposits and investments of customer funds.

Additional staff recommendations include:

- Incorporating the NFA rules approved recently into the Commission's regulations;
- Ensuring that SROs and the CFTC have direct electronic access to FCMs' bank and custodial accounts for customer funds, without asking the FCMs' permission. Further, require that acknowledgement letters (letters acknowledging that accounts contain segregated customer funds) and confirmation letters come directly to regulators from banks and custodians;
- Providing that futures customers, if they so elect, to have access to information about how their assets are held and with whom, similar to that which is available to mutual fund and securities customers.

Question 5. The CFTC recently concluded an industry-wide spot check of major futures brokerages and did not find any material breaches of customer fund protections. The CFTC's spot check concluded there were no material breaches of customer fund protections. Isn't that what CME found both in the annual audit of MF Global that ended August 4th of last year and again in October, just days before the bankruptcy? Did the CFTC use any knowledge it has gained from the MF Global bankruptcy to sharpen its spot check?

Answer. The CME did not report MF Global being in violation of Commission segregation requirements as a result of its 2011 examination of MF Global, or during its review in late October 2011.

Commission staff, in coordination with the CME and NFA, conducted limited reviews of all FCMs that carry customer funds to assess their compliance with requirements to segregate such funds pursuant to Section 4d of the Act, and to set aside in secured accounts funds deposited for trading on foreign boards of trade under Section 4(b) of the Act and Part 30 of the Commission's regulations. The principal goal of the limited reviews was to obtain an appropriate level of assurance that FCMs holding customer funds were not in violation of the segregation and Part 30 secured amount requirements as of the review date.

DSIO staff conducted the reviews by obtaining from each FCM a detailed listing of assets held in segregated and Part 30 secured accounts as reflected in the firm's books and records. The listing of assets was compared to independent third-party source documents and reconciliations maintained at the FCM's offices supporting the asset balances. Staff also reviewed the third-party account documentation to determine that the funds were maintained in properly titled segregated or secured accounts, as appropriate. In addition, staff reviewed each FCM's reported segregation and Part 30 secured amount liabilities and reviewed underlying firm records to ensure that the records reflected such liabilities. The staffs of the CME and NFA performed comparable review procedures. Each FCM was determined to be in compliance with the segregation and secured amount requirements as of the respective review date.

Commission staff is using its experience with the MF Global bankruptcy to develop proposed enhancements to the customer protection regime, including strengthening FCMs' internal controls surrounding the handling of customer funds.

Question 6. Has there been a drop in trading volume since the MF Global bankruptcy? If so, how much of the drop can be attributed to the collapse of the firm? What more could have CFTC done to prevent this disaster?

Answer. During the first quarter of 2012, aggregate trading volume across all contract markets decreased 5.9 percent relative to 2011. While aggregate trading volume decreased over this period, aggregate open interest in futures and options combined increased 5.4 percent.

Commission staff is reviewing the facts and circumstances that led to the shortfall of customer funds at MF Global and conducting an enforcement investigation. Staff will use this information in assisting with the development of proposed enhancements to the protection of customer funds.

Dodd-Frank Implementation

Process

Question 7. For nearly 18 months, the CFTC has been in the process of writing rules to govern the swaps market—and you've finalized nearly 30 rules. But, the very cornerstone of the entire new regime—the definition of a swap—is still not final. Why is the definition of swap coming late in the game, when it should have been the first rule finalized?

Answer. The Commission recently finalized the swap definition rule, acting jointly with the Securities and Exchange Commission. The Commissions benefitted from substantial public comment, deliberate consideration of those comments, and frequent and substantial contact between staff of the two agencies.

Question 8. You mentioned in your testimony that there may be times when a re-proposal is necessary. Are there particular rules that you believe may require a re-proposal? Should we expect a re-proposal on the swap dealer definition in light of your assurances that significant changes have been made to improve the rule?

Answer. On April 27, 2012 the CFTC and the Securities and Exchange Commission adopted joint rules and interpretive guidance on the further definition of "swap dealer," "security based swap dealer," "major swap participant," and "major security based swap participant."

Question 9. What steps has the CFTC taken to minimize differences with the SEC's proposals on similar provisions related to security-based swaps?

Answer. The CFTC and SEC consult and coordinate extensively to harmonize Dodd-Frank rules. This close coordination will continue and always benefits the rulemaking process. The two agencies recently adopted joint final rules further defining the terms "swap" and "security-based swap."

Question 10. Recently, the CFTC finalized a rule requiring market participants to register as swap dealers with the Commission. However, many of the rules governing swap dealers have not been finalized. How can entities know whether they will register if they cannot evaluate the costs associated with the registration because of the various unknown regulatory requirements?

Answer. The Dodd-Frank Act provides the Commission with ample flexibility to phase in implementation of requirements. The Commission has utilized this flexibility where appropriate to allow for phased compliance with specific regulatory requirements.

Question 11. We have stressed to you in numerous hearings the importance of logical sequencing of proposed and final rules. Both to support useful public comment, and to minimize disruptions in the markets. In the FY 2012 Agriculture Appropriations bill, you were directed to develop and publish, with a 60 day comment period, a schedule of implementation and sequencing of Dodd-Frank rules. Can you update us on your compliance with this, and when we can expect the implementation plan?

Answer. The Commission has taken a number of actions to facilitate implementation of Dodd-Frank regulations in keeping with the instructions with the report language in the FY 2012 House Agriculture Appropriations bill. These include:

March 16, 2011—Implementing the Dodd-Frank Act, FIA's Annual International Futures Industry Conference, Boca Raton, Florida. Remarks of Chairman Gary Gensler (as posted on CFTC website and including listing of order in which rules might be considered).

April 12, 2011–June 10, 2011—Comment period open (292 written comments filed); Concepts document published as a guide for commenters.

May 2, 2011 and May 3, 2011—CFTC–SEC Staff-led Roundtable Discussion on Dodd-Frank Implementation.

May 4, 2011—Notice published in *Federal Register* re-opening and extending comment periods (through June 30) in order to "provide interested parties with an additional opportunity to participate in" Dodd-Frank Rulemakings. Also requesting comment on the order in which the Commission should consider final rulemakings.

June 17, 2011—Commission seeks public comment on proposed order to grant exemptive relief from the application of Dodd-Frank Act effective dates.

July 14, 2011—Commission publishes final order providing exemptive relief from effective dates of Dodd-Frank Act provisions in order to facilitate a smooth transition for market participants (expiring on December 30, 2011; extended on Dec. 23, 2011).

September 8, 2011—Outline published of Dodd-Frank Title VII Rules the CFTC May Consider in 2011 and the First Quarter of 2012

September 8, 2011—The Commission sought public comment on proposed rules specifically to establish schedules to phase in compliance with the swap clearing and trade execution requirement provisions of the Dodd-Frank Act. At that meeting, the Commission also approved a proposed rule to phase in compliance with previously proposed requirements, including the swap trading relationship documentation requirement and the margin requirements for uncleared swaps.

December 23, 2011—Commission publishes amendment to July 14 order extending effectivedate relief through July 16, 2012.

January 11, 2012—Update of order of consideration of final rules posted on Commission website.

July 3, 2012—Commission approves amendment to July 14 order extending effective daterelief through December 31, 2012. Individual proposed rules specifically request public comment regarding implementation and sequencing. Examples of such rules include: Reporting, record-keeping and Trading Records requirements ; Real-Time Public Reporting of Swap Transaction Data; Registration of Swap Dealers and Major Swap Participants; and Protection of Collateral of Counterparties to Uncleared Swaps

Commission staff—along with staff from the SEC and other implementing agencies—have conducted a number of roundtables (transcripts available on *CFTC.gov*):

August 20, 2010—Conflicts of interest in the clearing and listing of swaps.

September 14, 2010—Swap Data and Swap Data Repositories

September 15, 2010—Swap Execution Facilities

October 22, 2010—Credit Default Swaps

October 22, 2010—Customer Collateral Protection

December 2, 2010—Disruptive Trading Practices

December 12, 2010—Capital and Margin

June 3, 2011—Protection of Cleared Swaps Customer Collateral

June 8, 2011—Swap Data record-keeping and Reporting

June 16, 2011—Definition of Swap Dealer and Major Swap Participant

July 6, 2011—Changes related to Commodity Pool Operators and Commodity Trading Advisors

August 1, 2011—International issues

January 30, 2012—"Available to Trade" Provision for SEFs and DCMs

Feb 29 and March 1, 2012—Roundtables to discuss additional customer collateral protection

May 31, 2012—The Volcker Rule

June 5, 2012—Core Principle 9 for Designated Contract Markets

Cost-Benefit Analysis

Question 12. How has the CFTC been able to conduct cost-benefit analysis on any of its final rules pertaining to swap dealers or major swap participants if the rule defining these terms has not been finalized? How would they know the number, type or size of the entities affected by the regulations and how certain costs may impact them?

Answer. The Commission relies on information provided by industry participants, the general public, and currently available data to conduct cost-benefit considerations for all its rulemakings. For entity definitions, the Commission used a conservative estimate reported by the National Futures Association that the number of swap dealers and major swap participants is anticipated to be 125. Given the lack of transparency in the swap markets, it is difficult to accurately predict this number.

The entity definition rules have been finalized with an interim *de minimis* threshold of $8 billion notional swaps exposure (as opposed to $100 million in the proposed rules). Once the rules have been implemented, the CFTC and SEC will collate information from the swap markets and conduct additional studies regarding the threshold for swap dealers and major swap participants.

Question 13. Has the CFTC undertaken any analysis regarding the cumulative impact its rules will have—on particular sectors of the economy or the economy as a whole?

Answer. Two principles are guiding the agency throughout the rule-writing process. First is the statute itself. We intend to comply fully with the statute's provisions and Congressional intent to lower risk and bring transparency to these markets.

Second, we are consulting heavily with both other regulators and the broader public. We are working very closely with the SEC, the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and other prudential regulators, which includes sharing many of our memos, term sheets and draft work products. We also are working closely with the Treasury Department and the new Office of Financial Research. CFTC staff have held 600 meetings with other regulators on implementation of the Act.

The Commission is bound by the requirements of the Administrative Procedure Act, carefully reviews and addresses the thousands of comments received, and strives to arrive at a balanced result.

Question 14. How does the Commission ensure its cost-benefit analysis meets the standards set forth in Executive Order 13563—President Obama's Order "Improving Regulation and Regulatory Review"?

Answer. The Commission's guidance on costs and benefit considerations incorporates principles from OMB circular A–4 and Executive Orders 12688 and 13563.

Question 15. You mentioned in testimony that derivative markets help their participant's hedge or transfer $22 of risk for every dollar of goods and services produced in the U.S. economy. You also mentioned that these markets touch nearly every aspect of our economy from the food we eat, to the price at the pump, to our mortgages and credit cards, even our retirement savings.

If market participants—those who use these tools to mitigate risk—are subject to unnecessarily higher costs associated with new rules, would your analysis then also support the fact that the costs will be borne by the customers who use end-users products, such as electricity, fuel at the pump, or food at the grocery store?

Answer. I believe implementation of the Dodd-Frank Act will lower the risk of the swaps marketplace by directly regulating dealers for their swaps activities and by moving standardized swaps into central clearing. The Act also brings transparency to the swaps marketplace. The more transparent a marketplace is the more liquid it is, the more competitive it is and the lower costs will be for hedgers, borrowers and their customers.

In addition, the Commission finalized the end-user exception to the clearing requirement for swaps. Congress provided that non-financial entities, such as farmers, ranchers, manufacturers and other end-users, should be able to choose whether or not to clear those swaps that hedge or mitigate commercial risks. The Commission's final rule implements this exception for non-financial entities, establishing criteria for hedging or mitigating commercial risk and imposing minimal reporting requirements for those swaps that come under the end-user exception.

Entity Definitions/Registration Requirements

Question 16. We have heard from many end-users that the breadth of the swap dealer definition may miscategorize the swaps they enter into for hedging purposes as swap dealing. Will the definition of "swap dealer" resolve this issue by providing an explicit exemption for hedging?

Question 16a. How will you define "hedging"? Will it be consistent with the definition proposed in the Major Swap Participant definition and end-user exemption?

Answer 16–16a. The statutory definition of "swap dealer" does not specifically address hedging activity. However, the CFTC believes it is appropriate to provide, in an interim final rule, that swaps a person enters into for the purpose of hedging price risks related to physical positions are excluded from the swap dealer determination. The interim final rule draws upon principles in the Commission's long standing interpretation of *bona fide* hedging. It excludes swap activity for the purpose of portfolio hedging and anticipatory hedging. If a swap is not entered into for the specific hedging purposes identified in the rule, then all relevant facts and circumstances about the swap would be considered in determining if the person is a swap dealer. The CFTC is looking forward to receiving comment on whether the interim final rule appropriately excludes swaps for hedging.

Question 17. If the Commission adopts a definition of "hedging" that is specific to the swap dealer definition, the Commission will, in three separate rulemakings, have three definitions of hedging: one in the MSP rule; another in the position limits rule; and finally another in the swap dealer definition rule. Hedging is a generally understood and accepted term. Why would the Commission have three different definitions for the same activity across regulations that affect the same companies and firms?

Answer. CFTC rules define how instruments used for hedging are treated for various purposes. For example, where one definition is tailored to give full meaning to the end-user exception from clearing, another is crafted in the context of the Volcker Rule with its limitation on proprietary trading. (*See* ATTACHMENT 3).

Question 18. Why is the end-user exemption provided for on a transactional basis as contemplated by the Commission's proposal? Wouldn't this be unduly burdensome and costly for end-users? Instead, why not allow end-users to make an annual declaration to the CFTC that they will transact as an end-user, with an obligation to report to the CFTC should their situation change?

Answer. Under the Commission's final rule, when reporting a swap in compliance with the statutory requirements, the end-user must provide, or cause the swap dealer to provide, notice that the exception is being elected. The end-user has the option of providing additional required information in an annual filing or on a swap-by-swap basis.

Question 19. Will the CFTC distinguish between trading and dealing activities in the swap dealer definition? How? Will such a distinction appear in the Rule itself, or in the preamble?

Answer. The dealer-trader distinction is discussed in the preamble to the CFTC and the SEC joint final rules and interpretive guidance on the further definitions of "swap dealer," "security based swap dealer," "major swap participant," and "major security based swap participant." The CFTC anticipates that the dealer-trader distinction will be useful as one consideration, particularly in light of the degree to which it overlaps with many of the other characteristics identified in the release that are indicative of dealing activity.

Question 20. As you know, agricultural co-ops, for example, provide swaps to their members, and then enter into another swap to offset the risk. This is critical to their ability to continue to provide hedging tools to members of the co-op. In that scenario, would the offsetting swap make an entity ineligible for the end-user clearing exception? Would the offsetting swap meet the definition of a hedge of commercial risk?

Answer. Under the final rule, the exception is available with respect to a swap involving a non-financial entity, where the swap is hedging or mitigating the person's business risks.

Question 21. The Commission recently voted to propose the "Volcker rule," and it included a definition of what constitutes "market making." Will the final rule defining swap dealer also define what constitutes "market making" since it is one of the key criteria established under Dodd-Frank?

Answer. True to Congressional intent, end-users other than those genuinely making markets in swaps won't be required to register as swap dealers. The swap dealer definition benefited from the many comments from end-users who use swaps to hedge their risk. The final rule defining "swap dealer" includes the provision from the proposed rule which incorporates the statutory requirement that this term include a person that "makes a market in swaps." The preamble to the final rule includes an extensive discussion of what constitutes market making.

Question 22. Before Dodd-Frank, non-financial forward commodity contracts and commercial options were excluded from CFTC regulation. This allowed commercial commodity transactions to proceed without financial markets regulation. As you know, Dodd-Frank repealed these exclusions. Further, in a proposed rule, the CFTC deleted the regulatory exemption for commercial options, and has proposed other rules that imply physical forward commodity contracts will now be regulated as "swaps." In one of our previous hearings, you have stated that the Rural Electric Cooperatives are not dealing in swaps, but "forwards" or "forwards with embedded options." Should there be express exclusions from the definition of "swap" for commercial commodity contracts that utilities use every day—such as forward contracts for physical power, natural gas, coal and other fuels, and for commercial options, such as capacity contracts, reserve sharing agreements, and all-requirements contracts?

Answer. The Commission recently adopted a final rule to repeal and replace previously existing regulations concerning commodity options. The Commission also issued an interim final rule (with a request for additional comment) that incorporates a trade option exemption into the final rules for commodity options. The interim final rule provides a trade option exemption from the general swaps rules, subject to certain conditions, for certain physical delivery commodity options. The interim final rule was adopted in response to commenters that requested relief from Dodd-Frank swaps regulations for commodity options used by commercial entities to deliver and/or receive physical commodities in connection with their business. The trade option exemption conditions include position limits, large trader reporting, appropriate record-keeping and reporting requirements, anti-fraud and anti-manipulation rules, and the retention of certain swap requirements for swap dealers and major swap participants that engage in trade options. The Commission seeks public comment on the interim final rule.

Small Banks

Question 23. Out in the countryside, it is important for many farmers and ranchers that they be hedged against commodity price risk in order to qualify for loans from their local banks. This relationship between commodity hedging and borrowing is exactly what Congress intended to preserve in the "swaps in connection with loans" exemption from the swap dealer definition. Will community and mid-size banks that provide commodity swaps to their loan customers be eligible for this exemption under the final swap dealer rule?

Answer. The final "swap dealer" definition rule fulfills Congress's mandate that a swap entered into by an insured depository institution in connection with originating a loan is not to be considered dealing activity.

Question 24. According to recent data, 96% of the notional value of all derivatives within the U.S. banking system is held by only five of the largest banks. Among the largest 25 banks, that percentage increases to 99.86% of the total notional value. That means that the remaining .14% of the total notional value is spread among 1,046 small and community banks. Is it your view that the .14% of notional value spread among 1,046 small financial institutions is a threat to the stability of the financial system?

Question 24a. Can we expect that in the final rule "End-User Exception to Mandatory Clearing", the CFTC will use its authority to exempt smaller financial institutions, farm credit banks and credit unions from the definition of financial entity so that they are not subject to unnecessary costs—in recognition that they pose no systemic risk?

Answer 24–24a. The final rule exempts banks, savings associations, farm credit system institutions, and credit unions with total assets of $10 billion or less from the definition of "financial entity," making such institutions eligible for the end-user exception.

Extraterritoriality/International Coordination

Question 25. Will the CFTC issue a proposed rule related to the extraterritorial application of Dodd-Frank, as Chairwoman Schapiro has indicated the SEC will do, or is it your intent for the Commission to simply issue guidance? How can you ensure two different processes will produce consistent results? Will market participants be afforded the same opportunity to comment on the CFTC's guidance as they will on the SEC's rule proposal?

Question 26. When should market participants expect the CFTC to provide clarification on extraterritorial application?

Question 26a. If you intend to issue guidance, as opposed to a formal rule, will the Commission be obligated to perform cost benefit analysis?

Answer 25–26a. Section 722(d) of the Dodd-Frank Act states that swaps reforms shall not apply to activities outside the United States unless those activities have "a direct and significant connection with activities in, or effect on, commerce of the United States." Congress included this provision (722(d)) for swaps, but included a different provision with regard to the SEC's oversight of the security-based swaps market. In response to many requests, the Commission issued proposed guidance interpreting section 722(d) of the Dodd-Frank Act. The Commission is seeking public comment on the guidance and looks forward to the public's input.

Question 27. Chairman Gensler, you have reassured us that you are well coordinated with international regulators. I'm growing concerned that the international community does not agree.

In a recent article in the *Economic Times,* the U.S. role in international financial reform was described as this—

> *The United States is coming to be seen as a global threat, acting unilaterally with aggressive new market rules that critics say will hurt U.S. firms, foreign banks, and international markets in one swoop.*
>
> *Despite its talk of a global level playing field, the United States is being portrayed as a rogue country . . .*

Please respond to this.

Question 28. What regulatory coordination initiatives are you undertaking with your international counterparts with regard to Dodd-Frank and G20 regulatory goals? What initiatives are you undertaking with regard to mutual recognition or mutual accommodation schemes?

Question 29. In your testimony, you discuss your ongoing dialogues with Japan. In April of last year, the Financial Services Agency of Japan sent you a letter expressing concerns with the reach of Dodd-Frank. In fact, the letter states that "if (Japanese financial institutions) were also to be regulated under U.S. DFA framework, this will create an undesirable and redundant effect on these Japanese institutions."

Based on your ongoing discussions with Japanese regulators, will you take action to respond to the concern they've raised about the redundancy extraterritorial application of Dodd-Frank creates?

Answer 27–29. As we do with domestic regulators, the CFTC shares many of our Dodd-Frank Act rulemaking memos, term sheets and draft work product with international regulators. We have been consulting directly and sharing documentation with the European Commission, the European Central Bank, the UK Financial Services Authority, the European Securities and Markets Authority, the Japanese Financial Services Agency, and regulators in Canada, France, Germany, Singapore, and Switzerland.

Both the CFTC and European Union are moving forward to address the four key objectives set forth by the G20 in September 2009, namely clearing through central counterparties; trading on exchanges or electronic trading platforms; record-keeping, reporting; and higher capital requirements for noncleared swaps.

Section 722(d) of the Dodd-Frank Act states that the provisions of the Act relating to swaps shall not apply to activities outside the United States unless those activities have "a direct and significant connection with activities in, or effect on, commerce" of the United States.

Volcker Rule

Question 30. As you know, the markets for Treasury securities and Treasury futures and options are intertwined. Yet, the proposed Volcker rule excludes treasuries, but not futures and options on Treasuries. Is this purposeful? Will you commit to clarifying in the final rule that market making-related activities in exchange-traded futures and options are among the permitted activities in which a covered banking entity may engage, or in the alternative, use your exemptive authority to add Treasury futures and options on Treasury futures to the list of permissible proprietary trading activities for covered banking entities?

Answer. The Commission has solicited public comment with respect to the proposed Volcker rule and looks forward to reviewing submitted comments. The Commission will review, analyze and consider all public comments submitted in connection with this rulemaking before proceeding to issue a final rule.

CFTC FY 2013 Budget Request

Question 31. The FY 2013 Budget and Performance Plan details the redeployment of resources to process the surge of Dodd-Frank registrations and reviews during FY 2012. It states that staff will be reassigned from examinations and enforcement as necessary to support registration and reviews. The plan also states that the Commission acknowledges that this realignment creates risks in its critical oversight roles. Please describe which critical oversight roles will be at risk. How has Dodd-Frank impacted your ability to effectively oversee the futures markets?

Answer. The CFTC has been directed by Congress to oversee the swaps market as well as the futures market that it has traditionally regulated. The CFTC needs additional resources in order to oversee the swaps market, which is eight times larger than the futures market we have traditionally overseen. The National Football League would not significantly expand the number of games in a weekend without, at the same time, expanding the number of referees to protect the players, ensure fair competition, enforce the rules and protect the integrity of the game.

Question 31a. Chairman Gensler, since the bankruptcy of MF Global, has your agency refocused its oversight goals? Should it?

Answer. The Commission has been actively working to improve protections for customer funds. This includes:

- The completed amendments to rule 1.25 regarding the investment of funds bring customers back to protections they had prior to exemptions the Commission granted between 2000 and 2005. Importantly, this prevents use of customer funds for in-house lending through repurchase agreements;
- Clearinghouses will have to collect margin on a gross basis and futures commission merchants (FCMs) will no longer be able to offset one customer's collateral against another and then send only the net to the clearinghouse;
- The so-called "LSOC rule" (legal segregation with operational commingling) for swaps ensures customer money is protected individually all the way to the clearinghouse; and
- The Commission included customer protection enhancements in final rules for DCMs. These provisions codify into rules staff guidance on minimum requirements for self-regulatory organization (SROs) regarding their financial surveillance of FCMs.

In addition, the Commission approved an NFA proposal that stemmed from a coordinated effort by the CFTC, the SROs, and market participants, including from the CFTC's 2 day roundtable earlier this year on customer protection.

Question 31b. Please describe the priorities you have set for the CFTC. Has the writing of new rules taken higher priority over examinations and enforcement of the futures and commodities markets?

Answer. The Commission has been directed to promulgate and implement regulations to implement the derivatives reforms of Title VII of the Dodd-Frank Act. That direction is in addition to the Commission's traditional mandate: oversight of the futures market. The Commission is dedicated to carrying out its entire mission.

Question 32a. If yes—has this priority shift affected the Commission's core mission?

Question 33. Your testimony states that the Commission is completing rules in a thoughtful, balanced way—not against a clock. Have you mirrored this approach when instituting resources and manpower under the new authority and rule writing responsibilities in the Dodd-Frank Act?

Answer. The Commission has carefully developed a strategic plan which has led to the development and execution of a reorganization of the agency's staff.

Question 33a. What steps have you taken to become more efficient and effective with the resources your agency has in developing rules mandated by the Dodd-Frank Act?

Answer. The CFTC is dedicated to using taxpayer dollars efficiently—nearly a fourth of our overall budget request is for the development of Information Technology.

But it still takes human beings to watch for market manipulation and abuses that affect hedgers—farmers, ranchers, producers, commercial companies and the public buying gas at the pump.

For example, the Dodd-Frank swaps market transparency rules mean a major increase in the amount of incoming data for the CFTC to aggregate and analyze. The agency is taking on the challenge of establishing connections with SDRs and aggregating the newly available swaps data with futures market data. This requires high performance hardware and software and the development of analytical alerts. But it also requires the corresponding personnel to manage this technology effectively for surveillance and enforcement.

Position Limits

Question 34. When was the last time the CFTC calculation of deliverable supply was done to help set position limits?

Answer. The CFTC does not routinely calculate deliverable supplies for physical commodities. CFTC staff, as part of its due diligence reviews, evaluates related exchange filings. Staff conducts interviews with participants in the cash markets for the commodity underlying the contract to understand the production, consumption, and distribution of the underlying commodity and underlying deliverable supply. The cash market analysis and deliverable supply estimate are used together to assess the contracts' susceptibility to manipulation and to verify that the position limit is consistent with the Commodity Exchange Act and CFTC regulations and policy. CFTC staff last estimated a commodity's deliverable supply in 2009 when staff estimated deliverable supplies for crude oil, natural gas, RBOB gasoline, and heating oil. Staff concluded that deliverable supplies were adequate. Under the new rules recently adopted by the CFTC establishing position limits in 28 physical commodity markets, the exchanges and the CFTC would reevaluate deliverable supplies on a regular 2 year basis.

Other Issues

Question 35. This question is related to the efficient use of CFTC resources and judicial review of agency actions. When the SEC adopts a rule, a person affected by that rule may file a petition for review directly in a U.S. Court of Appeals challenging the SEC's rule under the Administrative Procedures Act. That has been true for decades. Direct appeals allow for expeditious and efficient review by the courts of agency action. The Commodity Exchange Act does not have a similar provision. When the CFTC adopts a rule, I understand the CFTC's position to be that a person affected by that rule must file a complaint in federal district court, not in the court of appeals. That means the CFTC and the plaintiff must go through two proceedings to challenge a CFTC rule—one in district court and one in appellate court—while a challenge to the SEC involves only a one step process with the court of appeals. In this instance, the SEC process is more direct and less costly for the agency. Do you support an amendment to the CEA that would allow direct appeals from CFTC rules to the courts of appeals?

Question 35a. If yes, would you favor enactment of such an amendment expeditiously so that it could take effect this year? Would that help to preserve CFTC resources? If no, why not?

Answer 35–35a. The Commission has not taken a position with regard to this matter.

Questions Submitted by Hon. Collin C. Peterson, a Representative in Congress from Minnesota

Question 1. Earlier this year, the CFTC published its final rule for real-time public reporting of swap transaction data included the term "publicly reportable swap transaction" as defining the types of swaps that would be subject to public dissemination. The rule excluded "internal swaps" or some swaps between affiliates, because such swaps were not arms-length transactions and disclosure would not enhance price discovery. In a footnote, the Commission does say that "covered transactions between affiliates as described in Sections 23A and 23B of the Federal Reserve Act" would be publicly reportable swaps transactions. Can you explain more about the nature of these specific covered transactions mentioned in the Federal Reserve Act and why the Commission unanimously voted to require their public dissemination despite being between affiliates? Did the Federal Reserve have any input regarding this subject?

Answer. Sections 23A and 23B of the Federal Reserve Act refer to transactions between a bank and its affiliate. Section 23A relates to all derivatives transactions of the bank that create credit exposure to the affiliate. Section 23B sets the "arm's-length requirement" for that section. The Commission determined that it would be appropriate to include certain covered transactions as publicly reportable and reflective of the market. The Commission did have the benefit of consultation with the Federal Reserve Board regarding this provision.

Question 2. Last month this Committee marked-up H.R. 1840, legislation which would amend the CFTC's legal standard for cost-benefit analysis. You and your staff may already be familiar with its contents, but generally the bill matches the directives included in President Obama's Executive Order "Improving Regulation and Regulatory Review." Do you believe there is a significant difference between the cost-benefit analysis conducted currently at the CFTC and the level of analysis that would be required by H.R. 1840/the President's Executive Order?

Answer. Section 15(a) of the Commodity Exchange Act (CEA) currently requires the CFTC, before it promulgates a regulation, to "consider the costs and benefits of the action." H.R. 1840 would amend section 15(a) to require that such determinations be done through the Commission's Office of the Chief Economist. It would require that the Commission consider qualitative and quantitative costs and benefits, and specify that the Commission could propose or adopt a regulation on a reasoned determination that the benefits of the intended regulation justify the costs of the intended regulation.

Question 2a. How difficult is it for the Commission to conduct quantitative and qualitative analysis on its proposed regulations?

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

As noted in the guidance for cost-benefit considerations for final rules memorandum to rulemaking teams from the Chief Economist and General Counsel dated May 13, 2011, rulemakings involve consideration of quantified costs and benefits to the extent it is reasonably feasible and appropriate. For rules that do not have quantifiable costs, the Commission seeks to explain why such costs are not quantifiable and to explain the reasoning and supportive explanation of its predictive judgments using qualitative measures.

Question 2b. How dependent is the Commission on factual data submitted from market participants on the costs associated with their market activity in conducting quantitative and qualitative analysis; can the Commission require market participants to submit information so you can have better data to guide your analysis?

Answer. The Commission recognizes the significance of meaningful issues raised by commenters regarding costs or benefits and takes those comments seriously as it is working on final rules. The Commission does not require that commenters provide data with regard to their operational costs. For those comments which persuade the Commission to modify its proposed rule, the Commission seeks to explain why the proposed alternative more effectively furthers the goals of the statute in light of the section 15(a) factors, not only in the cost-benefit section but throughout the rule's preamble. In contrast, for those comments which do not persuade the Commission to modify its proposed rule, the Commission seeks to explain its adoption of the proposed rule as the most effective means to further the goals of the statute in light of section 15(a). The Commission seriously considers commenters' concerns regarding costs or benefits and evaluates the alternatives presented.

Question 2c. Would enactment of H.R. 1840 significantly slow down the Commission's efforts to implement Dodd-Frank?

Answer. The bill does include provisions that generally would require additional steps in the Commission's regulatory process.

Question 3. One of your fellow Commissioners recently sent a letter to OMB asking them to review some of the CFTC's cost-benefit analysis to see if it complied with various Executive Orders and OMB guidance. But it is my understanding that these Orders and guidance do not apply to the CFTC and that the Commodity Exchange Act's statutory cost-benefit requirements set the cost-benefit standard that the Commission is required to meet. Is my understanding correct? Can the OMB direct how the Commission conducts its cost-benefit analysis?

Answer. The Commission is bound by section 15(a) of the Commodity Exchange Act in its rulemaking. The statute includes particularized factors to inform cost-benefit analyses that are specific to the markets regulated by the CFTC. The Commission's practices are largely consistent with the executive order principles.

Question 4. Last month this Committee passed by a bipartisan vote H.R. 2682, legislation to ensure that end-users are not subject to margin requirements for their swap transactions. The need for this legislation arose from the Prudential Regulators proposing rules that would require end-users to post margin. During many of our hearings, much attention has been focused on regulatory harmonization between agencies. This is an area which could benefit from some harmonization, particularly if was in the direction of the CFTC's position of not subjecting end-users to margin requirements. Have you been in contact with the Prudential Regulators to make the case for the CFTC's position? Do you detect any flexibility in their position on this issue?

Answer. The CFTC has been working with the Federal Reserve, the other U.S. banking regulators, the SEC, and international regulators and policymakers to align margin requirements for uncleared swaps. It is essential that we align these requirements globally, particularly between the major market jurisdictions. The international approach to margin requirements in the consultative paper (sponsored by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions) released this month is consistent with the approach the CFTC laid out in its margin proposal last year. It would lower the risk of financial entities, promote clearing and help avoid regulatory arbitrage. Consistent with the CFTC's proposal, it also excludes non-financial end-users from margin requirements for uncleared swaps.

The CFTC reopened the comment period on our margin proposal so that we can hear further from market participants and the public in light of the work being done to internationally harmonize margin rules. As we work with international regulators on this coordinated approach, I would anticipate that the Commission would only take up the final margin rules toward the end of this year.

Question 5. Last month this Committee passed by a bipartisan vote H.R. 3527, legislation to clarify the definition of "swap dealer." During debate on that bill in the Committee, Members raised questions about language in the amended bill which would directed the Commission to adopt standards distinguishing the "dealing" activities *versus* "entering into swaps for a person's own account for the purpose of achieving one's own trading objectives." This was an attempt to establish some dealer/trader distinction similar to what the SEC has in place. I know you are not a lawyer, but to you what does "achieving one's own trading objectives" mean?

Question 5a. While the goal of this language was to create a dealer/trader distinction, do you believe the language could be read in other ways inconsistent with that intent?

Question 5b. Can you again describe the differences between the CFTC and SEC proposed rules regarding the dealer/trader distinction in your respective definitions of swap dealer and security-based swap dealer? Do you believe such differences are reconcilable?

Answer 5–5b. The dealer-trader distinction is discussed in the preamble to the CFTC and the Securities and Exchange Commission joint final rules and interpretive guidance on the further definitions of "swap dealer," "security based swap dealer," "major swap participant," and "major security based swap participant". The dealer-trader distinction will be useful as one consideration, particularly in light of the degree to which it overlaps with many of the other characteristics identified in the release that are indicative of dealing activity.

Question 6. There have been several press reports for several months now about the CFTC and other federal and foreign financial regulators investigating a group of banks for using swaps to manipulate the price of the London interbank offered rate (LIBOR). While we know you cannot answer questions about the investigation specifically, we would like you to answer these more general questions. For the record, can you explain the LIBOR, how it affects Americans and the serious implications of this potential manipulation?

Question 6a. Do you have sufficient staff and other resources to conduct this investigation?

Question 6b. A recent *Financial Times* article (Feb 17, 2012) highlighted the role of voice brokers in the LIBOR "interdealer" market in this investigation. Do you believe there are market structures or barriers in place that make it easier for such manipulation to occur or harder for regulators to spot it?

Answer 6–6b. LIBOR and Euribor are indices at the center of the capital markets for both borrowings and derivatives contracts. LIBOR is the reference index for the largest open interest contracts in both the U.S. futures markets and swaps markets.

As of the end of June, the 3 month Eurodollar futures contracts that settle to U.S. Dollar LIBOR make up about 70 percent of the notional value of all futures contracts traded on the CME Group exchanges. U.S. Dollar LIBOR's traded volume in 2011 on the CME had a notional value exceeding $564 trillion. According to the British Bankers Association, swaps with a total notional value of approximately $350 trillion and loans amounting to $10 trillion are indexed to LIBOR.

The CFTC initiated in April of 2008 a review of LIBOR after media reports raised questions about the integrity of the index. Thereafter, we began coordinating with the United Kingdom's Financial Services Authority (FSA), which helped us facilitate information requests. The FSA and the U.S. Department of Justice subsequently joined the CFTC with regard to the Barclays matter, and it has been a collaborative effort throughout.

To conduct such a complicated case, the CFTC enforcement staff had to sift through a voluminous number of documents and audio recordings that spanned many years.

The CFTC's Order found that Barclays traders and employees responsible for determining the bank's LIBOR and Euribor submissions attempted to manipulate and made false reports concerning both benchmark interest rates to benefit the bank's derivatives trading positions. The conduct occurred regularly and was pervasive. Barclays' traders located at least in New York, London and Tokyo asked Barclays' submitters to submit particular rates to benefit their derivatives trading positions. In addition, certain Barclays Euro swap traders coordinated with and aided and abetted traders at other banks in each other's attempts to manipulate Euribor.

The Order also found that throughout the financial crisis, as a result of instructions from Barclays' senior management, the bank routinely made artificially low LIBOR submissions. Submitters were told not to submit at levels where Barclays was "sticking its head above the parapet." The senior management directive was intended to fend off negative public perception about Barclays' financial condition.

The CFTC's Order required Barclays to pay a $200 million civil monetary penalty for attempted manipulation of and false reporting concerning LIBOR and Euribor. In addition, Barclays is required to implement measures to ensure its future submissions are honest.

Among other things, these requirements include:

- Making submissions based on a transaction-focused methodology;
- Implementing firewalls to prevent improper communications, including between traders and submitters;
- Preparing and retaining documents concerning submissions and certain relevant communications; and
- Implementing auditing, monitoring and training measures concerning submissions and related processes, including making regular reports to the CFTC.

The CFTC has and will continue vigorously to use our enforcement and regulatory authorities to protect the public, promote market integrity, and ensure that these benchmarks and other indices are free of manipulative conduct and false information. The Commodity Exchange Act (CEA) is clear in its prohibitions against attempted and actual manipulation of futures, swaps and commodity prices. Further, the CEA's Section 9(a)(2) prohibits knowingly making false reports of market information that affects or tends to affect the price of a commodity.

Questions Submitted by Hon. Tim Huelskamp, a Representative in Congress from Kansas

Question 1. During the hearing, you stated that you could not exactly recall what you were told during the phone call that occurred at 2:30 a.m. the morning of October 31. Were you given any information at all about the possibility of misused, misappropriated, commingled, or missing funds from segregated customer accounts? What information were you given during this phone call?

Question 1a. If it was not during the 2:30 a.m. phone call, when did you learn that money was missing from customers' segregated accounts?

Question 1b. Who else was a part of that conference call in the middle of the night? Were there any MF creditors on that call?

Answer 1–1b. During the phone call, staff of MF Global informed regulators that there was a significant shortfall in segregated funds. The other participants on the call were staff of the SEC [and possibly UK FSA—I have no current recollection]. Other participants on the call were the consultants MF Global had retained to support sale of the assets of the company. I am not aware of any knowledge that creditors of MF Global were on the call.

Question 2. Once you learned that segregated funds were missing, why did you not immediately freeze all MF accounts (including those of MF Holdings), to ensure that those funds could be returned to the customers?

Answer. As an initial matter, CFTC has no authority to immediately freeze accounts without a court order. While the CFTC did have the authority to seek a court order freezing accounts of, or otherwise seek a receivership for MF Global, Inc., the FCM/BD, the Securities Investor Protection Act provides that after a SIPA filing the court is to stay any pending related action. Given that a SIPA proceeding for MF Global, Inc. was to be brought, it did not seem in the public interest to bring a competing equity receivership proceeding. Moreover, any freeze of MF Global, Inc.'s accounts could not, of itself, recover funds that had already been transferred out of MF Global, Inc.

Question 3. In your oral testimony, you said that when the SEC has any regulatory authority over a company, then that company can undergo a SIPA bankruptcy. Is it mandatory that the bankruptcy be processed according to SIPA standards? Why was it decided that the bankruptcy of MF Global undergo a SIPA bankruptcy, rather than a Commodities Exchange Act bankruptcy?

Question 4. Who at the CFTC was involved in making the decision regarding the type of bankruptcy that should be used in this particular situation? Who outside the CFTC was a part of that decision-making process? Did anyone at CFTC discuss the structuring of the bankruptcy with individuals at MF Global, the SEC, SIPC and/or the DOJ, and/or MF's creditors such as JP Morgan or Goldman Sachs? If so, who, when and with whom?

Answer 3–4. Futures Commission Merchants ("FCMs") are the financial intermediaries for futures market transactions. An FCM or "commodity broker" bankruptcy must proceed as a liquidation under Chapter 7 of the Bankruptcy Code, rather than a reorganization under Chapter 11, and the trustee has specified duties. Chief among those duties is to endeavor to transfer the positions of customers of the FCM to a solvent FCM. The financial intermediaries for securities are known as broker dealers ("BDs"), and the insolvency of a BD proceeds under SIPA. The insolvency of an entity that is both a commodity broker and a BD (a "BD/FCM") will, so long as there is at least one securities customer, proceed under SIPA.

Question 5. FCM's are required to file a monthly report with the CFTC detailing the status of segregated customer assets. Did MF Global submit their data for September 2011 within the required timeframe?

Question 5a. When did the CFTC publish this information and/or post it to the CFTC website?

Question 5b. Who is responsible for reviewing this information to ensure that segregated funds remain intact?

Answer 5–5b. Commission regulations require an FCM to file an unaudited monthly financial statement with the Commission and with the firm's DSRO within 17 business days of the end of the month. MF Global submitted its September 30, 2011 financial statements to the Commission within the 17 business days required by the regulations.

FCMs file monthly financial statements with the Commission in an electronic format. The CFTC uses an automated program to promptly review each FCM financial statement received. The review program immediately alerts an assigned Commission staff member if the financial statements indicate certain regulatory violations, including a violation of segregation or capital requirements.

MF Global's September 30, 2011 financial statements showed the firm to be in compliance with the customer funds segregation and capital requirements. Regional examination staff conducts further analysis of FCM financial statements after the documents are filed with the Commission.

The CFTC publishes monthly FCM financial data on its website shortly after it receives all filings. October 26, 2011 was the 17th business day during the month of October 2011. Commission staff was in the process of compiling the September 30, 2011 financial data when MF Global filed for bankruptcy on Monday, October 31, 2011. Staff did not publish MF Global's September 30 financial data as the firm had declared bankruptcy prior to the publication of the information, and questions existed regarding the accuracy of the firm's books and records.

Question 6. Did you speak with or have any other communication with Jon Corzine or any other MF Global executives during the period October 24–November 5?

Answer. During some calls with regulators on October 29–30 and into the morning of October 31, 2011, MFG representatives and representatives of a firm considering facilitating the transfer of MFG customer positions also participated. My involvement was in furtherance of the CFTC's effort to ensure to the maximum extent possible the protection of customer property that had been entrusted to MFG. Though it was not always apparent which representatives from MFG were present on these calls, to the best of my knowledge and recollection, Mr. Corzine was on the line for at least part of one of these calls, and discussed matters regarding MFG's European bond positions.

Question 7. After the CFTC was given an investigative role in the bankruptcy of MF Global, it took you a week before you made an announcement that you were to be a "non-participant" in the investigation. What is a "non-participant" and how does that differ from actually recusing yourself from the investigation? What investigatory activities did you participate in or lead before you removed yourself from the investigation?

Question 8. Prior to your becoming a "non-participant", what sort of responsibilities did you personally have in the oversight of MF Global? Were you required to sign off on any reports? Did you write reports or conduct any audits or investigations regarding anything at MF Global?

Answer 7–8. For the convenience of the Committee, I include two documents which address *Questions 7* and *8.* The first is the text of my statement of non-participation. The second is a Memorandum which includes information detailing my activities prior to my withdrawal from participation in the matter. (*See* ATTACHMENTS 1–2).

Question 9. The Commission recently finalized a rule setting forth requirements for margin segregation for cleared swaps, correct?

Question 9a. And wasn't failure to properly segregate funds for futures customers the problem with MF Global?

Question 9b. Why did you move forward with a segregation rule for swaps, without fully understanding what went wrong with the segregation regime for futures customers at MF Global? Couldn't the rule have benefited from more time to take account of what we're beginning to learn about MF Global? Won't you just have to revisit this rule if new facts come to light so that you can properly protect swaps customers—in addition to futures customers?

Answer 9–9b. The Commission's adoption of final rules for the segregation of customer funds for cleared swaps carries out the Dodd-Frank Act mandate that futures commission merchants (FCMs) and derivatives clearing organizations (DCOs) segregate customer collateral supporting cleared swaps. FCMs and DCOs must hold customer collateral in a separate account from that belonging to the FCM or DCO. It prohibits clearing organizations from using the collateral of non-defaulting, innocent customers to protect themselves and their clearing members. For the first time, customer money must be protected individually all the way to the clearinghouse.

We received a tremendous amount of public input on this rule, including through two roundtables, as well as through comments on an advanced notice of proposed rulemaking and a proposal. This rule builds on customer protections included in the clearinghouse core principles rule finalized in October requiring DCOs to collect initial margin on a gross basis for their clearing members' customer accounts.

In addition, in February, the Commission held a public roundtable on customer protection. Among the topics discussed were protections for the collateral of futures customers, consistent with the already-approved LSOC rule for cleared swaps.

Question 10. In light of what has happened with MF Global, does the Commission intend to recommend changes to the Bankruptcy Code?

Answer. The Commission has not recommended changes to the bankruptcy code. It has adopted important customer protection enhancements and continues to review further improvements. The completed amendments to rule 1.25 regarding the investment of funds bring customers back to protections they had prior to exemptions the Commission granted between 2000 and 2005. Importantly, this prevents use of customer funds for in-house lending through repurchase agreements. Clearinghouses also will have to collect margin on a gross basis and futures commission merchants will no longer be able to offset one customer's collateral against another and then send only the net to the clearinghouse. And the so-called "LSOC rule" (legal segregation with operational commingling) for swaps ensures customer money is protected individually all the way to the clearinghouse.

Question 11. Segregated funds have been the hallmark of customer fund protection. How do you believe customer funds should be treated in a bankruptcy scenario and how do you perceive the SIPC trustee is handling the funds of futures customers? If this was a CFTC led process, would the funds of futures customers be treated differently?

Answer. Commodity customers in a SIPA proceeding do not suffer any disadvantage relative to commodity customers in a subchapter IV, Chapter 7 bankruptcy proceeding.

Questions Submitted by Hon. Randy Hultgren, a Representative in Congress from Illinois

Question 1. The CFTC recently approved the final rule regarding registration requirements for market participants. However, since the joint rule on entity definitions and a determination of what a "swap" contract will be, many market participants are still unclear if they will have to register with the CFTC. Will additional time be provided by the CFTC for participants to comply with new registration requirements? Will the CFTC wait to apply these registration requirements until the final entity definitions have been completed? When does the CFTC expect market participants to be fully capable of compliance?

Answer. A swap dealer or a major swap participant is not required to apply for registration until 60 days after the joint final rule further defining the term "swap" is published in the *Federal Register*. Staff for the CFTC's Division of Market Oversight has already provided relief for some firms in the form of a "no-action" letter. That relief is intended to provide sufficient time for nonclearing member swap dealers to transition. The Commission is working with market participants and will continue to do so.

Question 2. Please describe the challenges experienced by the CFTC and SEC when engaging in joint rulemaking and other coordinated efforts. Specifically, please explain how agency coordination, or lack thereof, has complicated the process of defining "swap".

Answer. The CFTC and SEC consult and coordinate extensively to harmonize to the greatest extent possible on Dodd-Frank rules. This close coordination will continue and always benefits the rulemaking process. The two agencies recently adopted joint final rules further defining the terms "swap" and "security-based swap."

Question 3. In the CFTC's efforts to understand high frequency trading, what stakeholder groups do you think should be consulted and how involved with market participants be in this process?

Question 4. Is proprietary algorithmic trading data necessary to understanding the development of high frequency trading practices and what protections will be extended to this sensitive information when it is share with the CFTC?

Question 5. When considering high frequency traders, will the aggregate value of trades and total volume of trades be considered?

Answer. 3–5 In analyzing HFT activity, the Commission has consulted stakeholder groups with substantial knowledge of these trading practices. The Technology Advisory Subcommittee on High-Frequency Trading of the Commission was established in March of 2012, and includes experts from exchanges, clearing firms, sell-side firms, buy-side (hedging) institutions, data and technology service providers, academia, SROs and high-frequency firms themselves. A sequence of public meetings have been held to present, discuss and debate the findings and deliberations of the highly qualified members of the Subcommittee and in the process, help the Commission develop a detailed picture of high-frequency and other automated trading styles and their potential impact on the market.

Question 6. Has the CFTC considered how the indemnification provision of Dodd-Frank could undermine the mitigation of systematic risk and hamper transparency in the over-the-counter (OTC) derivatives market? How does the CFTC think these negative consequences could be avoided?

Answer. On May 1, of this year, the Commission issued a Proposed Interpretative Statement regarding the confidentiality and indemnification provisions in the Dodd-Frank Act. The proposal generally exempts foreign regulators from the indemnification and confidentiality provision in the Dodd-Frank Act, and ensures that foreign regulators have access to data in Swap Data Repositories (SDR). This exemption only applies to data that is required to be reported and if the SDR is recognized by the country's law and regulation.

Question 7. The House Agriculture Committee recently passed H.R. 1810 that would require a comprehensive cost-benefit analysis by CFTC of its rules and orders. How would this legislation, if passed, change the cost-benefit analysis currently preformed by CFTC related to the Dodd-Frank Act?

Answer. Section 15(a) of the Commodity Exchange Act (CEA) currently requires the CFTC, before it promulgates a regulation, to "consider the costs and benefits of the action." H.R. 1840 would amend section 15(a) to require that such determinations be done through the Commission's Office of the Chief Economist. It would require that the Commission consider qualitative and quantitative costs and benefits, and specify that the Commission could propose or adopt a regulation on a reasoned determination that the benefits of the intended regulation justify the costs of the intended regulation.

Question 8. Of the estimated 286 rulemakings requirements with specified deadlines in Dodd-Frank, well over half are still outstanding. While the CFTC has been better than some of its sister regulators, statutory rulemaking deadlines have been missed or delayed. Is it fair to say that, as passed, Dodd-Frank set an overly ambitious timetable for the development and finalization of the many new rules included?

Answer. The Commission has made significant progress in implementing Congress' direction to ensure that common-sense standards are established for the swaps market. To date, we've completed 36 rules and now have fewer than 20 to go. We are working to complete these rules in a thoughtful, balanced way—not against a clock.

Question 9. Recently former CFTC Commissioner Sharon Brown-Hruska from NERA authored a report that estimated the cost for a non-financial energy firm to comply with the obligations of a Swap dealer. The report estimates that non-financial energy firms designated as swap dealers will incur more the $70 million of annual (year-one) costs to comply with the CFTC's proposed rules. The CFTC estimated the annual cost of compliance with its Swap dealer rules at roughly $2 million. Will the CFTC reexamine its cost-benefit analysis of the Swap Dealer definition to address the omissions cited in the NERA report? How will the CFTC ensure that the Swap Dealer definition will not impose an undue burden without a detailed reexamination of its cost-benefit studies?

Answer. The CFTC strives to include well-developed considerations of costs and benefits in each of its proposed rulemakings. Relevant considerations are presented not only in the cost-benefit analysis section of the CFTC's rulemaking releases, but additionally are discussed throughout the release in compliance with the Administrative Procedure Act (APA). The APA requires the CFTC to set forth the legal, factual and policy bases for its rulemakings.

In addition, Commissioners and staff have met extensively with market participants and other interested members of the public to hear, consider and address their concerns in each rulemaking. CFTC staff hosted a number of public roundtables so that rules could be proposed in line with industry practices and address compliance costs consistent with the obligations of the CFTC to promote market integrity, reduce risk and increase transparency as directed in Title VII of the Dodd-Frank Act. Information from each of these meetings—including full transcripts of the roundtables—is available on the CFTC's website and has been factored into each applicable rulemaking.

With each proposed rule, the Commission has sought public comment regarding costs and benefits. The Commission welcomes each comment and incorporates those comments—including those relating to costs—in development of its final rule.

Questions Submitted by Hon. William L. Owens, a Representative in Congress from New York

Question 1. In your testimony, you note that the CFTC intends to follow Congressional intent by ensuring that non-financial companies using swaps to hedge or mitigate commercial risk will not be required to bring swaps into central clearing. However, you also claim the Commission's proposed rule adheres to this structure, despite many end-users claiming to the contrary. How do you account for this discrepancy?

Answer. Congress provided that non-financial entities, such as farmers, ranchers, manufacturers and other end-users, should be able to choose whether or not to clear those swaps that hedge or mitigate commercial risks. The Commission's final rule implements this exception for non-financial entities, establishing criteria for hedging or mitigating commercial risk and imposing minimal reporting requirements for those swaps that come under the end-user exception.

Question 2. The CFTC has approved the final rule requiring market participants to register with the CFTC but delayed a vote on finalizing definitions. Will the Commission be providing additional time for market participants to comply with this registration requirement so that this requirement is not effective until the final entity definitions has been completed?

Answer. A swap dealer or a major swap participant is not required to apply for registration until 60 days after the joint final rule further defining the term "swap" is published in the *Federal Register*. Staff for the CFTC's Division of Market Oversight has already provided relief for some firms in the form of a "no-action" letter. That relief is intended to provide sufficient time for nonclearing member swap dealers to transition. The Commission is working with market participants and will continue to do so.

Question 3. In your testimony, you note that you anticipate the Commission will seek public input on the extraterritorial application of Title VII. Can you shed some light on when the CFTC intends to propose a formal rulemaking process on the extraterritorial application of Dodd-Frank and if you believe these requirements should extend to transactions which are conducted outside of the United States through either foreign affiliates of domestic firms or by foreign entities with non-U.S. persons?

Answer. On June 29, 2012, the CFTC approved proposed interpretive guidance on the cross-border application of the Swaps Provisions of the Dodd-Frank Act and the Commission's regulations. The proposed guidance interprets Section 722(d) of the Dodd-Frank Act, which states that the swaps provisions of the CEA shall not apply to activities outside the United States unless those activities have a direct and significant connection with activities in, or effect on, commerce of the United States. The guidance will be open for public comment for 45 days. While the Commission is not required to solicit public comment on interpretive guidance, I am particularly interested in the public's input and look forward to comments on the proposed guidance.

Question 4. The House Agriculture Committee recently approved (H.R. 2779) legislation that would exempt certain inter-affiliate transactions of swap dealers from meeting margin and clearing requirements. You note in your testimony that you expect the Commission to consider a proposal on this issue later this year. Do you expect the Commission's rules to mirror the SEC's?

Answer. The Commission has benefitted from substantial public input on the treatment of swaps among affiliates of the same business entity. To address commenters' questions about a possible clearing requirement between affiliates of financial entities, I expect the Commission to consider a proposal and take public comments in the near future. The staff recommendation, which would exempt certain affiliate swaps from the clearing requirement, is under review by commissioners. The Commission will continue to consult closely with the SEC.

Question 5. With respect to the swap dealer definition, will the CFTC clearly define Market Making in a manner that provides clarity to market participants as to what distinguishes Market Making from other market activity that end-users engage in, such as hedging risk? Will you support a specific exemption from swap dealing for commercial hedging in the rule?

Answer. On April 18, 2012 the Commission adopted a joint final rule, required by Section 712(d)(1) of the Dodd-Frank Act with the SEC further defining the terms "swaps dealer," and "major swaps participant." The rulemaking incorporates an interim final rule, such that swaps a person enters into for the purpose of hedging price risks related to physical positions are inconsistent with swap dealing, and are excluded from the swap dealer determination. The interim final rule draws upon principles in the Commission's long standing interpretation of *bona fide* hedging. It excludes swap activity for the purpose of portfolio hedging and anticipatory hedging. However, the CFTC is not adopting a *per se* exclusion of all swaps that hedge or mitigate risk. If a swap is not entered into for the specific hedging purposes identified in the rule, then all relevant facts and circumstances about the swap would be considered in determining if the person is a swap dealer. The CFTC is looking forward to receiving comment on the interim final rule.

Question 6. Will you support a clear distinction between dealing activity and trading activity within the finalized definitions?

Answer. The dealer-trader distinction is discussed in the preamble to the CFTC and the Securities and Exchange Commission joint new final rules and interpretive guidance on the further definitions of "swap dealer," "security based swap dealer," "major swap participant," and "major security based swap participant". The CFTC anticipates that the dealer-trader distinction will be useful as one consideration, particularly in light of the degree to which it overlaps with many of the other characteristics identified in the release that are indicative of dealing activity.

ATTACHMENT 1

November 8, 2011

Statement of Non-Participation

With respect to the recent matters involving MF Global, the staff at the CFTC is working hard to recover customers' funds and to find out what happened to the missing customer money and how it happened. The CFTC has a tremendously capable staff and I do not want my participation to be in any way a distraction in this important matter.

Accordingly, I have determined that I will not participate personally and substantially in any enforcement matter involving specific parties MF Global, MF Global Holdings Ltd., MF Global Inc., and J.C. Flowers & Co. (the "specific parties"), and any matter directly related thereto. I will advise my principal subordinates of my decision not to participate in these matters. I also will instruct my principal subordinates that all inquiries and comments involving any of the matters described above should be directed to Dan Berkovitz, the General Counsel of the CFTC who will act on my behalf, without my knowledge or involvement.

In order to help ensure that I do not inadvertently participate personally and substantially in any particular matter that could have a direct or predictable effect on the specific parties with respect to such matters described above, I am directing Mr. Berkovitz to seek assistance from the alternate designated agency ethics official if he is ever uncertain whether or not I may participate in a matter.

I have instructed David Stawick, the Secretary of the Commission, to screen all CFTC matters directed to my attention that involve outside entities or that require my participation, to determine if they involve any of the specific parties and matters listed above. If Mr. Stawick determines that a matter involves any of the specific parties and matters, he will refer it to the appropriate official to take action without my knowledge or involvement.

11/8/11

Hon. GARY GENSLER, Date
Chairman.

ATTACHMENT 2

Confidential Memorandum

To: Chairman Gensler

From: DAN M. BERKOVITZ,
General Counsel and Designated Agency Ethics Official

JOHN P. DOLAN,
Counsel and Alternate Designated Agency Ethics Official

Date: December 13, 2011

Subject: Participation in Matters Concerning MF Global, Inc.

I. Introduction and Summary

Pursuant to 5 CFR § 2635.502, the Commodity Futures Trading Commission (CFTC or Commission) designated agency ethics official (DAEO) has undertaken this review of the participation of CFTC Chairman Gary Gensler in certain CFTC matters regarding MF Global, Inc. (MFGI), a futures commission merchant (FCM) registered with the CFTC. During the 1980s and 1990s Chairman Gensler and the former President and Chief Executive Officer (CEO) of MFGI, Jon Corzine, worked together and were partners at Goldman Sachs (GS), an investment bank.[1]

On November 3, 2011, the General Counsel and DAEO provided Chairman Gensler with an oral opinion that the Chairman was not required to withdraw from participation in MFGI matters as a result of his prior relationship with Mr. Corzine. On that same date Chairman Gensler nonetheless elected to not participate in enforcement matters related to MFGI.[2] Following this decision, the General Counsel

[1] Mr. Corzine resigned as President and CEO of MFGI on Friday, November 4, 2011.

[2] On November 8, 2011, Chairman Gensler executed a "Statement of Non-Participation." This statement explained the Chairman's decision: "With respect to the recent matters involving MF Global, the staff at the CFTC is working hard to recover customers' funds and to find out what happened to the missing customer money and how it happened. The CFTC has a tremendously capable staff and I do not want my participation to be in any way a distraction in this important matter."

and DAEO and ADAEO decided to undertake this review to determine whether Chairman Gensler's participation in matters involving MFGI was appropriate.

Based on the facts and circumstances detailed in this memorandum, and based upon the standards set forth in 5 CFR § 2635.502, this review concludes that Chairman Gensler was not required to withdraw from matters involving MFGI. From a legal and ethical perspective, Chairman Gensler's participation in Commission matters involving MFGI was not improper.

II. Factual Background

A. MF Global, Inc.

Subsidiary of MF Global

MG Global is a financial business comprising a holding company, MF Global Holdings Ltd., a Delaware corporation headquartered in New York City, and a variety of subsidiaries located in the United States and other countries.[3] One of the subsidiaries is MFGI, which is an FCM registered with the CFTC as well as a securities broker-dealer registered with the SEC.[4] According to the Annual Report (SEC Form 10–K) filed by MF Global Holdings Ltd. in May 2011, MF Global is a broker in markets for commodities and listed derivatives and a broker-dealer in markets for commodities, fixed income securities, equities, and foreign exchange.[5]

MFGI Bankruptcy

On October 31, 2011, the Securities Investor Protection Corporation (SIPC) filed an application for the entry of a protective order in the U.S. Bankruptcy Court placing MFGI in liquidation under the Securities Investor Protection Act (SIPA). On that same date, "the Commission's Division of Enforcement opened an investigation into whether the Commodity Exchange Act (CEA) or Commission regulations were violated in connection with MFGI, and the Commission [] authorized the Division to issue subpoenas."[6]

In a filing on November 2, the Commission informed the Bankruptcy Court that it "intends to take all appropriate action, within the purview of the Bankruptcy Code and the [CEA], to ensure that customers maximize their recovery of funds and to discover the reason for the shortfall in segregation."[7]

Key officials

Jon S. Corzine was the Chairman and Chief Executive Officer of MF Global Holdings Ltd. until his recent resignation.[8] According to the MF Global website, Mr. Corzine also is an operating partner at J.C. Flowers & Co. LLC.[9] According to the MF Global website, Mr. Corzine joined GS as a fixed income trader in 1975 and subsequently served as chief financial officer and as chairman and senior partner from 1994 through 1999.[10]

Bradley I. Abelow is the President and Chief Operating Officer of MF Global Holdings Ltd.[11] According to the MF Global website, Mr. Abelow previously was a partner and managing director of GS, where he managed the operations group.[12]

[3] MF Global Holdings Ltd. Form 10–K for fiscal year ended March 31, 2011 at 1, *http://www.sec.gov/Archives/edgar/data/1401106/000119312511145663/d10k.htm* (accessed November 6, 2011); see Disclaimer, MF Global Website, *http://www.mfglobal.com/disclaimer* (accessed November 6, 2011).

[4] Disclaimer, MF Global Website, *http://www.mfglobal.com/disclaimer* (accessed November 6, 2011).

[5] MF Global Holdings Ltd. Form 10–K for fiscal year ended March 31, 2011 at 5, *http://www.sec.gov/Archives/edgar/data/1401106/000119312511145663/d10k.htm* (accessed November 6, 2011).

[6] CFTC Press Release, PR6140–11, November 10, 2011.

[7] Statement of Commodity Futures Trading Commission in Support of the Trustee's Emergency Motion for an Order Approving the Transfer of Certain Segregated Customer Commodity Accounts of MF Global Inc. and Related Margin and Motion for Expedited Hearing, MFGI Bankruptcy Case, November 2, 2011.

[8] Executive Officers Biography, MF Global Website, *http://www.mfglobalinvestorrelations.com/phoenix.zhtml?c=194911&p=irol-govManage* (accessed November 6, 2011).

[9] Executive Officers Biography, MF Global Website, *http://www.mfglobalinvestorrelations.com/phoenix.zhtml?c=194911&p=irol-govBio&ID=198970* (accessed November 6, 2011).

[10] *Id.*

[11] Executive Officers Biography, MF Global Website, *http://www.mfglobalinvestorrelations.com/phoenix.zhtml?c=194911&p=irol-govManage* (accessed November 6, 2011).

[12] Executive Officers Biography, MF Global Website, *http://www.mfglobalinvestorrelations.com/phoenix.zhtml?c=194911&p=irol-govBio&ID=204097* (accessed November 6, 2011).

Earlier he was responsible for GS's operations, technology, risk, and finance functions in Asia.[13] He joined GS in 1989.[14]

Laurie R. Ferber is the General Counsel of MF Global Holdings Ltd.[15] According to the MF Global website, Ms. Ferber worked for GS for over 20 years beginning in 1987.[16] She held a number of different positions including serving as co-general counsel of the Fixed Income, Currency and Commodities Division and launching and running the economic derivatives business.[17]

J. Christopher Flowers is the founder and executive chairman of J.C. Flowers & Co. LLC, a private equity firm.[18] According to press reports, J.C. Flowers & Co. owns preferred stock in MF Global that, if converted to common stock, would amount to 6% of the total.[19] Also according to press reports, Mr. Flowers worked with Mr. Corzine at GS and later recommended that Mr. Corzine take over as MF Global's chairman and chief executive officer in March 2010.[20]

B. Relationship Between Chairman Gensler and Mr. Corzine [21]

Chairman Gensler's Employment at GS

Chairman Gensler worked at GS from September 1979 until September 1997, when he left to serve as Assistant Secretary of Treasury for Financial Markets.[22] In late 1988, when Chairman Gensler became a partner in the firm, there were approximately 128 partners at GS, including Chairman Gensler and Mr. Corzine.[23]

From his arrival at GS in 1979 until late 1991 or early 1992, Chairman Gensler worked in the Mergers and Acquisitions (M&A) Department.[24] In late 1991 or early 1992, Chairman Gensler and a few other junior partners at the firm were asked to transfer to other departments as part of their career development. The transfers were suggested by Mr. Robert Rubin (the co-Chairman and Co-Senior Partner of GS at the time) and Mr. Corzine (the co-head of the fixed income department (FI) at the time). Mr. Gensler was asked to transfer to FI and agreed.

Chairman Gensler's initial assignment in FI was in the mortgage trading department. In this capacity, he reported to Michael Mortara, who reported to Mr. Corzine and the other co-head of FI, Mr. Mark Winkelman. Chairman Gensler, Mr. Mortara, and Mr. Corzine all worked on the fixed income trading floor.

In January 1993, Mr. Corzine requested, and Chairman Gensler agreed, that Chairman Gensler serve as co-head of fixed income trading in the GS office in Tokyo, Japan. Chairman Gensler served in this position until late 1994. During this two-year period, Mr. Corzine and Mr. Winkelman were Chairman Gensler's direct supervisors.

In the fall of 1994, Chairman Gensler was asked by Mr. Steve Friedman, who was then co-head of GS with Mr. Rubin, to transfer out of FI to be the head of the Operations, Technology, and Finance Division (OTF) in Asia. Chairman Gensler reported to Mr. John Thain, head of worldwide OTF. Shortly thereafter, Mr. Corzine became the Senior Partner of GS and Chairman of the Management Committee.[25]

Chairman Gensler returned to New York in November 1995 to become co-head of Finance. In this position, Chairman Gensler continued to report to Mr. Thain, who continued to report to Mr. Corzine and Mr. Paulson. As co-head of Finance, Chair-

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[13] *Id.*

[14] *Id.*

[15] Executive Officers Biography, MF Global Website, *http://www.mfglobalinvestorrelations.com/phoenix.zhtml?c=194911&p=irol-govManage* (accessed November 6, 2011).

[16] Executive Officers Biography, MF Global Website, *http://www.mfglobalinvestorrelations.com/phoenix.zhtml?c=194911&p=irol-govBio&ID=186545* (accessed November 6, 2011).

[17] *Id.*

[18] J.C. Flowers & Co. LLC: Private Company Information—*Businessweek,* (accessed November 6, 2011) *http://investing.businessweek.com/research/stocks/private/snapshot.asp?privcapId=1089967.*

[19] *J.C. Flowers Fund Said to See $47.8 Million Loss on MF Global*—BUSINESSWEEK (November 2, 2011), *http://www.businessweek.com/news/2011-11-02/jc-flowers-fund-said-to-see-47-8-million-loss-on-mf-global.html* (accessed November 6, 2011).

[20] *Id.*

[21] The facts in this section are based primarily upon an interview with Chairman Gensler conducted on November 4, 2011.

[22] Chairman Gensler served as Assistant Secretary for Financial Markets from September 1997 until April 1999, and as Under Secretary of Treasury for Domestic Finance from April 1999 to January 2001.

[23] By 1997, when Chairman Gensler left GS, there were approximately 190–200 partners at GS.

[24] Chairman Gensler spent approximately 6–12 months during the 1983–1984 time period on the equity trading floor as part of a "mobility program."

[25] Executive functions were shared between Mr. Corzine and Mr. Henry Paulson, who served as Chief Operating Partner and Vice Chairman of the Management Committee. Mr. Thain reported to Mr. Corzine and Mr. Paulson.

man Gensler served on various committees of the firm, including the Risk Committee. Mr. Corzine also was a member of the Risk Committee (which had approximately 10–15 members), and sometimes he participated on other committees, too. Chairman Gensler served as co-head of Finance until he left GS in 1997 for the Treasury Department. Prior to leaving GS, Chairman Gensler visited with Mr. Corzine at the latter's apartment to provide departing observations.[26]

After Chairman Gensler Left GS

To the best of his recollection, Chairman Gensler believes he did not see Mr. Corzine for 3 years after Chairman Gensler left GS.[27] While Chairman Gensler served at Treasury, the only time that he saw Mr. Corzine was in late 2000 or early 2001. Then-Senator-elect Corzine had come to the Treasury Department to visit with Secretary of Treasury Lawrence Summers, and following the meeting with Secretary Summers, Mr. Corzine stopped by to say hello to then-Under Secretary Gensler.

In early 2002, Chairman Gensler volunteered to serve as an advisor to Senator Paul Sarbanes on legislation that eventually was enacted as the Sarbanes-Oxley Act. Senator Sarbanes was Chairman of the Senate Committee on Banking, Housing and Urban Affairs and Senator Corzine was a Member of the same Committee. In his role as advisor to Senator Sarbanes, Chairman Gensler occasionally spoke with Senator Corzine about the pending legislation. Chairman Gensler also spoke with Senator Corzine while Chairman Gensler, Senator Sarbanes, and Senator Corzine were on the Senate floor during the consideration of the legislation for final Senate passage.

In 2003–2004, Chairman Gensler served as Treasurer of the Maryland State Democratic Party. During the same time, Senator Corzine became head of the Democratic Senatorial Campaign Committee. As a result of their fundraising responsibilities, Chairman Gensler saw Senator Corzine at several political events attended by large numbers of people. This included an event to support the campaign of Senator Kerry for President in 2004, which was attended by approximately 400 others, including other Members of Congress.

In 2005, Chairman Gensler was invited to a fundraiser in Washington, D.C., for the New Jersey State Democratic Party. Approximately 100 people attended, including both Senator Corzine and the other Senator from New Jersey, Senator Frank R. Lautenberg. At the time, Senator Corzine was campaigning to be elected Governor of New Jersey. As a participant in the fundraiser, Chairman Gensler contributed $10,000 to the New Jersey State Democratic Party (as he similarly contributed to the State Democratic Party of several other States), which earned him the title of being a "host" of the fundraiser.[28] Chairman Gensler did not see Governor Corzine for another 3 years.

During the primary season for the 2008 Presidential campaign, Chairman Gensler first served as an unpaid senior advisor to the campaign of then-Senator Hilary Clinton. Chairman Gensler recalls speaking with Governor Corzine on a couple of occasions to answer Governor Corzine's questions about Senator Clinton's positions on various policy issues. Chairman Gensler recalls seeing Governor Corzine at a fundraising event in New Jersey in either August or September of 2008 for then-Senator Obama.

Chairman Gensler's Tenure at the CFTC

Chairman Gensler began serving as Chairman of the CFTC in May 2009. At the time he joined the CFTC, Chairman Gensler determined not to participate in any CFTC matters involving GS.

Shortly after joining MFGI in March 2010, Mr. Corzine met with Chairman Gensler and the Chairman's staff at CFTC headquarters. Mr. Corzine requested the meeting, which Chairman Gensler recalls as a "meet and greet" and that Mr. Corzine did not make any specific requests to Chairman Gensler.

In November 2010, Mr. Corzine asked Chairman Gensler to speak at a seminar at Princeton University that Mr. Corzine was conducting on financial institutions and regulation.[29] Mr. Andrew Ross Sorkin also spoke at this seminar, and Mr. Corzine introduced both of them. Following the seminar, Chairman Gensler joined

[26] Mr. Corzine subsequently left GS in early 1999.

[27] Chairman Gensler believes that he may have spoken with Mr. Corzine once or twice by telephone while serving at Treasury, but cannot specifically recall any such conversations.

[28] Chairman Gensler's contribution was to the New Jersey State Democratic Party, not directly to Senator Corzine's campaign for Governor.

[29] A copy of Chairman's Gensler's speech can be found at: *http://www.cftc.gov/PressRoom/SpeechesTestimony/2010/index.htm*. (last visited Nov. 6, 2011).

Mr. Corzine and approximately 15–20 students for dinner.[30] Chairman Gensler and Mr. Corzine did not discuss any issues relating to MFGI while Chairman Gensler was at Princeton.

In December 2010, Mr. Corzine and Ms. Ferber met with Chairman Gensler and other CFTC staff. Chairman Gensler does not recall the subject of the meeting or the matters discussed.

In June 2011, Chairman Gensler was the keynote speaker at lunch at a conference sponsored by Sandler O'Neill and Partners, an investment banking and broker/dealer firm.[31] Mr. Corzine was seated at the same table as Chairman Gensler during the lunch. The invitation did not come from Mr. Corzine, and Chairman Gensler and Mr. Corzine did not discuss any issues relating to MFGI while Chairman Gensler was at the conference.

In September 2011, Chairman Gensler and Mr. Corzine were both wedding guests of mutual acquaintances. Chairman Gensler and Mr. Corzine did not discuss any issues relating to MFGI while attending the wedding.

Chairman Gensler has been on two conference calls with Mr. Corzine during his term as Chairman of the CFTC. The first, on July 20, 2011, was a conference call to discuss topics relating to a rulemaking regarding CFTC Rules 1.25 and 30.7.[32] Second, Chairman Gensler participated in a series of conference calls with other regulatory authorities and MFGI during the days leading up to the filing of the MFGI bankruptcy proceedings. Chairman Gensler is aware that Mr. Corzine was on the line for at least part of one of these calls, regarding the European bond portfolio.[33] Since becoming Chairman of the CFTC, Chairman Gensler has not had any private telephone conversations with Mr. Corzine.[34]

Summary

Chairman Gensler worked with Mr. Corzine during the last 6 years of Chairman Gensler's tenure at GS. During two of those years (1993–1994), Chairman Gensler reported directly to co-heads Messrs. Corzine and Winkelman; during the other 4 years, Mr. Corzine was his second-level supervisor. Their relationship during this period was solely professional. Chairman Gensler and Mr. Corzine did not socialize or spend time together apart from their mutual professional activities.[35]

Since the time they worked together at GS over 14 years ago, Chairman Gensler's contacts with Mr. Corzine have been infrequent. Generally, they have met when they both were present at a function organized by others. Similarly, Chairman Gensler has not socialized with Mr. Corzine after his departure from GS, nor have their families socialized with each other. Chairman Gensler and Mr. Corzine do not correspond with each other; Chairman Gensler does not recall any e-mails or other electronic communications between himself and Mr. Corzine for at least as far back as 10 years. Chairman Gensler does not carry Mr. Corzine's personal phone number in his cell phone directory.

Chairman Gensler and Mr. Corzine have never attended any of each other's major non-professional life-events during the entire time they have known each other. Mr. Corzine did not attend Chairman Gensler's wedding (which occurred while Chairman Gensler was at GS), the bat-mitzvahs of Chairman Gensler's daughters, or the funeral of Chairman Gensler's wife. Similarly, Chairman Gensler did not attend Governor Corzine's inaugural in 2005 or his wedding in 2010.

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[30] Mr. Sorkin was unable to stay for the dinner.

[31] The firm regularly sponsors such conferences. *See, e.g., https://register.sandleroneill.com/conferences/* (last visited Nov. 6, 2011).

[32] A record of this call can be found at *http://www.cftc.gov/LawRegulation/DoddFrankAct/ExternalMeetings/dfmeeting_072011_928* (last visited Nov. 7, 2011). In response to media questions as to whether a delay in consideration of this rulemaking showed favoritism to MFGI, Chairman Gensler has stated that he has "been consistent on this rule, and I allowed more time for others to continue to look at it." *See* Silla Brush, *Bloomberg*, "MF Global Didn't Get Preferential Treatment, CFTC's Gensler," Nov. 7. 2011.

[33] It is possible that Mr. Corzine was on the line during other portions of these conference calls.

[34] On November 8, 2011, *BNA* reported that Chairman Gensler and Mr. Corzine spoke shortly after Mr. Corzine resigned from his positions at MF Global. *See* Steven Joyce, *BNA*, "Gensler Says Recusal Decision Made Days Before Corzine Resignation, Grassley Letter," Nov. 8, 2011. This report is not accurate; the reported conversation between Chairman Gensler and Mr. Corzine did not occur.

[35] Chairman Gensler recalls one non-professional interaction that indirectly involved Mr. Corzine during his tenure at GS. In 1991, Chairman Gensler learned that Mr. Corzine had registered to run in the New York City Marathon that year. Chairman Gensler recalls that he asked Mr. Corzine's secretary whether Mr. Corzine actually was going to run the marathon. A few weeks later Mr. Corzine's secretary told Chairman Gensler that Mr. Corzine would not run in the race and would not use the number he had been provided. Mr. Corzine's secretary gave Mr. Corzine's number to Mr. Gensler, who then used Mr. Corzine's bib number in the race.

Chairman Gensler did not ask Mr. Corzine for support of his nomination as CFTC Chairman. He has never contributed directly to any of Mr. Corzine's electoral campaigns. He has raised money for several national Democratic figures, but has never solicited a campaign contribution for Mr. Corzine. Nor does he recall ever soliciting a campaign contribution from Mr. Corzine.

C. Relationship Between Chairman Gensler and Other Former GS Officials Working for or on Behalf of MFGI [36]

Certain other current MFGI employees and officials previously worked at GS at the same time as Chairman Gensler. Chairman Gensler's relationship with these individuals is as follows:

Brad Abelow

Mr. Abelow became a partner at GS at around the time that Chairman Gensler was leaving GS. At some point, Mr. Abelow became head of OTF in Asia, the position Chairman Gensler had previously occupied. Chairman Gensler recalls that when he was in OTF he and Mr. Abelow had a "weekly to bi-weekly working relationship."

After leaving GS, Chairman Gensler did not see Mr. Abelow until August or September 2008, at a fundraiser for the Presidential campaign of then-Senator Obama. As previously noted, Governor Corzine also attended this event. At the time, Mr. Abelow was Governor Corzine's Chief of Staff. Chairman Gensler recalls speaking to Mr. Abelow for approximately 5 to 10 minutes at this event.

Chairman Gensler believes it is possible that he may have spoken to Mr. Abelow on one or more occasions in his capacity as Governor Corzine's Chief of Staff to facilitate the discussions with Governor Corzine previously noted during the Presidential primary season prior to the 2008 election. After that, Chairman Gensler did not speak with Mr. Abelow again until one of the multi-party conference calls between regulators and MFGI during the weekend prior to the bankruptcy filing of MFGI.

Chairman Gensler and Mr. Abelow did not have a social relationship apart from their professional relationship at GS.

Christopher Flowers

Chairman Gensler began working with Mr. Flowers in the M&A department at GS upon his arrival at GS in 1979. They worked together in M&A for approximately 12 years—until Chairman Gensler was transferred from M&A to FI. While Chairman Gensler was in the M&A department, he and Mr. Flowers frequently discussed M&A issues and strategies, but Chairman Gensler and Mr. Flowers specialized in different industries and, to the best of his recollection, did not work together on any specific deals.

After Chairman Gensler left GS, Mr. Flowers visited him once at the Treasury Department. Chairman Gensler recalls that as part of this visit they may have had lunch together.

Chairman Gensler does not recall seeing Mr. Flowers in person since that meeting at the Treasury Department. Mr. Flowers called Chairman Gensler twice at the CFTC. With respect to the first call, Chairman Gensler recalls that Mr. Flowers expressed condolences that his wife had passed away, and he provided Chairman Gensler with the name of an individual who was knowledgeable about financial market regulation.[37] Mr. Flowers did not ask for any action by Chairman Gensler or the CFTC.

In connection with the MFGI matter, Mr. Flowers called Chairman Gensler on October 31, 2011, before Chairman Gensler arrived at the office. Chairman Gensler returned Mr. Flowers' call after he arrived at the office. Several other CFTC employees were present in Chairman Gensler's office for the call and several individuals were present with Mr. Flowers, including Mr. Goldfield, Henri Steenkamp (Chief Financial Officer) and another MFGI official. The MFGI officials on the call provided the call participants with information regarding MFGI's financial status.

Chairman Gensler and Mr. Flowers did not have a social relationship apart from their professional relationship at GS.

Laurie Ferber

At the time that Chairman Gensler was in FI at GS, Ms. Ferber was a senior compliance officer/attorney at the firm. Chairman Gensler believes that he may

[36] The facts in this section are based primarily upon an interview with Chairman Gensler conducted on November 4, 2011.

[37] Chairman Gensler did not contact that individual and does not recall his or her name.

have spoken with Ms. Ferber on one or more compliance matters when he was in FI, but he does not recall anything specific.

After leaving GS, Chairman Gensler did not have any contact with Ms. Ferber until he met with the Board of Directors of the Futures Industry Association (FIA) in September 2010. At the time, Ms. Ferber represented MFGI on the FIA Board of Directors. Ms. Ferber also attended the meeting between Mr. Corzine and CFTC officials, including Chairman Gensler, in December 2010. Ms. Ferber also was on the July 20, 2011, conference call between MFGI officials (including Mr. Corzine) and CFTC officials, including Chairman Gensler, concerning topics relating to a CFTC rulemaking regarding Rules 1.25 and 30.7. Chairman Gensler does not believe that he met or spoke with Ms. Ferber after that, until she participated in one or more multi-party conference calls between MFGI and regulators prior to the bankruptcy filing.

Chairman Gensler and Ms. Ferber did not have a social relationship apart from their professional relationship at GS.

Jacob Goldfield

Chairman Gensler first met Mr. Goldfield in late 1991 or early 1992, after Chairman Gensler began working in FI. Mr. Goldfield also worked in FI, trading options on the government bond desk.

At the time that Chairman Gensler was co-head of fixed income trading in Tokyo, he also had co-supervisory responsibility for the trading of Yen currency swaps conducted in Asia. At the same time, Mr. Goldfield, who was located in New York, had supervisory responsibility for the worldwide GS swap book. Accordingly, Chairman Gensler and Mr. Goldfield had overlapping responsibilities with respect to the GS Yen swap book. Chairman Gensler recalls that he and Mr. Goldfield also later may have served together on the Risk Committee.

Mr. Goldfield visited Chairman Gensler on one occasion at the CFTC. During the consideration of the Dodd-Frank legislation, Mr. Goldfield met with Chairman Gensler and at least one other member of the Chairman's staff. Mr. Goldfield told the Chairman that he was doing good work and if he ever needed anything, to give him a call. Chairman Gensler does not recall any other meetings with Mr. Goldfield since Chairman Gensler left GS.

On October 30, 2011, Mr. Goldfield e-mailed Chairman Gensler to inform him that he was at MF Global "in case there are questions." Mr. Goldfield also informed Mr. Gensler that he had "no financial interest in the company and [was] not looking at it for investment." Mr. Gensler asked Mr. Goldfield whether there were "any observations you wish to pass along?" Mr. Goldfield replied, "Not as of now, I want only to send along novel insights that are useful." Chairman Gensler responded, "Novel and useful. Now those are limiting conditions, though I would say that most everything you have shared over our long knowing each other has been useful." Mr. Goldfield then stated, "Also want to make sure that I am right before I comment." Chairman Gensler does not recall any further comments or information from Mr. Goldfield.

Mr. Goldfield was present at MFGI during one of the conference calls between MFGI and regulators on October 30, 2011. To the best of his recollection, Mr. Goldfield did not speak on the call. A participant from another regulatory agency who was present at MFGI headquarters in New York and who was on the call relayed to Chairman Gensler during the call that Mr. Goldfield walked by and requested that he say "hello to Gensler."

Mr. Goldfield also was present at MFGI during a conference call between MFGI and regulators on the morning of October 31, 2011.

Chairman Gensler and Mr. Goldfield did not have a social relationship apart from their professional relationship at GS.

III. Legal Standard

The standard for determining whether an employee may participate in a matter affecting the employee's financial interests, or involving persons with whom the employee has or has had a professional, business, economic, or personal relationship, is set forth in 5 CFR § 2635.502.

Specifically, § 2635.502(a) provides:

> (a) *Consideration of appearances by the employee.* Where an employee knows that a particular matter involving specific parties is likely to have a direct and predictable effect on the financial interest of a member of his household, or knows that a person with whom he has a covered relationship is or represents a party to such matter, and where the employee determines that the circumstances would cause a reasonable person with knowledge of the relevant facts to question his impartiality in the matter, the employee should not partici-

pate in the matter unless he has informed the agency designee of the appearance problem and received authorization from the agency designee in accordance with paragraph (d) of this section.

(1) In considering whether a relationship would cause a reasonable person to question his impartiality, an employee may seek the assistance of his supervisor, an agency ethics official or the agency designee.

(2) An employee who is concerned that circumstances other than those specifically described in this section would raise a question regarding his impartiality should use the process described in this section to determine whether he should or should not participate in a particular matter.

With respect to a "covered relationship," § 2635.502(b)(iv) provides that an employee has a "covered relationship" with any person "for whom the employee has, *within the last year,* served as officer, director, trustee, general partner, agent, attorney, consultant, contractor or employee." (Emphasis added.)[38]

When the circumstances identified in § 2635.502(a) are not present—*i.e.,* there is no direct and predictable effect on the financial interest of a member of his household, and there is no covered relationship—§ 2635.502(a)(2) provides that the procedures specified in § 2635.502 should still be followed if a question concerning the employee's impartiality may nevertheless remain.[39]

"For example," the Office of Government Ethics (OGE) explains, "if an employee believes that a personal friendship, or a professional, social, political or other association not specifically treated as a covered relationship, may raise an appearance question, then the employee should use the section 2635.502 process to resolve the question."[40]

In this event, under the § 2635.502 process, the threshold determination is to "consider whether the employee's impartiality would reasonably be questioned if the employee were to participate in a particular matter involving specific parties where persons, with certain personal or business relationships with the employee are in-

[38] Section 2635.502(b) provides in full that an employee has a "covered relationship" with:

(i) A person, other than a prospective employer described in § 2635.603(c), with whom the employee has or seeks a business, contractual or other financial relationship that involves other than a routine consumer transaction;

(ii) A person who is a member of the employee's household, or who is a relative with whom the employee has a close personal relationship;

(iii) A person for whom the employee's spouse, parent or dependent child is, to the employee's knowledge, serving or seeking to serve as an officer, director, trustee, general partner, agent, attorney, consultant, contractor or employee;

(iv) Any person for whom the employee has, within the last year, served as officer, director, trustee, general partner, agent, attorney, consultant, contractor or employee; or

(v) An organization, other than a political party described in 26 U.S.C. 527(e), in which the employee is an active participant. Participation is active if, for example, it involves service as an official of the organization or in a capacity similar to that of a committee or subcommittee chairperson or spokesperson, or participation in directing the activities of the organization. In other cases, significant time devoted to promoting specific programs of the organization, including coordination of fundraising efforts, is an indication of active participation. Payment of dues or the donation or solicitation of financial support does not, in itself, constitute active participation.

[39] Under these circumstances—where no financial interest is affected and no covered relationship exists—the Office of Government Ethics (OGE) does not consider the failure to follow these procedures to be "an ethical lapse":

OGE has consistently maintained that, although employees are encouraged to use the process provided by section 2635.502(a)(2), '[t]he election not to use that process cannot appropriately be considered to be an ethical lapse.' OGE Informal Advisory Letter, 94 x 10(2); *see also* OGE 97 x 8 ('obligation' to follow process where covered relationships involved, but employees 'encouraged' to use process in other circumstances); OGE 95 x 5 ('not required by 5 CFR 2635.502 to use the process described in that section' where there is no covered relationship with person who is a party or represents a party); OGE 94 x 10(1) (employee may 'elect' to use process in section 2635.502(a)(2), but 'election not to use that process should not be characterized, however, as an 'ethical lapse').

OGE 01 x 8, Impartiality and Romantic Relationships, August 23, 2001. OGE has further indicated that in such circumstances, "even if it were now determined, in hindsight, that a reasonable person with knowledge of the circumstances would question the [person's] impartiality, we cannot say that she violated the impartiality rule." *Id.*

[40] OGE, Memorandum dated April 26, 1999, from Stephen D. Potts, Director, to Designated Agency Ethics Officials, Regarding Recusal Obligations and Screening Arrangements, 99 x 8. Under section 2635.502(a)(2), an employee may determine not to participate in a matter due to appearance concerns even if that employee's withdrawal is not required. *Id.*

volved." [41] If it is determined that the employee's participation would "raise a question in the mind of a reasonable person about his impartiality," the agency's designated ethics official may nonetheless authorize the employee to participate in the matter "based on a determination, made in light of all relevant circumstances, that the interest of the Government in the employee's participation outweighs the concern that a reasonable person may question the integrity of the agency's programs and operations." [42]

IV. Analysis

Is there a financial interest or "covered relationship"?

Neither Chairman Gensler nor any member of his household has a financial interest in MFGI, or in any commodity or security interest held by MFGI. More broadly, neither Chairman Gensler nor any member of his household has any other financial interest that would be predictably or directly affected by a CFTC investigation involving MFGI or associated CFTC actions, including participation in the MFGI bankruptcy proceedings, and the recovery of customer funds. Accordingly, the resolution of the MFGI matter would not have a "direct and predictable" effect upon the financial interests of Chairman Gensler or any member of his household. Chairman Gensler does not have a "covered relationship" with MFGI or any of its employees, officers, directors, or shareholders. Chairman Gensler's partnership with GS, Mr. Corzine, and other partners at GS terminated in 1997, more than 14 years ago. This is far beyond the 1 year "cooling off period" provided in § 2635.502(b)(iv) for a person who was a general partner with another person to be considered to have a "covered relationship" with such other person.[43]

Is there a reasonable basis to question the employee 's impartiality?

The sole fact that Chairman Gensler at one time was a business partner with Mr. Corzine, without more, does not constitute a reasonable basis, within the meaning of § 2635.502, to question Chairman Gensler's impartiality with respect to matters relating to MFGI.

Once the 1 year cooling-off period has passed, the fact that an employee previously was within a covered relationship with respect to another individual, without more, cannot by itself be the basis to reasonably question an employee's impartiality. To hold otherwise would, in effect, transform the 1 year cooling off period into a lifetime prohibition, for in every such instance the covered relationship within the 1 year period could be cited as the basis for disqualification beyond the 1 year period.[44]

The ethics regulations do not require such a result. To the contrary, the procedures in § 2635.502 clearly contemplate that employees who at one time may have had a covered relationship with respect to another person or entity, but that no longer have such a covered relationship, may participate in a matter involving the person or entity that previously was within the covered relationship.

To constitute a reasonable basis to question Chairman Gensler's impartiality, therefore, there must be some additional *indicia* of a relationship between Chairman Gensler and Mr. Corzine, GS, or its partners, beyond the factors that would establish a covered relationship—*i.e.,* facts in addition to Chairman Gensler's partnership at GS some 14 years ago. However, the facts regarding Chairman Gensler's relationship with Mr. Corzine and others at GS who are now associated with

[41] *Id;* 5 CFR § 2635.502(c).

[42] 5 CFR § 2635.502(d). This section provides the following factors that may be considered in making this determination:

> (1) The nature of the relationship involved;
> (2) The effect that resolution of the matter would have upon the financial interests of the person involved in the relationship;
> (3) The nature and importance of the employee's role in the matter, including the extent to which the employee is called upon to exercise discretion in the matter;
> (4) The sensitivity of the matter;
> (5) The difficulty of reassigning the matter to another employee; and
> (6) Adjustments that may be made in the employee's duties that would reduce or eliminate the likelihood that a reasonable person would question the employee's impartiality.

[43] 5 CFR § 2635.502(b)(iv). As previously noted, OGE has stated that if no financial interest is involved and a covered relationship is not present, a determination not to follow the procedures in § 2635.502—and hence to participate in the matter—cannot be considered to be an "ethical lapse." Nonetheless, in accordance with OGE recommendations, Chairman Gensler has determined to follow the § 2635.502 process.

[44] This conclusion is consistent with the OGE position that in circumstances in which no financial interest is involved and a covered relationship is not present, a determination not to follow the procedures in § 2635.502 cannot be considered to be an "ethical lapse."

MFGI—both during the time that Chairman Gensler worked at GS and afterwards—are insufficient to provide such *indicia*.

The record set forth above indicates that at all times, both during their partnership and afterwards, the relationship between Chairman Gensler and Mr. Corzine was exclusively a professional relationship. Chairman Gensler and Mr. Corzine did not socialize or meet apart from their professional obligations and interests. The record indicates that since Chairman Gensler and Mr. Corzine left GS in the late 1990s, they have met only infrequently and solely on matters of mutual professional interest. Indeed, most of their encounters have occurred when they both have been invited to attend an event by others. Although both Chairman Gensler and Mr. Corzine have been involved in political fundraising and electoral campaigning, neither has done so on the other's behalf or at the other's request. They have not socialized, and they have not been involved in each other's personal lives. Their infrequent professional contacts, over a 14 year period following their departure from their partnership at GS, do not constitute a covered relationship or a similar type of relationship that would form a reasonable basis under section 2635.502 to question Chairman Gensler's impartiality with respect to MFGI.[45]

Following his departure from GS, Chairman Gensler's contacts with Mr. Abelow, Mr. Flowers, Ms. Ferber, and Mr. Goldfield have been more attenuated than his contacts with Mr. Corzine. Based on the highly infrequent nature of Chairman Gensler's contacts with these individuals since he left the GS partnership in 1997, Chairman Gensler's relationships with these individuals, both individually and collectively, are insufficient to constitute a reasonable basis under section 2635.502 to question Chairman Gensler's impartiality with respect to MFGI.

In sum, this review determines, based on the facts and circumstances stated herein, that there is not a reasonable basis under 5 CFR § 2635.502 to question Chairman Gensler's impartiality with respect to the Commission's investigation of MFGI and involvement in related matters, such as the MFGI bankruptcy proceedings. Accordingly, 5 CFR § 2635.502 does not preclude Chairman Gensler's participation in these matters, and Chairman Gensler is not required to withdraw from participation. From a legal and ethical perspective, Chairman Gensler's participation in Commission matters involving MFGI would not be improper.[46]

ATTACHMENT 3

Rule 151.5(a), adopted under CEA section 4a(c)(2):

(1) Any person that complies with the requirements of this section may exceed the position limits set forth in § 151.4 to the extent that a transaction or position in a Referenced Contract:

(i) Represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel;

(ii) Is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise; and

(iii) Arises from the potential change in the value of one or several—

(A) Assets that a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;

(B) Liabilities that a person owns or anticipates incurring; or

(C) Services that a person provides, purchases, or anticipates providing or purchasing; or

(iv) Reduces risks attendant to a position resulting from a swap that—

(A) Was executed opposite a counterparty for which the transaction would qualify as a *bona fide* hedging transaction pursuant to paragraph (a)(1)(i) through (iii) of this section; or

(B) Meets the requirements of paragraphs (a)(1)(i) through (iii) of this section.

[45] Chairman Gensler's contribution to the New Jersey State Democratic Party at the time Mr. Corzine was campaigning for Governor of New Jersey is not sufficient to warrant a different conclusion. During this time period, Chairman Gensler was an active fundraiser for and contributor to Democratic candidates for elected office in many states. Chairman Gensler's contribution to the New Jersey State Democratic Party therefore is not sufficient to establish a special relationship between Chairman Gensler and Mr. Corzine that would warrant a different conclusion.

[46] This review solely addresses matters before the Commission prior to and at the time of the Chairman's election not to participate and is based on the facts contained herein.

(v) Notwithstanding the foregoing, no transactions or positions shall be classified as *bona fide* hedging for purposes of § 151.4 unless such transactions or positions are established and liquidated in an orderly manner in accordance with sound commercial practices and the provisions of paragraph (a)(2) of this section regarding enumerated hedging transactions and positions or paragraphs (a)(3) or (4) of this section regarding pass-through swaps of this section have been satisfied.

(2) ENUMERATED HEDGING TRANSACTIONS AND POSITIONS. *Bona fide* hedging transactions and positions for the purposes of this paragraph mean any of the following specific transactions and positions:

(i) Sales of Referenced Contracts that do not exceed in quantity:

(A) Ownership or fixed-price purchase of the contract's underlying cash commodity by the same person; and

(B) Unsold anticipated production of the same commodity, which may not exceed 1 year of production for an agricultural commodity, by the same person provided that no such position is maintained in any physical-delivery Referenced Contract during the last 5 days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(ii) Purchases of Referenced Contracts that do not exceed in quantity:

(A) The fixed-price sale of the contract's underlying cash commodity by the same person;

(B) The quantity equivalent of fixed-price sales of the cash products and by-products of such commodity by the same person; and

(C) Unfilled anticipated requirements of the same cash commodity, which may not exceed 1 year for agricultural Referenced Contracts, for processing, manufacturing, or use by the same person, provided that no such position is maintained in any physical-delivery Referenced Contract during the last 5 days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(iii) Offsetting sales and purchases in Referenced Contracts that do not exceed in quantity that amount of the same cash commodity that has been bought and sold by the same person at unfixed prices basis different delivery months, provided that no such position is maintained in any physical-delivery Referenced Contract during the last 5 days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(iv) Purchases or sales by an agent who does not own or has not contracted to sell or purchase the offsetting cash commodity at a fixed price, provided that the agent is responsible for the merchandising of the cash positions that is being offset in Referenced Contracts and the agent has a contractual arrangement with the person who owns the commodity or holds the cash market commitment being offset.

(v) ANTICIPATED MERCHANDISING HEDGES. Offsetting sales and purchases in Referenced Contracts that do not exceed in quantity the amount of the same cash commodity that is anticipated to be merchandised, provided that:

(A) The quantity of offsetting sales and purchases is not larger than the current or anticipated unfilled storage capacity owned or leased by the same person during the period of anticipated merchandising activity, which may not exceed 1 year;

(B) The offsetting sales and purchases in Referenced Contracts are in different contract months, which settle in not more than 1 year; and

(C) No such position is maintained in any physical-delivery Referenced Contract during the last 5 days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(vi) ANTICIPATED ROYALTY HEDGES. Sales or purchases in Referenced Contracts offset by the anticipated change in value of royalty rights that are owned by the same person provided that:

(A) The royalty rights arise out of the production, manufacturing, processing, use, or transportation of the commodity underlying the Referenced Contract, which may not exceed 1 year for agricultural Referenced Contracts; and

(B) No such position is maintained in any physical-delivery Referenced Contract during the last 5 days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(vii) SERVICE HEDGES. Sales or purchases in Referenced Contracts offset by the anticipated change in value of receipts or payments due or expected to be due under an executed contract for services held by the same person provided that:

(A) The contract for services arises out of the production, manufacturing, processing, use, or transportation of the commodity underlying the Referenced Contract, which may not exceed 1 year for agricultural Referenced Contracts;

(B) The fluctuations in the value of the position in Referenced Contracts are substantially related to the fluctuations in value of receipts or payments due or expected to be due under a contract for services; and

(C) No such position is maintained in any physical-delivery Referenced Contract during the last 5 days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(viii) CROSS-COMMODITY HEDGES. Sales or purchases in Referenced Contracts described in paragraphs (a)(2)(i) through (vii) of this section may also be offset other than by the same quantity of the same cash commodity, provided that:

(A) The fluctuations in value of the position in Referenced Contracts are substantially related to the fluctuations in value of the actual or anticipated cash position; and

(B) No such position is maintained in any physical-delivery Referenced Contract during the last 5 days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts.

(3) PASS-THROUGH SWAPS. *Bona fide* hedging transactions and positions for the purposes of this paragraph include the purchase or sales of Referenced Contracts that reduce the risks attendant to a position resulting from a swap that was executed opposite a counterparty for whom the swap transaction would qualify as a *bona fide* hedging transaction pursuant to paragraph (a)(2) of this section ("pass-through swaps"), provided that no such position is maintained in any physical-delivery Referenced Contract during the last 5 days of trading of the Core Referenced Futures Contract in an agricultural or metal commodity or during the spot month for other physical-delivery contracts unless such pass-through swap position continues to offset the cash market commodity price risk of the *bona fide* hedging counterparty.

(4) PASS-THROUGH SWAP OFFSETS. For swaps executed opposite a counterparty for whom the swap transaction would qualify as a *bona fide* hedging transaction pursuant to paragraph (a)(2) of this section (pass-through swaps), such pass-through swaps shall also be classified as a *bona fide* hedging transaction for the counterparty for whom the swap would not otherwise qualify as a *bona fide* hedging transaction pursuant to paragraph (a)(2) of this section ("non-hedging counterparty"), provided that the non-hedging counterparty purchases or sells Referenced Contracts that reduce the risks attendant to such pass-through swaps. Provided further, that the pass-through swap shall constitute a *bona fide* hedging transaction only to the extent the non-hedging counterparty purchases or sells Referenced Contracts that reduce the risks attendant to the pass-through swap.

(5) Any person engaging in other risk-reducing practices commonly used in the market which they believe may not be specifically enumerated in § 151.5(a)(2) may request relief from Commission staff under § 140.99 of this chapter or the Commission under section 4a(a)(7) of the Act concerning the applicability of the *bona fide* hedging transaction exemption.

Rule 1.3(z), revised under CEA section 4a(c) to apply only to excluded commodities as defined in CEA section 1a(19):

(1) GENERAL DEFINITION. *Bona fide* hedging transactions and positions shall mean any agreement, contract or transaction in an excluded commodity on a designated contract market or swap execution facility that is a trading facility, where such transactions or positions normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, and where they arise from:

(i) The potential change in the value of assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising,

(ii) The potential change in the value of liabilities which a person owns or anticipates incurring, or

(iii) The potential change in the value of services which a person provides, purchases, or anticipates providing or purchasing.

(iv) Notwithstanding the foregoing, no transactions or positions shall be classified as *bona fide* hedging unless their purpose is to offset price risks incidental to commercial cash or spot operations and such positions are established and liquidated in an orderly manner in accordance with sound commercial practices and, for transactions or positions on contract markets subject to trading and position limits in effect pursuant to section 4a of the Act, unless the provisions of paragraphs (z)(2) and (3) of this section have been satisfied.

(2) ENUMERATED HEDGING TRANSACTIONS. The definitions of *bona fide* hedging transactions and positions in paragraph (z)(1) of this section includes, but is not limited to, the following specific transactions and positions:

(i) Sales of any agreement, contract, or transaction in an excluded commodity on a designated contract market or swap execution facility that is a trading facility which do not exceed in quantity:

(A) Ownership or fixed-price purchase of the same cash commodity by the same person; and

(B) Twelve months' unsold anticipated production of the same commodity by the same person provided that no such position is maintained in any agreement, contract or transaction during the 5 last trading days.

(ii) Purchases of any agreement, contract or transaction in an excluded commodity on a designated contract market or swap execution facility that is a trading facility which do not exceed in quantity:

(A) The fixed-price sale of the same cash commodity by the same person;

(B) The quantity equivalent of fixed-price sales of the cash products and by-products of such commodity by the same person; and

(C) Twelve months' unfilled anticipated requirements of the same cash commodity for processing, manufacturing, or feeding by the same person, provided that such transactions and positions in the 5 last trading days of any agreement, contract or transaction do not exceed the person's unfilled anticipated requirements of the same cash commodity for that month and for the next succeeding month.

(iii) Offsetting sales and purchases in any agreement, contract or transaction in an excluded commodity on a designated contract market or swap execution facility that is a trading facility which do not exceed in quantity that amount of the same cash commodity which has been bought and sold by the same person at unfixed prices basis different delivery months of the contract market, provided that no such position is maintained in any agreement, contract or transaction during the 5 last trading days.

(iv) Purchases or sales by an agent who does not own or has not contracted to sell or purchase the offsetting cash commodity at a fixed price, provided that the agent is responsible for the merchandising of the cash position that is being offset, and the agent has a contractual arrangement with the person who owns the commodity or has the cash market commitment being offset.

(v) Sales and purchases described in paragraphs (z)(2)(i) through (iv) of this section may also be offset other than by the same quantity of the same cash commodity, provided that the fluctuations in value of the position for in any agreement, contract or transaction are substantially related to the fluctuations in value of the actual or anticipated cash position, and provided that the positions in any agreement, contract or transaction shall not be maintained during the 5 last trading days.

(3) NON-ENUMERATED CASES. A designated contract market or swap execution facility that is a trading facility may recognize, consistent with the purposes of this section, transactions and positions other than those enumerated in paragraph (2) of this section as *bona fide* hedging. Prior to recognizing such non-enumerated transactions and positions, the designated contract market or swap execution facility that is a trading facility shall submit such rules for Commission review under section 5c of the Act and part 40 of this chapter.

Rule 1.3(kkk), adopted under the definition of the term "major swap participant" in CEA section 1a(33):

For purposes of Section 1a(33) of the Act, 7 U.S.C. 1a(33) and § 1.3(hhh), a swap position is held for the purpose of hedging or mitigating commercial risk when:

(1) Such position:

(i) Is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise (or of a majority-owned affiliate of the enterprise), where the risks arise from:

(A) The potential change in the value of assets that a person owns, produces, manufactures, processes, or merchandises or reasonably anticipates owning, producing, manufacturing, processing, or merchandising in the ordinary course of business of the enterprise;

(B) The potential change in the value of liabilities that a person has incurred or reasonably anticipates incurring in the ordinary course of business of the enterprise; or

(C) The potential change in the value of services that a person provides, purchases, or reasonably anticipates providing or purchasing in the ordinary course of business of the enterprise;

(D) The potential change in the value of assets, services, inputs, products, or commodities that a person owns, produces, manufactures, processes, merchandises, leases, or sells, or reasonably anticipates owning, producing, manufacturing, processing, merchandising, leasing, or selling in the ordinary course of business of the enterprise;

(E) Any potential change in value related to any of the foregoing arising from interest, currency, or foreign exchange rate movements associated with such assets, liabilities, services, inputs, products, or commodities; or

(F) Any fluctuation in interest, currency, or foreign exchange rate exposures arising from a person's current or anticipated assets or liabilities; or

(ii) Qualifies as *bona fide* hedging for purposes of an exemption from position limits under the Act; or

(iii) Qualifies for hedging treatment under (A) Financial Accounting Standards Board Accounting Standards Codification Topic 815, Derivatives and Hedging (formerly known as Statement No. 133) or (B) Governmental Accounting Standards Board Statement 53, Accounting and Financial Reporting for Derivative Instruments; and

(2) Such position is:

(i) Not held for a purpose that is in the nature of speculation, investing or trading; and

(ii) Not held to hedge or mitigate the risk of another swap or security-based swap position, unless that other position itself is held for the purpose of hedging or mitigating commercial risk as defined by this rule or § 240.3a67–4 of this title.

Proposed rule 39.6(c), adopted under the end-user exception from the clearing requirement in CEA section 2(h)(7):

For purposes of section 2(a)(7)(A)(ii) of the CEA and Sec. 39.6(b)(4), a swap shall be deemed to be used to hedge or mitigate commercial risk when:

(1) Such swap:

(i) Is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where the risks arise from:

(A) The potential change in the value of assets that a person owns, produces, manufactures, processes, or merchandises or reasonably anticipates owning, producing, manufacturing, processing, or merchandising in the ordinary course of business of the enterprise;

(B) The potential change in the value of liabilities that a person has incurred or reasonably anticipates incurring in the ordinary course of business of the enterprise; or

(C) The potential change in the value of services that a person provides, purchases, or reasonably anticipates providing or purchasing in the ordinary course of business of the enterprise;

(D) The potential change in the value of assets, services, inputs, products, or commodities that a person owns, produces, manufactures, processes, merchandises, leases, or sells, or reasonably anticipates owning, producing, manufacturing, processing, merchandising, leasing, or selling in the ordinary course of business of the enterprise;

(E) Any potential change in value related to any of the foregoing arising from foreign exchange rate movements associated with such assets, liabilities, services, inputs, products, or commodities; or

(F) Any fluctuation in interest, currency, or foreign exchange rate exposures arising from a person's current or anticipated assets or liabilities; or

(ii) Qualifies as *bona fide* hedging for purposes of an exemption from position limits under the Act; or

(iii) Qualifies for hedging treatment under Financial Accounting Standards Board Accounting Standards Codification Topic 815, Derivatives and Hedging (formerly known as Statement No. 133); and

(2) Such swap is:

(i) Not used for a purpose that is in the nature of speculation, investing, or trading; or

(ii) Not used to hedge or mitigate the risk of another swap or securities-based swap, unless that other swap itself is used to hedge or mitigate commercial risk as defined by this rule or the equivalent definitional rule governing security-based swaps promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934.

Interim final rule 1.3(ppp)(6)(iii), adopted under the definition of the term "swap dealer" in CEA section 1a(49):

In determining whether a person is a swap dealer, a swap that the person enters into shall not be considered, if:

(A) The person enters into the swap for the purpose of offsetting or mitigating the person's price risks that arise from the potential change in the value of one or several (1) assets that the person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising; (2) liabilities that the person owns or anticipates incurring; or (3) services that the person provides, purchases, or anticipates providing or purchasing;

(B) The swap represents a substitute for transactions made or to be made or positions taken or to be taken by the person at a later time in a physical marketing channel;

(C) The swap is economically appropriate to the reduction of the person's risks in the conduct and management of a commercial enterprise;

(D) The swap is entered into in accordance with sound commercial practices; and

(E) The person does not enter into the swap in connection with activity structured to evade designation as a swap dealer.

The Commission addressed these definitions in its recent release adopting the rules further defining the terms swap dealer, eligible contract participant and major swap participant.

- Regarding interim final rule 1.3(ppp)(6)(iii), the Commission stated: "[A]lthough the CFTC is not incorporating the *bona fide* hedging provisions of the CFTC's position limits rule here, the exclusion from the swap dealer analysis draws upon language in the CFTC's definition of *bona fide* hedging. For example, the exclusion expressly includes swaps hedging price risks arising from the potential change in value of existing or anticipated assets, liabilities, or services, if the hedger has an exposure to physical price risk. And, as in the *bona fide* hedging rule, the exclusion utilizes the word 'several' to reflect that there is no requirement that swaps hedge risk on a one-to-one transactional basis in order to be excluded, but rather they may hedge on a portfolio basis. For these reasons, swaps that qualify as enumerated hedging transactions and positions are examples of the types of physical commodity swaps that are excluded from the swap dealer analysis if the rule's requirements are met."
- The Commission explained that "The definition of *bona fide* hedging in [rule] § 1.3(z), which applies for excluded commodities, is not relevant here, because it does not contain the requirement that the swap represents a substitute for a transaction made or to be made or a position taken or to be taken in a physical marketing channel, as required by [rule] § 1.3(ggg)(6)(iii)(B). We believe that this requirement is an important aspect of how principles from the *bona fide* hedging definition are useful in identifying swaps that are entered into for the purpose of hedging as opposed to other purposes."

The Commission addressed how the interim final rule compares to the definition of hedging or mitigating commercial risk in rule 1.3(kkk), explaining that "the usefulness of an exclusion of all swaps that hedge or mitigate commercial risk for certain aspects of the major swap participant definition is not a reason to use the same exclusion in the swap dealer definition, since the swap dealer definition serves a different function. The definition of the term 'major swap participant,' which applies only to persons who are not swap dealers, is premised on the prior identification, by the swap dealer definition, of persons who accommodate demand for swaps, make a market in swaps, or otherwise engage in swap dealing activity. The major swap participant definition performs the subsequent function of identifying persons that are not swap dealers, but hold swap positions that create an especially high level of risk that could significantly impact the U.S. financial system. Only for this subsequent function is it appropriate to apply the broader exclusion of swaps held for the purpose of hedging or mitigating commercial risk."

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